

Running like clockwork?

How coronavirus may influence supply chain disruption



The COVID-19 outbreak has been declared a pandemic by the World Health Organisation (WHO) and is now genuinely a black swan, which is likely to have a huge impact on people's lives, families and communities. As each country looks to steer a course to manage and control the pandemic, business is facing similar stresses and strains as we seek to protect our workforce and to maintain business continuity. As we move forward one of the key areas of disruption and risk for business failure is supply chain disruption. This affects every business and we all need to ensure that we have a robust plan to protect and preserve our supply chains.

With the unique issues created by COVID-19 there are a number of areas where thought and protection needs to be implemented as soon as possible. The key areas are as follows:

Good housekeeping

As the position in relation to COVID-19 continues to develop it is not certain how long it will be necessary to ringfence your supply network and as a result your own cash management has to be a priority. Attention should be given to maintaining a healthy balance sheet and strong cash management so that there is cash available to cover and protect any crisis arising in the supply chain. For instance there may be requirements to meet new liabilities such as tariffs, FX movements, supplier funding, redundancy programmes and ransom payments.

As a result consideration should be given to the deferral of capital projects or other significant investments in the short-term with an emphasis on supply chain protection.

In addition it may be necessary to defer other large payments, this may not be possible for your suppliers who may be on extended payment terms but other deferrals should be considered. Given the future uncertainty it may be possible to tap into the support being offered by national governments which may include agreeing time to pay arrangements where support is needed to help protect the supply chain of a major employer given the knock on impact across the supply chain. If you do consider seeking deferred payment terms with creditors then make sure that this will not give rise to a default in your own banking arrangements. We would expect senior lenders in the current circumstances to be very supportive of deferring creditor payments where possible.

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Proactive management and early warning signs

Whilst a plan needs to be implemented to identify risks and spot early warning signs the starting point has to be proactive management of suppliers. Take time now to reach out to suppliers and discuss with them the plans that they are implementing to protect the supply chain and their own infrastructure. In particular you should consider those suppliers where there are integrated arrangements involving IT, infrastructure and tooling.

Early warning signs might include inability to reach key personnel at your supplier; failure to deliver on time; the urgent renegotiation of contract terms (and in particular payment terms); the supply of poor quality goods or defective products; changes in senior management behaviour or the loss of senior management; late corporate filings; the withdrawal of credit insurance; market gossip or speculation from competitors or creditors; or ill-founded disputes in relation to the payment of invoices with threats to go "on stop."

As part of the proactive management it is essential to try and avoid disputes which could irreparably harm your supply chain. To the extent that disputes do arise then strategies need to be implemented to avoid ransom positions and to preserve the continuation of supply.

In addition, increased caution is required when concluding new contracts during the current coronavirus epidemic. It is therefore strongly recommended that the situations of default, i.e. delay, termination options, cases of force majeure, be clearly and explicitly dealt with in the contract.

Operational supply chain review

Have you undertaken an operational review of your supply chain to identify key weaknesses and potential solutions? For instance is there a concentration issue in your supply chain with possible over reliance on a single supplier? Or is there a supplier where IT and integrated systems are key to the continuation of supply? Have you undertaken a deep dive into your supply chain to make sure you understand all manufacturer relationships, sub-manufacturers, distributors and logistics providers to fully understand where weaknesses may occur in the future? It is critical to understand all tiers of your supply chain network and where the weak links may arise. Thought should be given as to how those relationships can be managed in a distress situation – do you have access rights, licences or source codes to facilitate the continuation of supply?

Of particular importance is understanding the workforce plans for your suppliers and how they will be managing their workforce to protect the staff and maintain continuity of supply. At the heart of any supply chain is the workforce behind it and all businesses should be managing their staff appropriately to support business continuity.



Co-operation and collaboration arrangements

COVID-19 will create universal supply chain disruption and those issues will be widespread across the global business community. As a consequence you should not disregard the possibility of co-operation or collaboration arrangements with competitors and other suppliers. This is a unique situation and business will need to adapt and pull together collectively to find solutions. Key collaboration partners are often easy to identify with obvious synergies but historically the reluctance to partner with a competitor has overridden the potential benefits that can be achieved. Pandemics create a new set of rules and the opportunity for business to define a new approach.

