



SUPPLY CHAIN UNDER THE 'DUAL CIRCULATION' STRATEGY

Implications of the 'dual circulation' strategy on your supply chain

The phrase '双循环', or 'dual circulation' in English, first appeared during the meeting of the Standing Committee of the Political Bureau of the Communist Party of China (CPC) Central Committee in May 2020, and later during a meeting of the Political Bureau of the CPC Central Committee in July 2020. It was described as “a new development state in which the domestic economy is accelerated to form a key pillar, while both international and domestic economies would form a dual circulation to mutually promote each other.”

Since then, the 'dual circulation strategy' has been used as a guiding principle, influencing both the economic development thinking and policy formulation of the central and local governments. The phrase also began showing up in public discourse.

The 'dual circulation strategy' was originally proposed as a reaction to the deepening Sino-US trade conflicts and the negative impact of COVID-19 on the international economy. However, it was put forward not only because of the need to address the challenges in international trade, but also because of the need to put China into a new development model: first, the international trade environment had undergone structural changes and such changes would continue; and second, as the economy continued to develop, the old economic model which heavily

relied on exports might not be suitable nor sustainable for a large economy like China going forward. The 'dual circulation strategy' continues to develop the 'external circulation' of international trade, but more importantly, it focuses on enhancing the scale and quality of the 'internal circulation' domestic economy, enabling 'internal circulation' to be a key growth pillar. It is worthwhile to note that the 'dual circulation' strategy is not an advance plan for future development. Rather, it is a national strategy that is developed based on the latest trends that are already in place. In other words, every company and every individual are already in this new reality. Adapting to and leveraging this new development to solidify and grow in China no longer an option. There is a pressing need to understand how to maximize opportunities presented by this change in national strategy.

We believe that in the context of 'dual circulation', both domestic and overseas markets will gradually undergo a series of changes.

INTERNAL CIRCULATION

First of all, with “internal circulation as the key growth pillar,” the domestic market will become even more competitive. The Chinese companies previously focusing on foreign trade may expand their business to the domestic market, while new foreign players will seek opportunities to enter the Chinese market as China will continue to open up to international markets. Secondly, with increasing investments in advanced technologies, technological breakthroughs and new products and services will emerge continuously, which will dramatically transform the current market. Thirdly, consumer demand will be further unleashed as a result of increasing income, policy impetus, and changing attitudes. New demand will be created and current demands upgraded as consumption become more mature and sophisticated.

EXTERNAL CIRCULATION

On the one hand, with the transformation of China’s economic model, the products for export and sources of their competitiveness will no longer be the same as today. China’s continuous efforts in industry development and improvement in companies’ capabilities, more high-tech products from China will enter the global market. Influence of these Chinese brands will also strengthen helping to build globally recognizable brands. Price competitiveness will remain, but it will shift from cheap labor to higher labor productivity. On the other hand, with changes in future international trade, more and more trading companies that continue to participate in the 'external circulation' may have to choose a new operating model, that is, to transit from “make in China and export overseas” to that of “make and sell overseas”. Meanwhile, some competitive companies serving the domestic market will also seek opportunities to expand outward and establish overseas supply chain, to take advantage of raw materials, human resources, and technology in different markets (to serve both domestic and overseas markets). However, we also see risks or uncertainties increase in the external circulation. Supply disruptions and changes in consumer demands will occur more frequently due to factors such as political and economic turmoil, populism, natural disasters and diseases.

These changes in both 'internal circulation' and 'external circulation' pose new requirements for the supply chain. These requirements are mainly in four categories.

