Unlocking supply chain value and resilience through regionalized restructuring

Introduction

In just a few years since the start of the COVID 19 pandemic, the factors that drive corporate supply chain decisions have dramatically shifted. For decades, the default view favored globalization the creation of increasingly complex supply relationships spanning the globe to tap lower labor costs and other competitive advantages. This has given way to a new decision landscape that puts a higher value on supply chain resilience, reflects ongoing changes in production and transportation costs, and in some cases dictates a closer to customers strategy.

What has caused this shift? Some of the trends affecting supply chain decisions developed over years, including the gradual erosion of manufacturing cost advantages in Asia due to rising wages there and the leveling effect of more sophisticated automation.[1] Other issues arrived suddenly, as the pandemic created or exposed supply challenges and fragility. First in 2020, measures to slow the spread of the virus led to factory and port shutdowns that rattled global commerce. Then in 2021, transportation bottlenecks and supply shortages frustrated efforts to meet resurgent demand.[2]

The situation leads companies to weigh whether they could benefit from supply chain reshoring, bringing production to a home country or point of customer demand, or nearshoring, which brings production closer to the home country or domestic market.

The actions that follow a reshoring or regionalization decision can include divestitures and acquisitions that affect profitability and viability far into the future. In a Deloitte database[3] review of 98 major reshoring events over the past four years, 19% of companies involved in reshoring events used some form of an M&A transaction, including joint ventures or partnership, to execute on the new supply chain strategy.

The constantly shifting calculus around reshoring presents companies with the opportunity to unlock significant value, reduce key risks, and better reflect the values of their customers. But the decisions required are complex, and they will vary industry by industry, company by company.

Drivers of supply chain disruption

Before tackling the analysis of total costs involved in a reshoring decision, it's important to consider the full range of factors that may come into play. The drivers of supply chain disruptions seem to fall into three broad groups: quantitative, qualitative, and risk-related.

- **Quantitative drivers** include labor costs; transportation costs; lead time; working capital requirements; taxes and duties; and defect rates. These factors are controllable, and they certainly can be measured. They will likely have a meaningful impact on cost of goods sold, which will help determine profitability.
- **Qualitative drivers** include intellectual property management; environmental, social and governance (ESG) improvement; cross-functional complexity; and brand reputation. These factors are controllable, but they may be difficult for a company to measure in an objective way. While direct impact on profitability may be more difficult to establish, these factors can be highly relevant to an organization's global competitiveness.
- **Risks** can include regulatory changes; geopolitical developments; natural disasters; and financial and economic volatility. These are issues mostly out of a company's control and difficult to quantify. They may nonetheless have a significant effect on a company's business continuity and competitiveness.

Quantitative supply chain factors are the starting point for any decision about where products will be sourced, and we discuss changes in these factors in the next section. But qualitative issues and hard-to-quantify risks must also be weighed.

How all these factors combine to influence procurement decisions varies by industry. For some companies, competing successfully on a global scale may increasingly dictate a shrinking of the supply-make-deliver chain in ways that accelerate delivery, mitigate risks, and increase agility across the value chain.[4]

Year after year, the interconnected global marketplace has resulted in greater fragility along a convoluted supply chain. Resiliency has become a deeper challenge for procurement as disruptive events increasingly have the potential to break connections and bring production and transport to a halt in some far corner of the globe.

