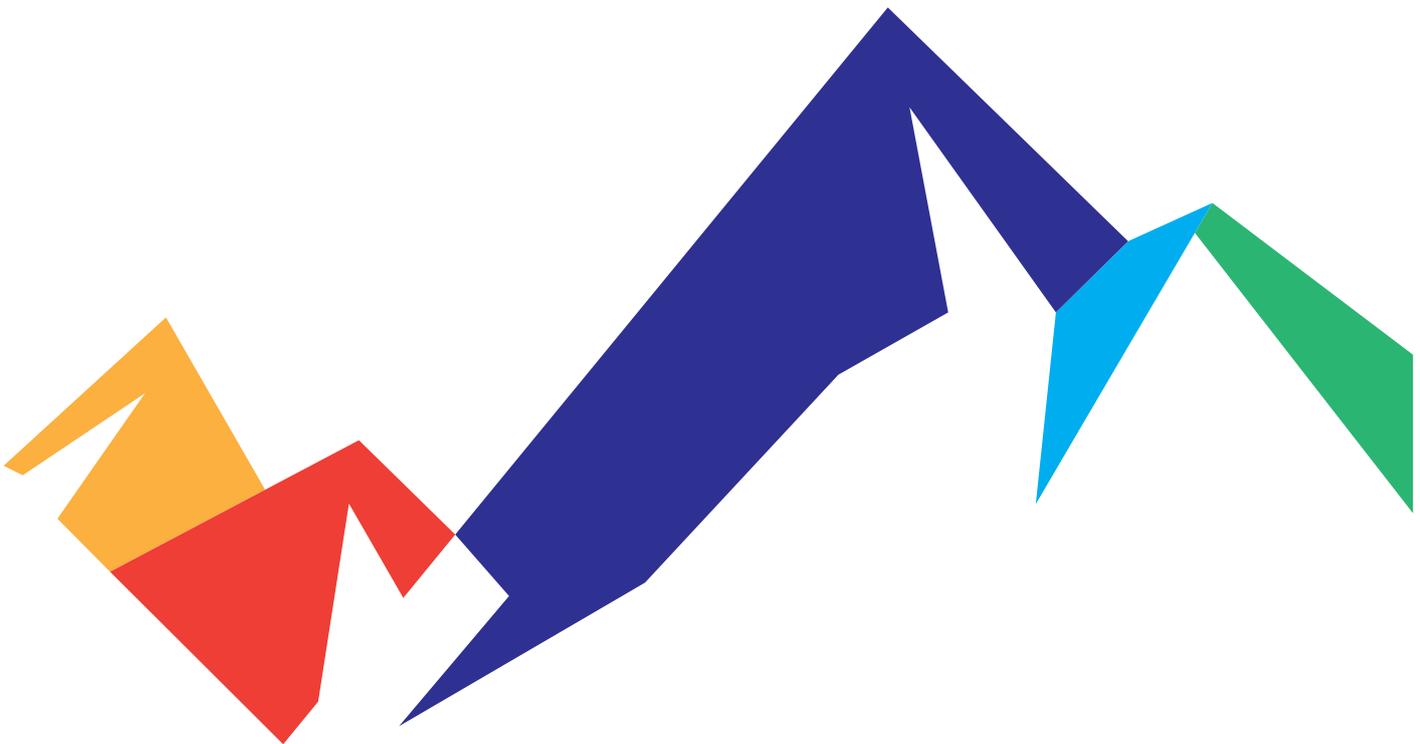


Board Briefing Series

Assessing the impact of Covid-19 on your supply chain

Board Briefing Series ref no: CP04

This white paper is one of a series of Board Briefings that consider the various challenges and opportunities facing directors which result from the turbulence to their business caused by the Coronavirus Pandemic. It is written from our perspective as turnaround investors who have the benefit of objectivity and the desire to ensure that any businesses we partner with will both survive and grow.



Over 30 years' experience of backing directors by investing in their business

Executive Summary

Boards need to not only ensure their companies survive short term, by managing tactically, but to prepare and position for the long term by thinking and resourcing strategically.

Your business is a link in a value chain and will be dependent on both suppliers and customers who will all want to derive value from doing business with you.

The turbulence for business caused by Covid-19 has introduced risk to your business, not only directly due to sales to your customers and purchases from your suppliers but indirectly due to the impact on them, whether it is their jobs their income, their own customers or their own suppliers. Essentially all businesses are part of an upstream and downstream supply chain web which comprises a large number of distribution networks.

This Board Briefing looks at the reliability of supply chains and highlights some considerations for the board of directors to ensure they are right for the future.

