



IOD POLICY PAPER

Reorienting

The impact of geopolitics
on business supply chains

August 2023

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The impact of geopolitics on
business supply chains

The international trading environment has proved challenging over the last couple of years as businesses have grappled with Brexit-related border friction, pandemic disruption and unstable economic conditions. On top of that, businesses are sensing geopolitical shaped clouds on the horizon.



One in four members

feel impacted by geopolitical pressures, particularly in relation to China, and are therefore altering or considering diversifying their supply chain in response.





This research sets out to explore the extent to which IoD members are taking geopolitical issues into account when considering their global operations, and the reasons behind their decisions. Our main findings are that businesses are looking for greater stability in their supply chains; they are willing to increase costs in the short-term to achieve this, and they feel that the UK should adopt a more cautious approach to China, balancing the superpower's economic importance with its potential to disrupt global political relations. IoD members are predominantly SMEs based in all regions of the UK.

73%

have supply chains that involve cross-border trade.

For a long time, relations between the US and China have been chilly, and numerous large corporations have begun to find alternative locations for manufacturing and distribution. The pandemic exposed vulnerabilities in international supply chains as both supply and demand were subject to huge shocks, and multiple industries were affected by commodity shortages and rising prices. Then, the war in Ukraine sent further shockwaves into already disrupted supply chains and brought to light the consequence of being too reliant on countries perceived to be high-risk to the UK.

We asked IoD members whether they have felt sufficiently impacted by geopolitical pressures to make changes to their supply chain. We then asked those who indicated they did feel sufficiently impacted to tell us more about how and why they are making alterations, the impact on business costs, the advantages and disadvantages of reorientating, and whether they believe it is practical for the UK to completely decouple from China should China become a significant risk to the UK.

Of those that import from outside the UK, one in five firms have already altered their supply chain away from China.

20%

of importers have already altered their supply chain away from China; an additional

15%

of importers are considering doing so

31%

of SMEs (businesses with 0 - 250 employees) are responding to pressures compared to

53%

of large businesses (businesses with 250+ employees)



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Our research tells us companies have become more risk aware since the pandemic and the invasion of Ukraine. There are numerous drivers behind this. However, the one reason all respondents had in common was 'stability'.

Many firms are concerned about long term engagement with China. They feel that should relations deteriorate, they want to avoid sudden disruptions and are therefore choosing to take a slight hit to business costs in the short-term to ensure their supply chain is sufficiently resilient and future-proofed. Some members also expressed the view they feel uncomfortable trading with regimes that do not conform to western democratic ideals. Moreover, firms want to be able to provide certainty to their own end customers that they are a reliable supplier, and the less exposed to perceptions of supply chain risk they are the easier it is to do that.

Delving deeper, there were a few recurring themes. Firstly, business has been hampered by global commodity shortages, particularly in critical minerals, semi-conductors and certain chemicals. While this was primarily a symptom of pandemic related shifts in supply and demand, the war in Ukraine exacerbated difficulties in sourcing key components like grain, fertiliser, chemicals, and fanned the flames of the fuel crisis. Moreover, these pandemic related shifts contributed to delays at ports, shipping times and the reliability of logistics.



Relationships with suppliers are ideally long term... If there is danger in any long term relationship being disrupted it is important to prepare to develop new alternatives.

(Small, consultancy, considering diversifying)



Switching to a localised supply chain has had significant benefits... it has reduced our exposure to geopolitical tensions and potential disruptions, providing our customers with more certainty about their orders.

(Small, electrical engineering, has already diversified)





We are considering altering our supply chain in order to ensure continuity of supply for critical products and services and avoid the risk of price spikes arising from supply constraints. We are currently gathering information from our supply base to understand the level of reliance on China and or Taiwan in terms of finished product, components, services and embedded infrastructure.

(Large, health and social care, considering diversifying)



Our business in the oil and gas exploration sector needs timely support and ordering through UK or US suppliers stipulating only non Chinese means there are serious delays in obtaining critical items.