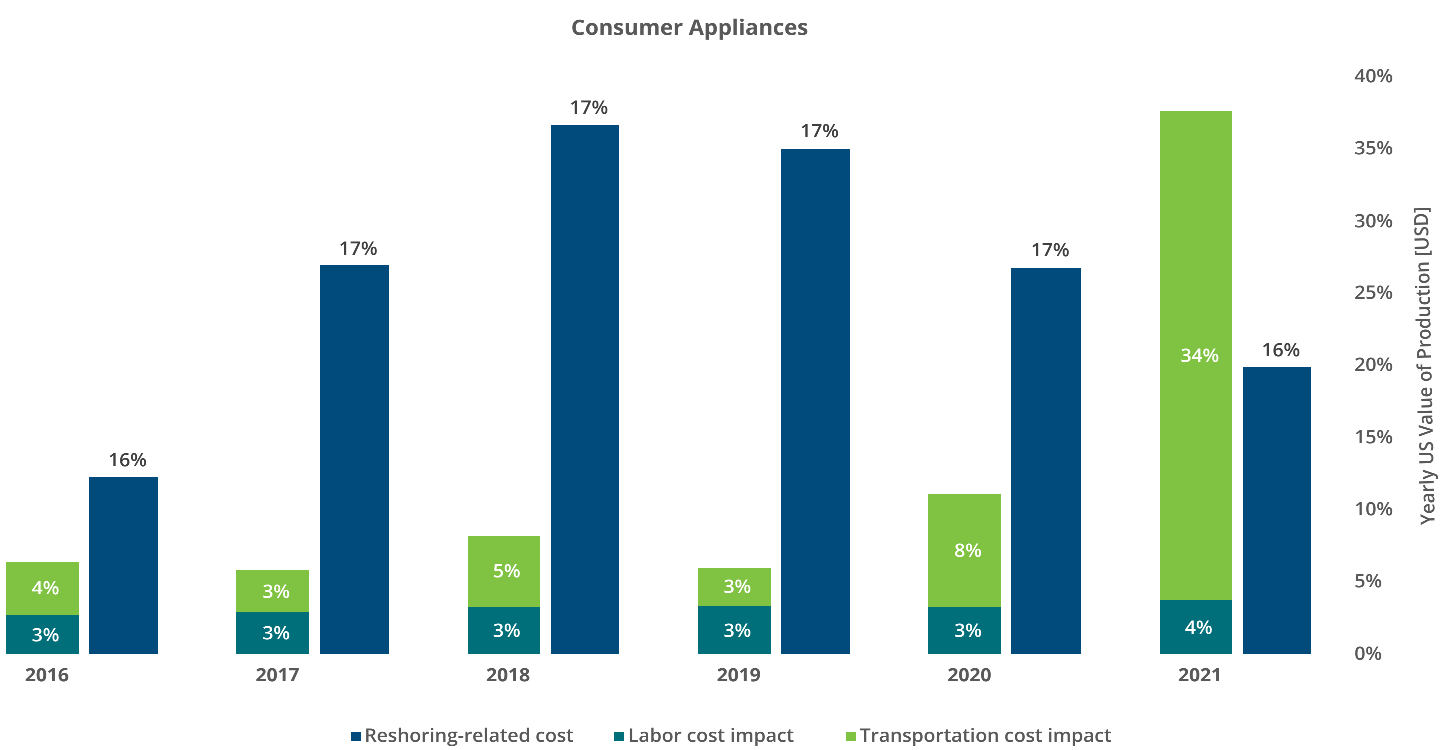
Reshoring cost analysis by industry

Deloitte has analyzed the total cost, across several industries, to manufacture products and bring them to US markets. We compared labor and transportation expenses for Chinese-sourced goods against a reshoring scenario for the years 2016 to 2021.

