Building supply chain resiliency in a world of increased macroeconomic volatility

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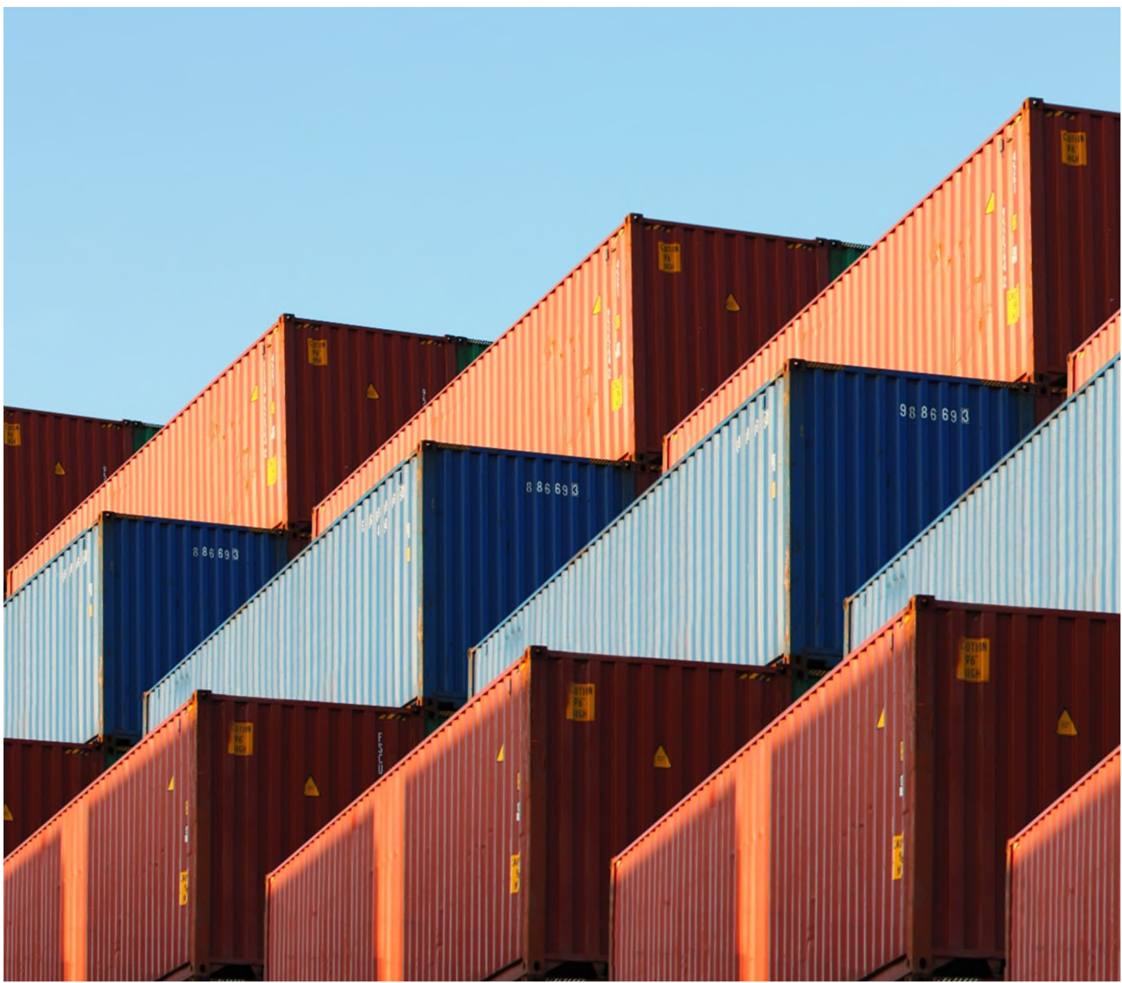

pwc

Interconnected crises are snarling global supply chains—and leading retail and consumer markets executives are taking note. Our 26th Annual Global CEO Survey of 4,410 business leaders found many retail and consumer markets CEOs around the world feel highly or extremely exposed to various risks in the coming years, including inflation (31%), macroeconomic volatility (29%), geopolitical conflict (27%) and cyber threats (22%)[1].

We're seeing some businesses zero in on the threats these risks pose to their business. More than half (57%) of global retail and consumer goods CEOs say supply chain disruptions will significantly affect their industry's profitability over the next decade[1]. A similar number (55%) say they're acting now to adjust their supply chains and mitigate their exposure[1].

In our view, this means that too few CEOs across the industry are investing time into reinventing their business to mitigate today's and tomorrow's risks. Macroeconomic risks are particularly relevant for Canadian retail and consumer companies with multi-tiered global supply chains—especially as they face rising stakeholder concerns over volatile costs being passed through to consumers.