(Large, drilling company, considering diversifying)



The impact of covid on China component supply (city/port shut downs); disruption in shipping schedules (again covid related) and very significant increase in costs led us to reassess. As these have resolved we have been increasing our inventory holdings, developed alternative logistics routes (although with Russia/Ukraine war this has become increasingly difficult). We have looked to extend/localise our supply base to increase reliability and resilience.

(Large, automotive manufacturing, have diversified)



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Secondly, businesses are worried about the security of their data in Chinese systems and have therefore moved their supply chain to avoid data breaches and intellectual property theft. Firms feel that transferring to suppliers closer to home, and which are more reliable, gives them more control and oversight of their data and IP.



Whilst our business was small and developing we needed to source components wherever we could and China was a good source of low volume manufacture as this is mostly done on hand build benches. Now that we are growing we are concerned that if we transition to larger scale assembly line manufacture our IP will be stolen once there is recognition of the volumes involved.

(Small, manufacturing, considering diversifying)



In response to the escalating global tensions, we felt it necessary to revamp our supply chain to secure the confidentiality of our deep tech assets. We started to review our supply chain in late 2022. It primarily involved reassessing our key partnerships, suppliers, and manufacturers, with a focus on areas where there was an inherent risk of technological leakage.

(Small, electrical engineering, have diversified)

Finally, businesses are acting for moral reasons, namely China's association with human rights accusations, its authoritarian regime and attitude towards Taiwan. Additionally, many businesses have recognised the environmental benefit of shortening their supply chain and keeping supply routes as local as they can.



Human rights abuses in Xianjing. Most organisations have modern slavery and ESG policies and you cannot stand behind these and ignore the evidence from organisations such the UN Human Rights office.

(Medium, scientific services, considering diversifying)



Operationally, concern over Chinese state's ability to close down key suppliers with zero notice, allied with several of our customers requesting contingency for their products with Chinese content. Politically, concern over the regime, human rights, threat of conflict with Taiwan and others (notably US).

(Manufacturing, large, considering diversifying)



We need a reset on what we buy and need as individuals and nations and build an alliance of nations with similar values to bring our own supply chain into friendlier hands. Its also better for the environment not having to ship goods halfway around the planet.

(Medium, scientific services, considering diversifying)

While members are ultimately motivated to create a supply chain that is reliable and reduces risk with suppliers they can trust, they have had to make sacrifices to achieve this, the main challenge being higher costs. Those which have already diversified their supply chain have found local suppliers to be more expensive than Chinese ones, and have had to invest in moving operations, a process that takes months, sometimes years, to see through. At the same time, they have found there is a more limited choice of vendors outside China. They have therefore had to factor in a slight reduction of capacity while implementing the changes.

Of those which are considering diversifying their supply chain, many would expect to see a ten to twenty per cent increase in costs, also related to the process of moving operations and finding the right suppliers for their product. Members have had to consider what is the right balance between cost and quality of supply.



if we were to need to quickly move our injection moulded product lines then there would be significant capital tooling cost implications and the costs associated with re-establishing quality standards.

(Small, pet services, considering diversifying)

Moreover, although businesses are striving to find local suppliers which are reliable, there is always the concern that supply can inadvertently originate from China anyway if, for example, a local supplier sources their own supply from China. Firms are therefore placing more emphasis on due diligence to mitigate this.



Investment in the UK by China and manufacturing by the UK in China may be difficult to unravel. If the UK creates strong barriers to Chinese investment here there will also be an impact on housing in the south east. However in the long term these might be costs we have to face to curtail China's support for despots around the world.

(Small, electrical engineering, have diversified)





However, most firms have balanced the potential losses from taking the decision to diversify their supply chain and felt that any short-term damage will be worth the long-term gains in security.

