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LOGISTICS REPORT

Commentary: It's Not Premature to Set Supply Chains for a Coronavirus Recovery

Companies shifting into survival mode should think now about how to build the healthiest business outcome



A worker wearing a protective mask and gloves delivers packages in New York.

PHOTO: DEMETRIUS FREEMAN/BLOOMBERG NEWS

By Yossi Sheffi

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As countries shut down, stock markets crumble and economic activity slows to a crawl, it is hard to believe that in a few months the coronavirus crisis may be over.

Bigger, well-capitalized companies have the financial strength to withstand the rapidly developing downturn, but most other companies are in tougher situations and survival for many will come into question. However, it is not too early for companies to think about how to position themselves for a successful, speedy recovery.

To do that companies must look deep into how they manage the most basic mechanisms of their supply chains and operations.

One of the most important short-term goals is to conserve cash as the world heads into what could be a significant recession. For supply-chain managers, this means four basic things:

Increase days payable outstanding. This is the average time that a company takes to pay its bills.

Reduce days sales outstanding. This is the average time that receivables remain outstanding before they are collected. In simple terms these two initiatives mean longer payment terms for suppliers so the company can keep its cash longer, and collecting money owed from customers as early as possible. Companies should strive to balance DSO with DPO on every project.

Reduce days of inventory on hand. Inventory ties up cash. Even in today's just-in-time inventory management systems, most companies accumulate too much inventory. The favorable business environment over the last decade encouraged companies to focus on customer service and use large inventories to reduce out-of-stock situations.

Defer capital expenditures and even use *force majeure* clauses to get out of contracts with long-term paybacks.

These steps are aimed only at helping a company survive financially. Several other measures can be taken to ensure that businesses come out of the crisis swinging.

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Most companies now realize that their most important assets “go down the elevator every evening.” They should be paying attention to their workers now, and getting them in position to resume operations as rapidly and efficiently as possible as business demand returns.

Toyota Motor Corp. provides one possible model. During the 2008-2009 financial crisis, the auto maker used downtime to extend the training of its employees. In the same period, the German government changed its labor laws to allow employees to collect partial unemployment to help German industry rebound quickly from that downturn. Thus, a worker might be put to half-time work and the government would pay 70% of the other half of his or her salary.

Another critically important step is to identify suppliers that are in trouble because of the crisis and offer to help shore them up where necessary.

First, business managers should assess if there are problems in specific areas by mapping all the manufacturing facilities of each supplier and record what is made in each location and which products and customers depend on parts and material made at that location.

The playbook here is similar to what companies should be doing to ensure their resilience ahead of a crisis. Consider supporting suppliers that are struggling, especially those that provide unique and/or critical materials and parts. Tell-tale signs include late or incomplete deliveries, late or restated filings, changes in bank covenants and the departure of key personnel. The support can take many forms, such as committing to orders, guaranteeing loans, applying the company’s credit to loans and lending against future production. In particularly critical cases it can even require equity investment.

Then there are actions companies should be taking with their customers.

The way a company treats customers during a crisis can determine whether or not they retain them when the dust settles. There is a strong likelihood that at some point a business will be unable to meet all its customers’ product needs. Mapping the upstream supply chain—where the suppliers are and what they provide—can give a company a timely warning if one of them goes down and which products and customers will be affected.

Some companies might prioritize the allocation of products and customers by profit margin to keep serving the most valuable customers. This may turn out to be a myopic strategy, however, if it jeopardizes future growth with a new customer or causes a small company that depends on your products to collapse. The damage to a company’s reputation in such cases may be hard to repair.

Other approaches include “fair allocation,” where every customer experiences restrictions such as receiving only a given percentage of their orders. To avoid over-ordering in this case, some

companies may base their allocations on customers' average ordering history.

Some companies reallocate products based on both margin and inventory levels. General Motors Co. did this in 2011 when it decided to close a Louisiana plant that made a relatively unprofitable small truck and redirected vital parts and inventory to more profitable lines.

In general, it is most important to be seen as fair and responsible during a crisis.

These and other actions taken now can make or break a company's ability to survive the current Covid-19 emergency and the inevitable upheaval in business that will come in a recovery. For supply-chain managers, the task is to keep critical suppliers viable and to treat customers in ways that do not create resentment.

Companies that achieve this balance should come out strong on the other side.

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