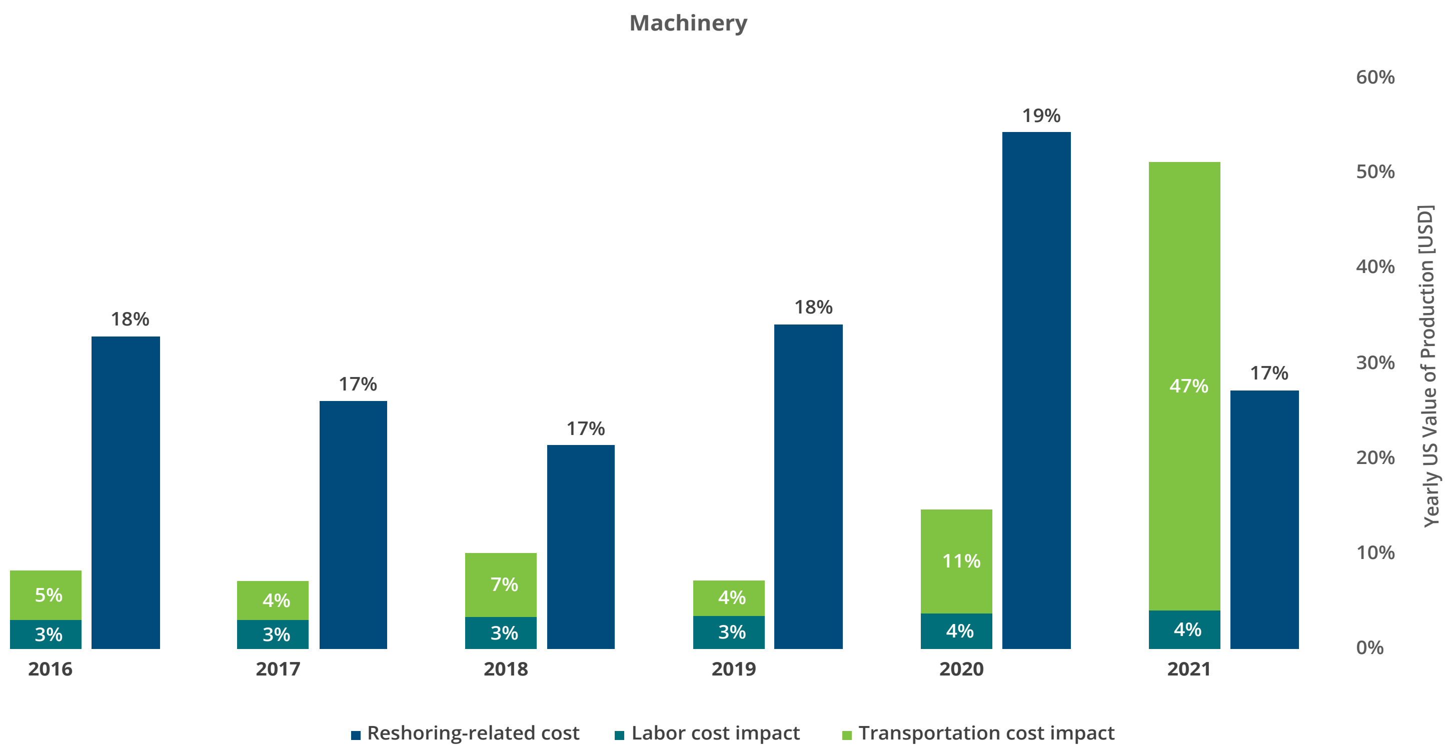
In three of the four categories we examined—machinery, consumer appliances, and furniture—soaring transportation costs in 2021 suddenly made the reshoring option attractive. In our analysis, only the apparel and fashion category still favored Chinese suppliers in 2021, reflecting the relatively low cost of transporting a large volume of clothing across the oceans.[5]

While transportation pricing has normalized since 2021, as ports cleared their backlogs, the potential volatility in transportation costs can no longer be ignored. Our analysis also reflects the change in the delta of labor costs between China and the United States, a trend that is occurring in other Asian countries, though slightly more slowly (figure 1).[6]

