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CONSIDER THE SOURCE

West Michigan manufacturers search for supply chain solutions amid coronavirus outbreak

By **JESSICA YOUNG | MiBiz**
jyoung@mibiz.com

The ongoing coronavirus outbreak in China is forcing West Michigan manufacturers to find creative solutions to avoid production disruptions.

Coupled with trade tariffs and other issues in the region, manufacturers increasingly are realizing they need to intimately understand their downstream supply chains and prepare for the worst at all times.

Hill

"Our clients are looking for any solution they can come up with, and the solution they ultimately choose will just be a matter of time," Scott Hill, partner at the Grand Rapids-based law firm **Varnum LLP**, told *MiBiz*. "Just not knowing yet where the chips will fall, there's a lot of damage control happening right now in terms of if you can't get 100 percent of your supply, can you at least get 50 percent?"

Even before the outbreak of coronavirus, which began to take shape in January, many manufacturers had already begun moving their supply chains out of China because of risk and expenses stirred up by U.S. trade policies.

Benton Harbor-based appliance manufacturer **Whirlpool Corp.** (NYSE: WHR) is largely dual-sourced, which gives the business "a little bit of hedging," company chairman and CEO Marc Bitzer told investors during an earnings call on Jan. 28.

"Throughout the last couple of years, (for) the most critical components, we went aggressively for dual-sourcing," Bitzer said. "We're single-sourced only in very, very few components."

Coming out of the recession, single-sourcing became the trend in order to mitigate costs, according to Hill. Dual-sourcing — which is the practice of using two suppliers for a given component — can work to lower risk, but the system is complicated and often more expensive than single-sourcing, especially for critical parts that need to be verified by an OEM.

"You have to balance as a supplier whether you want to go down the route of dual-sourcing because the fact is you're probably going to pay a little more to have that risk protection," he said. "The unknown then comes in when you have dual sources, if one shuts down then do you automatically have the other source to protect you?"

Often, dual-sourcing cannot protect an entire supply chain. Factories enter into agreements that lock in a percentage of the total components that will come from each source. During a crisis or shortage in a particular region, this could mean that some supply of components can flow into the supply chain, but the missing pieces still will not be replaced.

"It's not a 'flip the switch' kind of thing," Hill said.

Manufacturers that have shorter durations in their supply agreements are probably better positioned at the moment than those with longer-term contracts.

"In the longer-term relationship, you might get a couple of percentage points off from a pricing standpoint, which is good, but you're locked into a situation," Hill said. "If you look at somebody who has still two and a half years to go on a three-year-long term supply agreement as compared to somebody who is ready to exit in six months, you can better position yourself in the future with a shorter duration. I could see where manufacturers are entering into shorter-term arrangements and paying a little bit more in the short term for flexibility."

Additional costs

Nearly every manufacturer with an international supply chain has dealt with added expense, uncertainty and risk as the U.S. and China have been locked in a bitter trade battle that began in 2018.

The conflict has seen the world's two largest economies impose tariffs on hundreds of billions of dollars worth of goods from both countries. Negotiations are continuing but have proven tricky.

In the meantime, manufacturers who source raw metals, electronics or other components directly or indirectly from China have dealt with the ongoing uncertainty of the trade war by shifting their supply chains or finding ways to eat the added costs.

The coronavirus has just further fueled this strain between U.S. and Chinese manufacturers, sources said.

The crisis fell in tandem with the Chinese New Year holiday, which lasted until Feb. 8. As an official public holiday, many Chinese people planned to take a week off from work for the celebration. As the virus spread from person to person, the holiday break was extended because of quarantines and travel restrictions to contain the virus.

Chinese workers finally began trickling back into work last month, a week or more later than usual. However, most of the available evidence indicates many healthy workers, either facing quarantine measures or simply scared of catching the virus, still remain home.

Rockford-based shoe manufacturer **Wolverine World Wide Inc.** (NYSE: WWW) expects the virus will cost the company approximately $30 million in the first half of 2020, according to an earnings call last week. That's on top of about $15 million in incremental costs associated with the trade dispute.

This financial loss comes even despite the company diversifying its supply chain away from China in recent years, according to Wolverine CEO Blake Krueger. Wolverine expects China to represent less than 20 percent of its global production in 2020, down from about 40 percent in 2019.

"We are fortunate to have greatly reduced our reliance on China sourcing over the last five years. However, we expect some production delays from China factories and a potential slowdown in the supply of some raw materials sold by China vendors to manufacturers outside of China," Krueger said in the call, adding that the situation will be difficult to quantify until factories have more clarity on the return of workers from the Chinese New Year.

"So far, the return rate of workers to factories has been better than expected and is not expected to have a material impact on production in Q1," he said.

At Allegan-based **Perrigo Co. plc** (NYSE: PRGO), CFO Raymond Silcock told analysts last week that the coronavirus should not cause any disruption for the company.

"Obviously the situation continues to evolve, but currently we don't anticipate it having more than a modest impact on our results," Silcock said. "Most of our manufacturing facilities are in the U.S. and Europe, although some of our products are manufactured and we source raw and other materials from around the world, including in China.

"All of the plants in which we manufacture and from which we source our products are currently running. While we have incurred small incremental air freight costs to date this year, we don't expect these to have a material impact on our results in Q1, and based on what we know today, we don't expect more than a modest impact on our fiscal year."

Complex system

Getting people to return to work is just the first step in a complicated process to get factories restarted and producing at a meaningful rate.

Jim Gavin, purchasing manager for **ADAC Automotive**, said some of the Grand Rapids-based Tier-1 supplier's direct suppliers needed to get specific approval from the Chinese government to return to production.

"They had to show they had procedures in place, (the government) had to know that all their workers would have an adequate supply of masks, and they had to show that they're not going to contaminate people through the way they're going to have people congregate with each other," Gavin said.

As *MiBiz* previously reported, a tooling engineer from ADAC was near Wuhan when the public health crisis broke in late January and had to be flown out of the country on a chartered jet from the U.S. Embassy. Upon landing at a U.S. Air Force base in California, the employee was under quarantine for two weeks.

To mitigate any supply disruption, ADAC maintains a "safety stock" of components in a U.S. warehouse that holds about four weeks of inventory, according to Gavin. ADAC also had several ocean containers of products that were shipped before the Chinese New Year. Gavin said these stockpiles could keep the company at full production until late March or early April.

However, ADAC is a single cog in the notoriously multifaceted automotive supply chain.

"It only takes one part to shut down," Gavin said. "What's really going to be the issue is how long the OEMs are going to be able to keep production going with all of their suppliers."