

## COVID-19: (ASIA PACIFIC) RENAISSANCE OF THE SUPPLY CHAIN

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### Asia-Pacific Regulatory & Policy Alert

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This is the second in our series on supply chains and customs risks and compliance. (See our earlier alert, “As Supply Chains Reopen, What are the Risks?”)

As mentioned in the earlier alert, there are signs that China has begun export activities, although no one seems to know to what extent the “factory of the world” is functioning.

There have also been concerns about the quality of the products that have been produced following China's reopening and that is not a good sign. It's important for foreign owned companies who are reopening in China to take stock of this fact and to consider the steps they need to take in order to ensure the products they resume producing are of a very high quality.

Read further to examine what we provide as areas for your company to consider as they reopen anywhere in the world. We discuss your greatest asset, your staff, and we consider ways to increase visibility across the supply chain possibly with the use of blockchain.

### BLACK SWAN EVENT PREPAREDNESS

The COVID-19 pandemic would definitely qualify as a “black-swan” event because it is doubtful that anybody could have predicted the scale, speed, timing, or the severity of this event. This event did not just create obstacles to trade that may have work-around solutions, it completely stopped global supply chain flows.

Given this fact, could businesses have been better prepared to deal with the fallout from the pandemic? Could businesses have learnt anything from previous events that had affected the global supply chain in some form or other?

For companies, supply chain executives, customs compliance and logistics teams, the last two decades were notable for major supply chain disruptions, such as the tsunami in Japan, flooding in Thailand, the SARS pandemic in China, Hong Kong and other countries, the U.S.-China trade dispute, the volcano eruption in Iceland, and the Hong Kong protests. These events have highlighted the vulnerabilities of individual companies and entire industries globally. The Japanese tsunami in 2011 left the world auto industry in disarray for several months while Thailand's 2011 floods hit hard disk manufacturers and Japanese auto companies with plants in that country.

Over the many years spent advising companies on customs compliance and supply chain matters, we have seen many large, well-known and successful companies break when they came under stress because they were actually more fragile than they appeared to be; some household names have all but

disappeared. Large, successful organizations tend to fall into the rigid and fragile category. They do not like volatility, uncertainty, disorder, and chaos. Unfortunately, the reality is that we live and operate in a very dynamic world, a world where disruption and uncertainty are increasing. Then, there are companies that have proven to be very resilient and have withstood the various challenges they faced, emerging even stronger. These are “anti-fragile” companies<sup>1</sup>. One of the critical elements of an anti-fragile enterprise is that its employees at all levels are not just well trained for their respective roles, they are also well trained in problem solving. So, when a crisis or major disruption occurs, these problem solvers do what they are trained to do — think of a solution to solve the problem. They act quickly, with the trust and support of senior management; the “buy-in” from the top and the bottom is also critical. Such enterprises do not normally have rigid command structures. They give priority to ensuring that their employees at all levels are continually trained to be fast and reliable problem solvers, as well as are given the authority and trust to act.

When reflecting on companies, large and small, that we have advised or had contact with over the past two decades, many companies resisted implementing recommendations for fine-tuning their supply chains and customs compliance processes: (1) due to cost concerns; and (2) because they believed a black swan event would or could never occur.

For most heads of supply chain, customs, and logistics, they actually do understand that they need to protect their supply chains from serious and costly disruptions. However, few take action because any solution to reduce risk must be evaluated against the impact on cost efficiency; cost efficiency almost always takes priority.

The weighing of solutions against supply chain cost efficiency is a very common, very normal business practice. After all, a company must always ensure that it is profitable. However, in a just-in-time operating environment, nothing cuts into profits more quickly than a key supplier going offline, as has been fully demonstrated during the COVID-19 pandemic. There is now a greater recognition of the need to seriously consider and implement risk minimising solutions as companies move on from COVID-19.

## **SOLUTIONS MOVING FORWARD**

We suggest companies consider the following:

### **Supply chain flexibility**

In the early stages of the COVID-19 pandemic, enterprises that had placed all their sourcing of finished goods, components or raw materials in China, had no immediate solution if they did not carry stock. Enterprises will need to consider diversifying and making their supply chains more flexible to deal with such future events. Companies may want to establish a list of potential alternative suppliers that they could turn to in times of crisis. It is also timely for companies to start evaluating options and running due diligence on potential alternative suppliers.