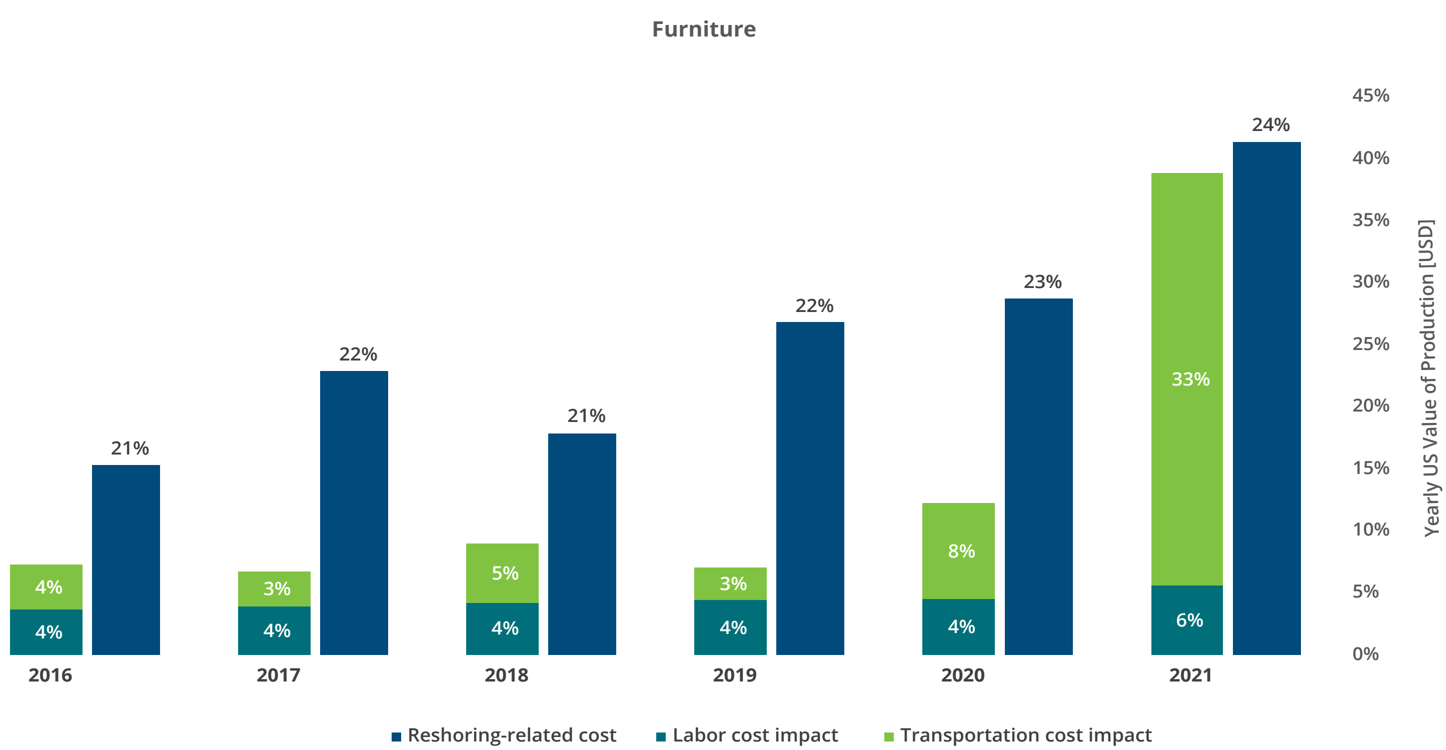
Figure 1. Cost comparison for delivery to US consumers



Sources: US Bureau of Labor Statistics, IPC, International Labor Organization, Freightos container freight index for East Asia to US West

