Shifting Trade Means Business Executives Must Rethink Supply Chain and Tech Integration

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The past 50 years of expanding free trade improved living standards around the world and ushered in the age of the multinational corporation. Technology accelerated globalism, rewiring both businesses and economies across the globe. For decades, the calculus of finding the most efficient cost of labor dominated much of corporate boardroom thinking, and supply chains were extended into the furthest reaches of civilization. Everyone benefited, even as it seemed that some low-cost countries like China were accruing outsize returns.

But the evidence suggests otherwise. A recent report from the libertarian-leaning Cato Institute illustrated how generations of iPhones (brandished with "assembled in China") were actually global products, with the majority of both production costs and revenue accruing to companies based outside of China, such as those in the U.S. and South Korea. Globalization fueled growth, and the movement of information and materials was never so easy … until it wasn't.

Now, global tensions, world health challenges, cyber-attacks, wars, rising nationalism, and regulation have all threatened globalization. Brexit and President Donald Trump's rapid-fire escalation of tariffs were just the beginning. In recent years, sentiment against trade has shifted in many countries and across political party lines.

Economists have argued for decades that free trade lowers costs, improves living standards and fuels collaborative relationships. Indeed, world peace and global prosperity have always been dependent on trade. But now, with economies sputtering under the weight of inflation, rising interest rates and energy costs, the longstanding arguments for trade seem even less pleasing to the populist, just at the moment when populism is rising across the globe and open markets are so desperately needed.

Business insights. Trade policy aside, business managers have no choice but to adapt to the new calculus of rising regulation and increased risk. Integration is out; decoupling is in. All across the globe, information and supply chains will shift closer to home. As Nissan's Americas Chairperson Jérémie Papin quipped in a recent interview, "Our plants in the USA have a great future!"

The result will increase costs for everyone and create a different set of complexities for firms. Certainly, moving supply chains closer to customers will reduce one set of risks and improve the environmental optics of supply chains. But carving the world back into more segmented countries and regions creates a different set of complexities altogether.

We heard firsthand from a number of global corporate information chiefs at a 2022 gathering of executives at the SDA Bocconi School of Management in Milan, about the abrupt changes and the challenges they are facing. First on many minds was the impact of Russia. "There are so many potential threats that all lead to the same conclusion," noted Mark Meyer, head of global information management at food packaging giant Tetra Pak, at the event. "Who thought we couldn't have operations in Ukraine because it was going to be overrun? Who thought sanctions on Russia would be at this level, or how fast they would come?" The changes brought on by Russia's invasions in Ukraine are breathtaking, and the new strategic landscape has clear implications for multinational business managers.

In the face of such uncertainty, what kinds of strategic moves work?

First, managers must examine risks and build strategies that are customized to the markets they serve. Risk and regulation will require keeping data and supply chains closer to home. As a result, localization will help managers protect the chains of information, design and supply.

But all of that will come with new costs. Meyer noted, "We spent our entire careers building central platforms to support everything, to be efficient. Now we have to keep that, but somehow tear it all apart and decentralize it. We want the same business outcomes as before, but now we need to be compliant everywhere we run systems."

Tearing centralized enterprises apart comes with a cost "that goes beyond IT," emphasized Chris Wright, chief information officer of the Nestlé Group, also at the Milan event. "We did the calculation of what separate geographical landscapes cost – not just to IT, which was expensive enough, but to the business as a whole. Given all the efficiencies gained from shared services over the years, we estimate in-country resources will increase significantly, and the smaller the country, the higher the increase. These losses from de-globalization are scary."

Localizing means using area vendors and solutions, from technology providers to material suppliers, to ensure smooth operations. In many counties, local sourcing has become an imperative, even without formal laws. In China, "we already have to use China-local systems on the customer-facing side, or we can't get the performance," noted Ray Huber, senior vice president of information technology and sector chief information officer at Eaton, an American-Irish power management firm.

Second, operations hedging – a process that spreads capabilities to reduce risk of disruption – will become increasingly important, in turn reducing economies of scale and increasing costs. For example, earlier this month, Apple partner Foxconn Technology Group announced plans to invest about $700 million on a new plant in India to reduce reliance on China.

Technology firms are not the only firms contemplating such moves. From toys to apparel, manufacturers are analyzing the risk landscape and looking for ways to diversify.

Staying nimble. Threats can come quickly from surprising sources. "There has been a period of stability, in which we all drove efficiency," Bill Braun, CIO of Chevron, mused. "We are now going into a period of instability, and we have to drive for resilience." Threats originate anywhere – from changing political regimes and regulation to withering taxes and cyberattacks. "You don't know which threat it's going to be, but they all lead to the same basic idea, which is you need to spread your capabilities, whether that's people or facilities or anything else."

A well-formed hedging strategy allows firms to move quickly when things change. "The problem with China the last few years is that you wake up and something is shut off, but nobody ever said it was going to be," Steve Zerby, CIO of manufacturer Owens Corning, remarked. "We used to see these trends coming over a period of years. Now, we are one act of legislature away from not being able to continue to operate in the same way. The days of having a five-year plan and getting there in four years are over. We may have to get to a new model in four days."

Lastly, managers should evaluate exiting some countries due to the expense of supporting subscale operations or serving small markets. American clothing retailer Gap sold its Chinese business to Baozun, a local e-commerce company, in late 2022 after 12 years of operating in the region.

Citing the challenging business and legal environment in China, both Yahoo and Microsoft's LinkedIn exited the country in 2021. To them, the costs had outweighed the benefits. "Understanding the true costs is very relevant," noted Twila Day, CIO of Huntsman, in Milan last year. "Even though China might be one of the largest parts of your business, you can reach a point where the costs mean it's no longer profitable. But so much of the spend tends to get buried that you don't really know what it's truly going to cost to do all the segregation."

The events of the past five years have made it clear that decoupling is a strategy that's here to stay. It also means that business leaders and consumers must plan for continued inflationary pressure.