PwC sees five major macroeconomic risks facing Canadian retail and consumer goods companies, both today and into tomorrow:

Increasing regulatory burden	**Geopolitical uncertainty**	**Inflation and economic pressure**	**Disruptive technology and cyber threats**	**Black swan events**

Increasing regulatory burden

The regulatory burden on retailers is increasing through a mix of tariff and non-tariff barriers, and new environmental, social and governance (ESG) rules. When we think of "regulated" industries, it's typically sectors such as financial services, rather than retail and consumer companies, that come to mind. But that's rapidly changing.

Notably, Canada's new modern slavery rules force many Canadian companies to understand their supply chain beyond just their direct suppliers and carries penalties that include direct financial sanctions and legal repercussions for board directors, including personal liability[2]. Elsewhere, we see ESG regulations as a growing trend as governments and regulators introduce new ESG reporting requirements. The Canadian Securities Administrators has already released recommendations following the US SEC's recommendation for all public companies to report Scope 1, 2, and 3 emissions by early 2024[3] [4].

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[1] PricewaterhouseCoopers, PwC's 26th Annual Global CEO, Winning today's race while running tomorrow's, 2023
[2] PricewaterhouseCoopers, How new modern slavery reporting requirements affect Canadian companies, 2023
[3] PricewaterhouseCoopers, 2023 Canadian ESG Reporting Insights, 2023
[4] PricewaterhouseCoopers, SEC climate disclosures and your company, 2023

Geopolitical uncertainty

Geopolitical uncertainty is increasing and directly affecting supply chains. COVID-19 and Russia's invasion of Ukraine brought national security questions to the top of many countries' trade and economic considerations, with a focus on building resilience in a volatile world. Notably, we've seen the Russian-Ukraine war drive up prices for key inputs with governments looking to secure alternative sources of supply[5] [6]. And COVID-19 brought into focus just-in-time supply chains and the need for on-shoring of critical materials and processes.

We've also seen geopolitical tensions between the US and China. That includes tariffs of 25% on around US$200 billion of goods in 2018 and the 2022 US CHIPS Act, which pledges US$200 billion over 10 years for local manufacturing and R&D while tightening controls over the global technology supply chain[7] [8]. Continuing tensions in global trade relationships could result in the increased use of tariff and non-tariff barriers.

Closer to home, even free-trade zones like North America cannot be taken as a given as the 2020 United States-Mexico-Canada Agreement (USMCA) contains a six-year review clause[9]. All of these geopolitical uncertainties are disrupting global supply chains today.

Inflation and economic pressure

Persistent inflation in the face of the fastest interest rate hikes since the 1980s has highlighted that it's not just easy access to funding that's driving up prices. Macroeconomic events including the decoupling of global supply chains, an increased regulatory burden and labour shortages across the supply chain—from truck drivers to retail employees—are also contributing.

These cost pressures are directly impacting Canadian retail and consumer companies. They can partially mitigate the impact on their business through consumer price increases (Canada's consumer price index increased 11.4% over the past two years, versus 3.4% the two years prior)[10]. But this can negatively affect brand, market share and stakeholders' perception. Rapid rate hikes are also slowing global economic momentum and increasing the likelihood of a recession that would challenge company profitability.

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[5] Economist, Russian and Ukrainian Commodities Review: Base Metals, May 2022
[6] Reuters, European steel prices to extend rally as Ukraine conflict cuts supply, March 2022
[7] Forbes, Trump's Tariffs Were Much More Damaging Than Thought, May 2021
[8] McKinsey, The CHIPS and Science Act: Here's what's in it, October 2022
[9] US Customs and Border Protection, United States - Mexico - Canada Agreement (USMCA), June 2022
[10] Bank of Canada, Consumer Price Index, 2023

Disruptive technologies and cyber threats

New disruptive technologies such as generative AI and the Internet of Things (IoT) create opportunities for retail and consumer companies, as well as potential competitive and cyber threats. Cyber attacks are a persistent and growing threat to Canadian retail and consumer companies. Our threat intelligence research found that more than one in ten cyber attacks in this country in 2021 targeted the retail sector[11]. And our recent Digital Trust Insights survey shows that more than 60% of Canadian organizations do not believe they've fully mitigated the cyber risks associated with their recent digital moves such as the move to remote work, adoption of cloud technology and their increased use of IoT[12].

Black swan events

This brings us to the last major macroeconomic risk of black swan events. The threat of black swan events remains relevant for Canadian retail and consumer companies and their supply chains. These events could include another pandemic, a major terrorist event, extreme weather, a further escalation of the Russian-Ukraine war or deterioration of the US and China relationship, among other unforeseen incidents.