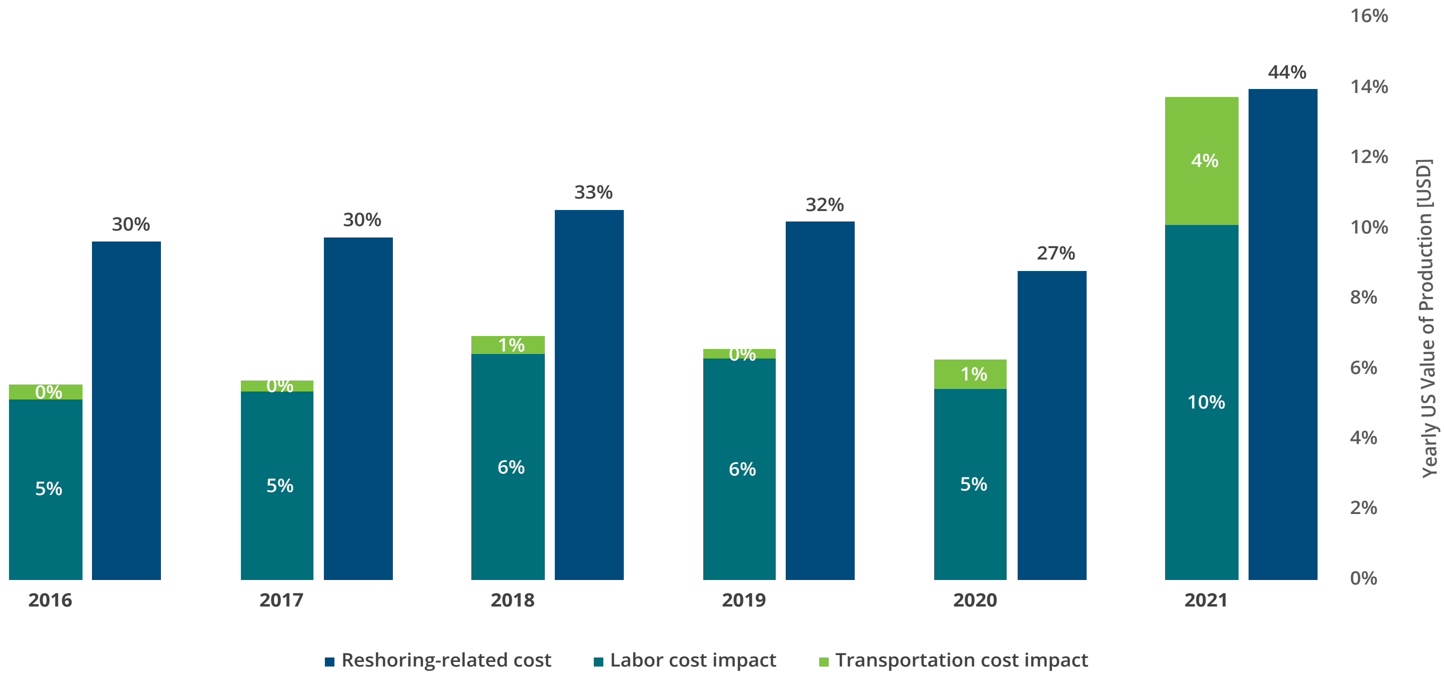


Sources: US Bureau of Labor Statistics, IPC, International Labor Organization, Freightos container freight index for East Asia to US West



Sources: US Bureau of Labor Statistics, IPC, International Labor Organization, Freightos container freight index for East Asia to US West

Apparel and Fashion



Sources: US Bureau of Labor Statistics, IPC, International Labor Organization, Freightos container freight index for East Asia to US West

Each of the industries we examined has its own dynamics affecting supply chain economics.

- **Consumer appliances** — An elevated level of automation is shrinking the labor cost gap between China and the United States, and the transportation cost impact on this category is intermediate. These products are near a tipping point that favors reshoring, and rising productivity in US manufacturing may become the deciding factor.[7]
- **Machinery** — Manufacturing automation and design advances are reducing the labor cost differential. Also, US production may deliver quality advantages. Transportation costs are high, and containerized transportation limits can affect design and modularity for some types of heavy machinery. Reshoring is a reality in the sector.
- **Furniture** — The labor cost differential for production in Asia is still significant, and for modular or user-assembled furniture, transportation costs may not offset that advantage. For higher-end furniture, transportation costs favor reshoring.
- **Apparel and fashion** — The labor cost difference between China and the United States is very high, and transportation costs are low, meaning low-cost products have no reason to reshore.[8]

Major companies including General Motors, Caterpillar, and Airbus recognize the changing economics—and the potential benefits from supply chain realignments that move manufacturing closer to customers.[9] Technology companies as well are bringing capacity closer to market demand with facilities in Brazil, Mexico, and Eastern Europe, even as they keep significant manufacturing in China.[10]

Recent Deloitte research[11] on the future of the freight industry suggested that reshoring and nearshoring may redraw the transportation map. Executives with transportation and manufacturing companies surveyed for this report expect 20% or more of freight originating from Asia to shift to the Americas by 2025.

Labor cost changes are part of the picture, along with volatility in goods transportation costs, which caught global companies off guard in 2022 and may be harder to predict.[12] Working capital considerations can also bolster the case for reshoring or nearshoring, as a fully loaded container represents frozen money while in transit or stuck in a port. The ESG considerations that might drive supply chain decisions include reductions in carbon dioxide emissions from manufacturing or greater oversight of labor and environmental risks.