### **Production diversification**

The globalization of supply chains has given rise to the development of specialist production zones. These are usually cities, specialized zones or countries that specialize in the production of a few key products, which have been effective in ensuring the supply of key components in a normal fully functioning world. They have helped lower the overall cost of supply. But we are not living in a normal fully functioning world now; and what will happen

when the next crisis hits and whole cities/countries grind to a stop? This is an ideal time for manufacturers/suppliers to consider diversifying their operations so that they can be better prepared to service their customers and ensure that they remain fully functional.

## **Supply chain transparency**

Supply chain visibility is critical as most companies do not usually have visibility over what is happening beyond the first level in their supply chain. This makes them very vulnerable and fragile because they do not know where threats to their production capacity are and could not get early warning of potential threats to the supply chain. The solution may be in the greater use of information technology or block chain. However, this is not an easy solution as it will require partners, vendors and service providers to open up certain areas of information, which may be confidential.

## **Blockchain**

Blockchain may be a solution to improve supply chain management by providing more transparent and accurate end-to-end tracking. With agreement and buy-in from all entities along the supply chain, it may be possible to digitize physical assets and create a decentralized, unchangeable record of all transactions. It may be possible to track an asset from production to delivery or further, thereby providing greater product history and transparency. In this, environment of greater awareness and increased regulations, the two sectors that could benefit the most from the use of blockchain are the pharmaceutical and food industries. Some advantages of leveraging blockchain are as follows:

- Strengthen a company's reputation and credibility through the transparency of the materials used in products; this is particularly important to the food and pharmaceutical industries.
- Greater visibility and compliance of outsourced contract manufacturing.
- Improved traceability of raw materials and other components to ensure compliance with regulatory requirements.
- Reduction in miscommunication or data transfer errors, by providing all parties within a supply chain with access to the same information.
- Reduction in paperwork and administration costs.
- Better understanding on how ingredients, components and finished goods are transferred to each sub-contractor in the production chain.
- Reduction of malpractice risks along the supply chain.
- Better detection of fraudulent practices.
- Reduction or elimination of grey market and counterfeit goods.

Blockchain does however, present some areas of concern such as:

- Information security.
- Data privacy — with suppliers likely to be in different countries operating under different data privacy laws, ensuring the collection and storage of data will require very careful consideration.

- Potential difficulty in getting “buy-in” from suppliers and other parties due to proprietary information and intellectual property concerns.
- Determining who will maintain and secure the data and where that will happen.
- Negotiation of contracts and agreements and the types of protection to be contained within.

## Employees

One of the biggest costs extracted by the COVID-19 pandemic is the human cost. There are daily reports of how businesses are hurting and how much money they are losing. But business closures, whether permanent or only temporary, mean thousands of workers are laid off from their jobs because companies could not afford to pay them. As businesses reopen and the economy picks up, this is a good time to reflect on and implement good employment policies that recognize employees as an asset to that business. As mentioned in the sidebar, anti-fragile companies are the ones that commit to good employee training, as well as trust and support their employees to become great problem solvers.

We highlighted some issues and possible solutions that companies may want to consider when preparing to enter the post-COVID-19 world. We are operating in a very difficult and uncertain time, but how we want to emerge in the future will determine what actions need to be taken now. Will a business with total reliance on one supply source/market decide to move out? If yes, then where will it move to? Will it be a total move or partial? What are the risks of exiting a market, including the regulatory and business reputational risks? There are a lot of questions and considerations, and if you need to discuss these, we would be happy to be of assistance. Please contact any of our team listed on this alert.

## FOOTNOTES

<sup>1</sup> Anti-fragile is a term coined by author Nassim Nicholas Taleb in his book “Antifragile: Things That Gain from Disorder”. The author describes how anti-fragile systems love randomness and uncertainty, how they go beyond resilience or robustness, and how they get stronger with stress and volatility.

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