Mitigation strategies to build supply chain resilience

Canadian retail and consumer goods companies that develop a thorough grasp of the risks across their value chains have an opportunity to better understand their exposure. They can also consider tactical and strategic mitigation options that build resilience against macroeconomic risks. These mitigation options fall within three main buckets:

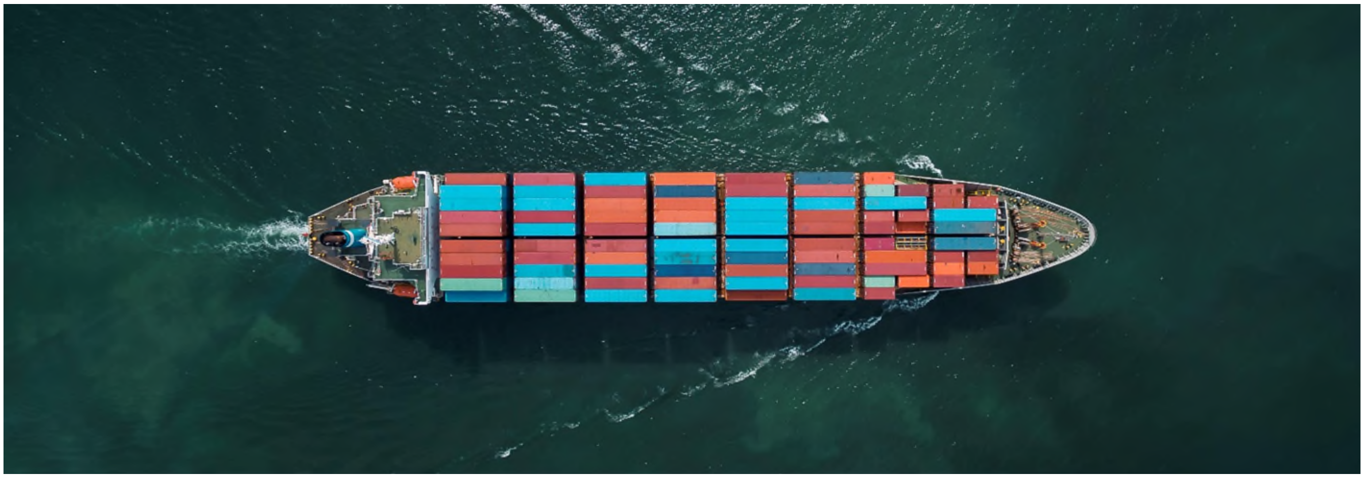
1. Using technology to mitigate risk
2. Planning and preparing for macroeconomic disruption
3. Finding alternative supply and manufacture sources

Using technology to mitigate risk considers new ways of implementing hardware and software to increase end-to-end supply chain visibility beyond direct suppliers. This can help retail and consumer goods companies achieve their vision of a connected supply chain through real-time monitoring of supply chain performance and what-if scenario simulations. It also includes a greater focus and investment in cyber resilience across the supply chain, including understanding the risks facing your suppliers and using technology to systemize the capture and reporting of ESG data and metrics.

Planning and preparing for macroeconomic disruption requires understanding the impact of commodity inflation in supplier and customer contracts as well as actively monitoring, scenario planning, and preparing for existing and potential logistics constraints, sanctions, tariffs and non-tariff barriers.

Finding alternative supply and manufacturer sources includes consideration of diversifying, near-shoring or on-shoring parts of the supply chain and updating inventory policies and planning parameters for strategic stocking of crucial materials.

[11] PricewaterhouseCoopers, Canadian Cyber Threat Intelligence, 2021
[12] PricewaterhouseCoopers, 2023 Canadian Digital Trust Insights, 2023



Assessing these mitigation strategies within a mature risk management framework and system that includes scenario planning lets Canadian retail and consumer goods companies understand their exposure to macroeconomic risks. It also helps create a financial business case to reinvent your business to build resilience for today and tomorrow's risks.

Importantly, we're seeing leading global retail and consumer companies act today to reinvent their business and reduce their exposure to macroeconomic risks. Macy's is diversifying its source countries and shipping ports, and investing in digitization and visibility across its supply chain[13]. Elsewhere, Mattel is nearshoring production to bypass supply chain bottlenecks. And IKEA is investing in measuring, disclosing and reducing its impact on the climate at each stage of its supply chain[14].

These are just a few examples among many. If you would like to discuss your business, your exposure to macroeconomic risks and how to build resilience in a world of increased macroeconomic volatility, please contact us.

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[13] Seeking Alpha, Macy's, Inc. (M) Management presents at 2022 Morgan Stanley Global Consumer & Retail Conference (Transcript), December 2022
[14] IKEA, IKEA Climate Report FY 22, 2023