As global manufacturers rethink their supply chain decisions, pursuing reshoring and nearshoring strategies, we may be entering a new era characterized by regionalization—reshoring and nearshoring[13]—as a complement to globalization, boosted by Western policies.[14] Regionalization may not be a universal trend, but clearly some companies are bringing manufacturing and procurement closer to markets that dominate their sales.[15]

Figure 2. Globalization-regionalization decision factors

	Costs	Risks	Other factors
Reshoring/ nearshoring (regionalization)	- Moderate transportation costs - Mitigated financial exposure - Reduced direct and indirect costs across production life cycle - Less overall supply chain complexity - Productivity challenge for industries with high level of robotization	- Less exposure to natural disasters and geopolitics - More ability to cope with market dislocations - Greater adaptability for demand fluctuation	- Improved sustainability (emissions, other environmental, social) - Enhanced brand reputation - Lessened industrial footprint complexity
Far East cost baseline (globalization)	- Suppliers' portfolio reduction - Higher transportation costs - Increased financial exposure - Tax inefficiency	- More volatile transportation costs - Greater exposure to natural disasters and geopolitics - Higher obsolescence risk	- Increased industrial footprint complexity - Greater supply chain complexity - Reduced market differentiation - Less corporate governance control - Less sustainability

Source: Deloitte

Conclusion

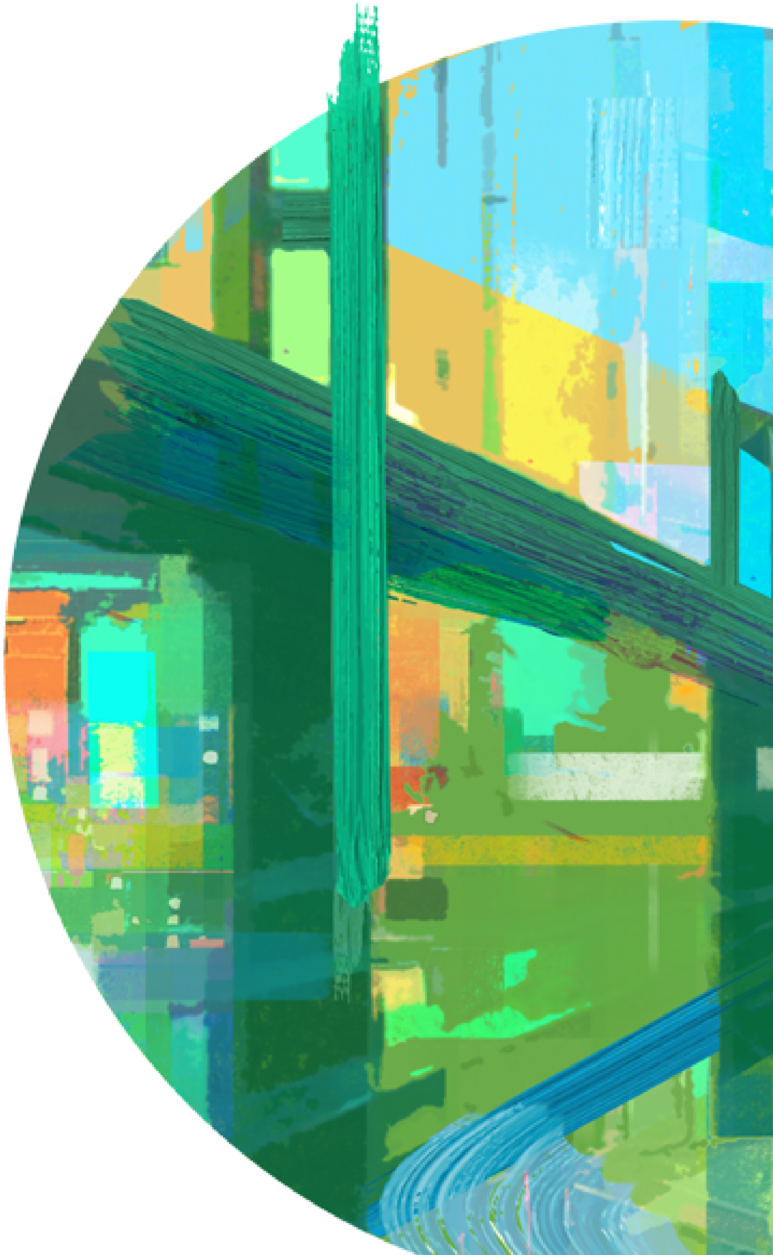
Maintaining a global presence while also restructuring to optimize operations and reduce risks may be harder today than it has been at any other time in the past several decades. Some companies may choose to gain strategic and cost advantages by moving all or part or their capabilities back to the West, reversing earlier offshoring decisions. But this is not a simple change and will not be straightforward to execute.[16]

Where the equation includes a long supply chain to the customer, plus shrinking price elasticity, plus geopolitical risk, the result likely is restructuring of the supply chain. Global leaders are clearly coping with new, more difficult challenges. But they may also see the current trends as presenting opportunities to maximize flexibility and profitability while also reducing risks.