Financial distress, supplier funding and intervention

It is inevitable that COVID-19 will create stress in the supply chain for those businesses that were under resourced and cash constrained before the pandemic began. Managing financial distress is a challenge and the first challenge is to ensure that the extent of the distress is fully known. A simple request for advanced payments from a supplier to help with cashflow can easily turn into a subsequent request to make supplier funding payments. In our experience the first request for a supplier funding payment is not always the last and therefore intervention is needed to ensure that there is clear visibility on a future funding requirement.

Accountants should be engaged to complete a 13-week rolling cashflow forecast for your supplier to understand whether the funding request is sufficient and whether future funding requests will be made. This gives you the opportunity to weigh up the option of supporting supply or resourcing new supply. You may wish to use your internal accounting team or professional firms where the cost should be met by the supplier as part of the critical payment request. We work closely with restructuring specialists who can support on supplier cash management to preserve the sanctity of the supply chain as well as considering the various funding options which may include advanced payments to suppliers; soft loans; secured loans; or acquisition of supplier debt to prevent an insolvency event.

Ransom requests and supplier insolvency

Financial distress in your supply chain should give rise to a much higher level of scrutiny and investment of time to manage through the distress curve. It is essential to try and preserve supply and avoid uncontrolled supplier insolvency wherever possible. In the event of the insolvency of a supplier then you may receive substantial ransom requests from the appointed officeholder to facilitate the continuation of supply. If you are agreeing to fund an officeholder then you will want to seek to limit the extent of those requests. This needs to be supported by proper preparation and awareness of your own exposure, title to tooling, stock and raw materials which are critical for maintaining the supply chain. We have extensive experience of dealing with restructuring and insolvency processes whether preparing for them or seeking to avoid them and we can support you in order to manage and maintain essential supply and to avoid, where possible, ransom requests.

Whilst the maintenance of supply is clear it is also imperative to ensure the recovery of stock or tooling to manage the transition of supply to a third party to supersede the short term trading relationship.

Foreign jurisdictions

Do you know or understand the jurisdictions in which your suppliers are operating; the premises from which your client is supplying; the location of your goods throughout transit; and the likely issues arising if there is distress or an insolvency in a foreign jurisdictions? Many supply chains have a multi-jurisdictional dimension and it is essential that you can navigate through the jurisdictional issues such as the ability to terminate contracts and how to navigate a formal insolvency which could bring delay to supply chain delivery. Clear plans are needed to manage the movement of goods seamlessly across borders including the re-routing of goods or the ability to repatriate goods on the seas or trapped at ports or docks. In Central and Eastern Europe we have a supply chain taskforce to support you throughout all aspects of the supply chain.



Resourcing elsewhere and contingency planning

It has to be recognised that it is not always possible to maintain business as usual supply through a prolonged period of challenge. As a result contingency planning should start immediately to consider plans to source alternative suppliers or to start resourcing goods elsewhere. The received wisdom from the WHO and others is that the virus could return in a second wave and could return again next year. As a result this may not be an isolated incident which makes it necessary to start contemplating much longer term plans to preserve the resilience of the supply chain for an extended period or what may be the new normal of diversifying key supplies with multiple suppliers to reduce concentration and future pandemic risk.

Partnering and acquisition

Is it time to consider plans for partnering with other businesses for the delivery of goods or the production of products through a joint venture or a merger/acquisition of trading divisions? When faced with supplier funding requests consideration should be given as to whether it is better to fund or acquire the business. If the supplier is facing a potential insolvency position then it may be more cost effective to acquire the supplier rather than continuing to fund losses for the benefit of all the supplier customers. The evolving experience being gained in relation to COVID-19 will deliver the financial shock to business to consider a new approach to your supply chain and its future management.

Managing your own financial distress

Whilst this is a point that no-one wishes to contemplate thought should be given as to how to manage any warning signs of financial distress within your own business. Stakeholder management is pivotal to any successful financial restructure and consideration of options such as additional borrowing or funding structures; asset based lending or receivables finance; or access to Government funding initiatives. We have extensive experience of delivering both operational and financial restructurings in order to ensure business continuity.

COVID-19 presents one of the greatest challenges to supply chain management for a generation but also creates with it great opportunity and the ability to build greater resilience into your supply chain for the future.

Contact a commercial contracts lawyer or attorney

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Coronavirus Hub

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