Of course, while China is potentially the most powerful and immediate geopolitical business risk, members have recognised other warning lights in the international sphere. Unsurprisingly, the most common countries businesses have concerns about are all those which do not necessarily conform to western politics: Russia, India, North Korea, Brazil, Middle Eastern nations. This is rather reminiscent of the 1980s, with phrases like 'East-West divide' and 'political polarisation' cropping up.

Businesses have also cited a rise in government interventionist policies, for instance the US Inflation Reduction Act, as a threat to globalisation, which in turn is a threat to business growth. However, and perhaps slightly paradoxically, an intentional reorganisation of global supply chains in response to a changing global dynamic, it could be argued, is in itself a challenge to globalisation. If western companies deliberately avoid partnerships with any country which does not adhere to the same moral and political values, the so-called 'East-West divide' could become something of a self-fulfilling prophecy.



There is also the east-west type of partitioning currently underway. Countries are beginning to lean one way or the other: either with China-Russia or with USA-Europe. This poses many challenges for MNCs. China is also leveraging its influence in third-world countries and weaning away trade from the west.

(Small, consulting, have diversified)



Globalisation is moving back towards localisation, take the Inflation Reduction Act in the US, this will further reduce UK competitiveness as other large trading blocks inevitably create their own or similar types of initiative.

(Large, manufacturing, considering diversifying)



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Businesses are increasingly wary of geopolitical influences

So, with that in mind, do businesses think that decoupling from China is practical? Well, the general rhetoric is no – a complete severance would be extremely difficult, since UK supply chains are so entwined with China, and its economy is too important to be ignored. This is especially the case in the manufacturing sector. But firms do agree there must be a more cautious approach to doing business with the superpower. They would like to see an open dialogue with China that does not compromise or harm UK values.

Some argue that the government can counter Chinese dominance in manufacturing by better exploiting the UK's capabilities and investing in a UK industrial strategy. Others say that more guidance on 'doing business in China' would be a helpful way to highlight the risks with businesses looking to internationalise. Ultimately, the consensus is that there needs to be a realistic balance between thoughtful business with China and mitigating long-term potential risks.





I don't think it is practical to completely decouple from China in the near to mid term given how large the manufacturing sector in China is across sectors. Decoupling is important from a strategic geopolitical point of view as the west is vulnerable as long dependencies on single nations for critical manufacturing is high.

(Large, critical infrastructure, have diversified)



Investment in the UK by China and manufacturing by the UK in China may be difficult to unravel. If the UK creates strong barriers to Chinese investment here there will also be an impact on housing in the south east. However in the long term these might be costs we have to face to curtail China's support for despots around the world.

(Small, medical products and researcher, have diversified)



China is and will continue to be an economic powerhouse and we can grow and develop with that through our capacity for disruptive innovation in the UK, we just need to foster this and leverage our advantages. Commercialise our strengths, perhaps more focus of entrepreneurship within education and creating government policy that inspire those behaviours.

(Large, manufacturing, considering diversifying)



Diversifying away from China and Chinese products should be a genuine opportunity to upskill our own UK and EU workforces, increase our local productivity, and create the high-skills high-wage economy that we have failed to create for generations.

(Small, sector unknown, considering diversifying)

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The Institute of Directors is a non-party political organisation, founded in 1903, with approximately 20,000 members. Membership includes directors from right across the business spectrum – from media to manufacturing, professional services to the public and voluntary sectors. Members include CEOs of large corporations as well as entrepreneurial directors of start-up companies.

The IoD was granted a Royal Charter in 1906, instructing it to “represent the interests of members and of the business community to government and in the public arena, and to encourage and foster a climate favourable to entrepreneurial activity and wealth creation.”

The Charter also tasks the Institute with promoting “for the public benefit high levels of skill, knowledge, professional competence and integrity on the part of directors”, which the IoD seeks to achieve through its training courses and publications on corporate governance.

iod.com



The logo for the Institute of Directors, consisting of the letters 'I' and 'D' in a stylized, serif font, with a Greek letter Phi (Φ) between them.