As a framework for examining the need to reassess existing supply relationships, the following questions are clearly relevant:

- How long and complex is my global supply chain (geographically and logistically)?
- What competitive advantages or disadvantages does my supply chain confer in the marketplace?
- How does the total cost of goods sold change by shrinking the supply chain closer to the end consumer?
- How is my supply chain a result of price elasticity, and how does customer price elasticity impact decisions?
- What are the risks to my supply chain, and how can I control or mitigate them?
- Is there unpredictability in my supply chain that could affect business continuity?
- What's the impact of regulations or the potential arc of future regulations (e.g., EU's Carbon Border Adjustment Mechanism [CBAM], Corporate Sustainability Reporting Directive [CSRD])?[17]

The answers to these questions may well signal that supply chain risk is just beneath the surface, and that in turn may shape divestiture and acquisition strategy in coming years. Reshoring or nearshoring options that seemed uneconomical in prior years may actually be opportunities today.



Endnotes

1. Based on Deloitte's analysis of public series of data (International Labor Organization, Trading Economics, MacroMicro FBX01, Freightos, Baltic Exchange, OECD, MSC, US Bureau of Statistics – IPC by Industry and Measure, NAICS codes 315, 333, 335, 337) pulled in August 2022.
2. Jim Kilpatrick et al., *Agility: The antidote to complexity*, Deloitte 2021 Global Chief Procurement Officer Survey, Deloitte Insights, 2021; Kai Ryssdal and Maria Hollenhorst, "How's the containership backlog at Southern California's ports?," *Marketplace Radio*, September 29, 2022.
3. Based on Deloitte's analysis of M&A data pulled from ReshoreNow.org – Reshoring Initiative, Media Ford, Reuters, ThomasNet, BusinessWire, Global Atlanta, KSN, CNBC, prnewswire.com, Genenews in March 2023.
4. Kilpatrick et al., *Agility: The antidote to complexity.*
5. Based on Deloitte's analysis of public series of data (International Labor Organization, Trading Economics, MacroMicro FBX01, Freightos, Baltic Exchange, OECD, MSC, US Bureau of Statistics – IPC by Industry and Measure, NAICS codes 315, 333, 335, 337) pulled in August 2022.
6. Ibid.
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9. Caterpillar, "Building for a stronger future, Caterpillar announces restructuring and cost reduction plans," press release, September 14, 2015; General Motors,"GM accelerates its drive to lead the EV industry with $7 billion investment in Michigan, creating 4,000 new jobs and retaining 1,000," press release, January 2022; Luc Olinga, "Airbus opens first US production plant," *Industry Week*, September 14, 2015; Nelson D. Schwartz, "Supply chain woes prompt a new push to revive U.S. factories," *New York Times*, January 5, 2022.
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11. Larry Hitchcock et al., "The future of freight: Transforming the movement of goods," Deloitte Insights, November 1, 2022.
12. Based on Deloitte's analysis of public series of data (International Labor Organization, Trading Economics, MacroMicro FBX01, Freightos, Baltic Exchange, OECD, MSC, US Bureau of Statistics – IPC by Industry and Measure, NAICS codes 315, 333, 335, 337) pulled in August 2022; Ryssdal and Hollenhorst, "How's the containership backlog at Southern California's ports?"
13. Brown, "Reshoring, restructuring, and the future of supply chains."
14. Seth O'Farrell, "TSMC investment caps record year for US mega deals," *fDi Intelligence*, December 12, 2022.
15. Brown, "Reshoring, restructuring, and the future of supply chains."
16. Andrew Blau et al., "Facing headwinds, finding tailwinds: How companies can build enduring value and stability through an economic downturn," Deloitte, 2022; Trevear Thomas, "Macro trends transforming business—and impacting M&A," Deloitte, November 1, 2022; Paul Wellener et al., "Meeting the challenge of supply chain disruption," Deloitte Insights, September 21, 2022.
17. O'Farrell, "TSMC investment caps record year for US mega deals."

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