Equally important however is one of strategy and how the board positions the business for a new 'normal' and crucially how it takes advantage of changing circumstances.

Reviewing your current situation

It is important when carrying out a review or contemplating changes to have a good grasp of the current situation.

While any review will look at many factors, the key ones are:

- Financial position (cash and stock assets and liabilities, credit and facilities, reserves)
- Forecast (order book, cash flow, payment terms)
- Fixed costs (scope for cutting costs, reducing cash outflows)
- Supply model (dependence, Just In Time, stock availability, location, carrier options, financial stability)
- Employees (skills, availability, furloughed workers, redundancies needed)

A review of your supply model should consider reliance on a small number of suppliers, the impact that would be caused by any delay on delivery of goods or materials. Factors such as stock reserves, where goods are sourced, distances travelled, how they are carried, and border issues may be crucial.

Identifying the risks of disruption to supplies will allow you to make decisions about how to minimise them whether through holding stock, changing the supply chain, or adding approved suppliers.

Equally important is managing your order book and projections for stock supplies.

For example, in the UK after the first lockdown many consumer-facing, hospitality and retail businesses ordered stock in anticipation of a busy pre-Christmas season. But the second lockdown in November and then after a couple of weeks further restrictions in December have left many retailers stuck with unsold stock.

The current situation has made forecasting weeks and even months in advance almost impossible which makes long-tail supply chains such as ordering seasonal goods difficult to predict. While most of the Christmas goods were delivered and remain with unsold with retailers, a lot clothing garments that were manufactured abroad are stuck undelivered in the factory or undelivered in the supply chain. This in turn has had a huge impact on payments up and down the supply chain.

While there have been a number of high-profile retail insolvencies, the ongoing situation continues to be an existential threat to many firms in the supply chain.

Current suppliers

Given the above example you should consider:

- Suppliers: Are you speaking with them? Are they overseas? Are they still financially secure? Prospects for survival? Can they get the raw material they need? Are their own supplies secure?
- Prices & terms: Have they increased their prices? Have they changed payment terms? Are you offering terms that secure them prioritising you?
- Delivery: Are they reliable? Do they have global freight/airline disruption? Have delivery times lengthened? Is Just In Time sustainable? Do they hold stock?

Another example from the construction industry illustrates the difficulties facing otherwise viable businesses that have been able to carry on throughout lockdowns.

The California wildfires have affected both the supply and demand for soft wood like Pine for use in house construction. This has led to a huge demand in the USA which can no longer met by supply from Canada. This in turn has put pressure on demand for the Scandinavian wood supplies.

The increasing scarcity has made it more difficult for UK construction companies to source supplies and has also impacted prices where most construction contracts are based on a fixed price tender.

Notwithstanding the demand-related problems, Covid-19 has caused delays due to national lockdowns and restrictions on movement.

Relationship with suppliers

Given all the above, it makes sense for businesses to improve their relationship with key suppliers.

- Become a favoured/ preferred customer.
- Seek a closer relationship.
- Regular contact is imperative.
- Consider prompt or early payment of their invoices.
- Consider offering improved payment or more flexible delivery terms.

Alternative suppliers

It also makes sense to investigate whether you can shorten your supply chain by sourcing locally, even if a higher cost.

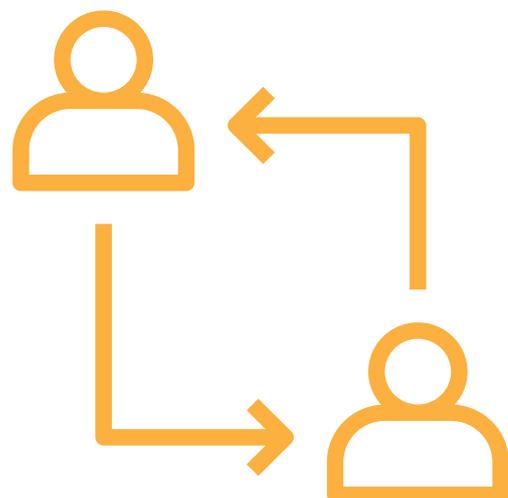
- Are there any local or closer suppliers?
- Do you have suitable local connections?
- How long will it take to build reliable relationships?
- Are there any switching costs?
- Is there scope for passing on costs increases to clients?
- What are the pros & cons for each supplier: Speed and reliability of delivery? Quality of products? Service & support? Prices & payment terms?

New business model & update business plan

Depending on the answers to the above it may be time to change your business model and update your business plan to reflect the new circumstances.

Much will depend on whether the existing business model is sustainable and you can continue to operate in the same way as you have in the past.

It is certainly worth updating your cash flow and profit & loss forecasts with sufficient detail to reflect the business model and highlight any changes that need to be implemented. A detailed forecast avoids the need for a business plan but an action plan for implementing change is useful as will be producing management accounts that can be compared with the forecast to monitor the impact of any change initiatives.



Questions for the Board

Does our team have all the right players to win in the current situation?

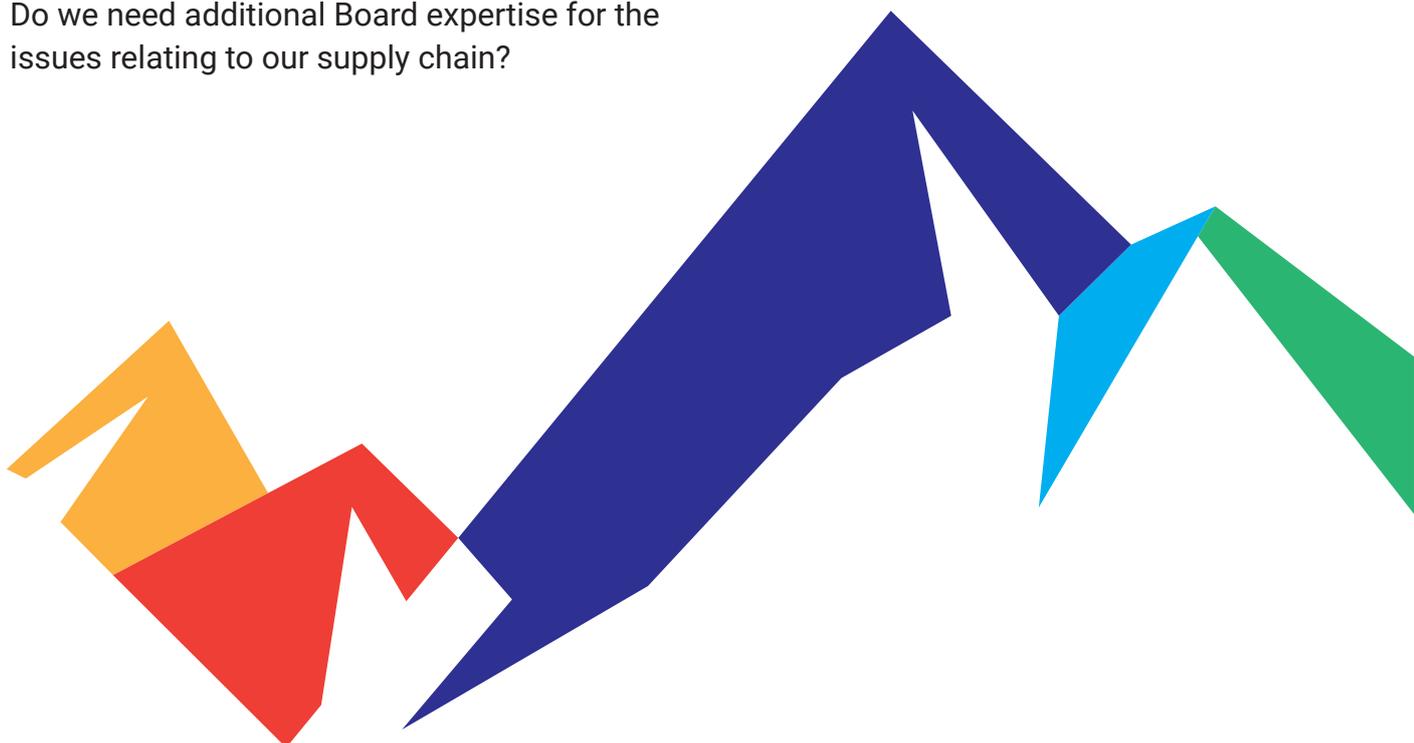
Have we assessed the risks in our supply chain?

What steps can be taken to manage / mitigate these?

Are there any opportunities to improve the security of our supply chain (eg by acquisition)?

Are we thinking strategically enough about a future beyond the immediate crisis?

Do we need additional Board expertise for the issues relating to our supply chain?



About K2 business partners

Trading as **K2 business partners** since 2001, we are turnaround investment partners, each of us with over 30 years' experience of backing directors by investing our time and expertise in the turnaround of their business and the realisation of business value.

We focus on companies with £5m-£20m turnover led by committed boards and with assets that other investors find difficult to value.

K2 invests in companies that manufacture and supply house building and construction products and services; IT & technology service providers; database, branded and intellectual property businesses; and industrial manufacturers.

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Are there any topics you would like us to cover in our Board Briefing series? Please let us know at info@k2-partners.com