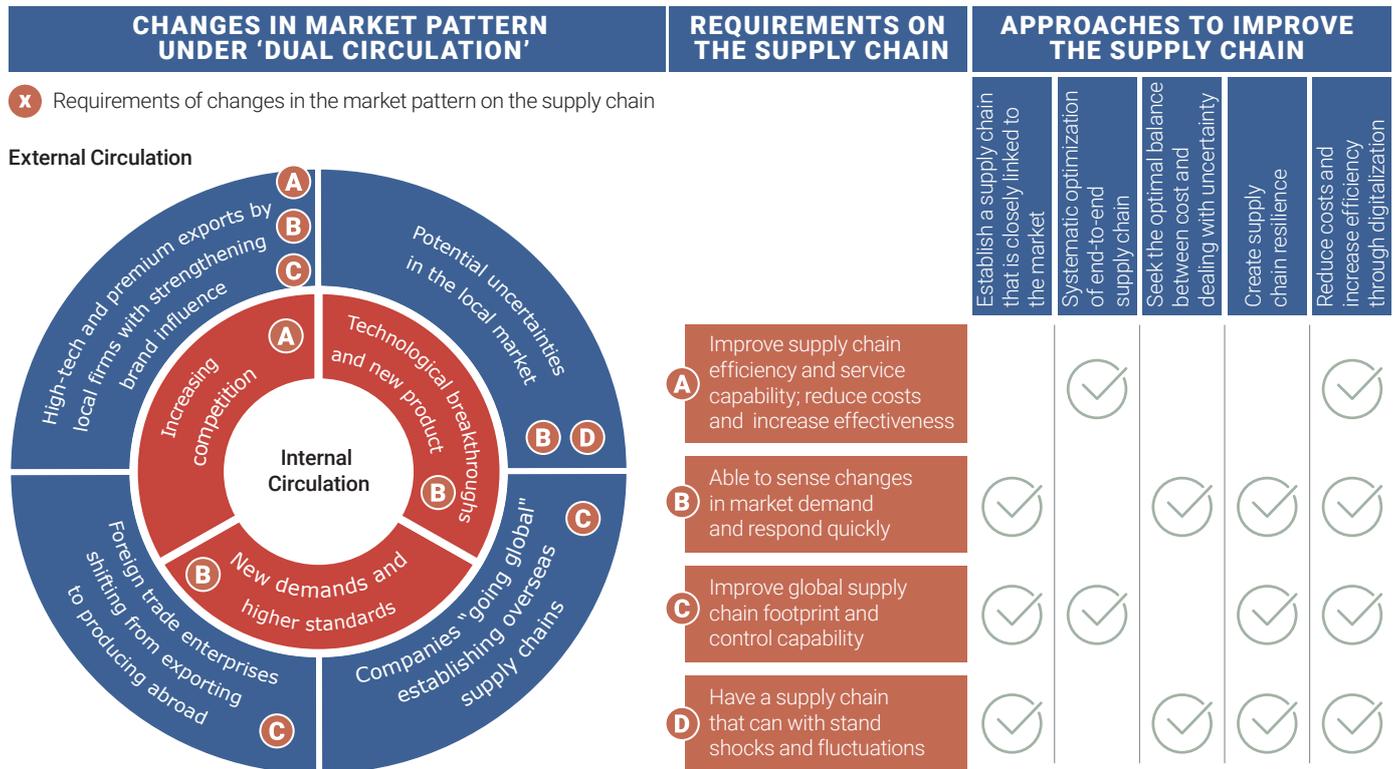
1 Improve supply chain efficiency and service capability; reduce costs and increase effectiveness – this means to shorten the lead time of each segment and to improve service level within a cost-controlled situation

2 Able to sense changes in market demand timely and respond quickly – the supply chain needs to be agile, to be able to detect or even predict market changes in real-time and make quick adjustments accordingly

3 Improve global supply chain footprint and control capability – the supply chain needs to be designed from a global perspective

4 Have a supply chain that can withstand shocks and fluctuations – the supply chain should be able to quickly recover from external impacts

Requirements of 'dual circulation' pattern on the supply chain and approaches to improve the supply chain



To meet these new requirements under the new context, companies need to make a range of adaptations and improvement in each segment of the entire supply chain. Specifically, this should be carried out in five aspects (as shown in the figure).

1 ESTABLISH A SUPPLY CHAIN THAT IS CLOSELY LINKED TO THE MARKET

Traditionally, supply chain is considered as a back office that supports front-end sales, and its daily operation is based on input information from the front-end sales department, such as order information in the IT system, or plans from periodic S&OP meetings. It follows processes and rules based on certainties (certain time, place, quantity, and volatility), so it is often difficult to respond quickly to changes. The circumstances, however, have already changed. The 'dual circulation' strategy is put forward based on the changed trends. Uncertainties in either 'internal circulation' or 'external circulation' will arise frequently in the future, either brought about by technological breakthroughs or new products, or triggered by some events. This requires the supply chain to be more closely connected with the market, be able to detect the changes in market trends timely and make quick responses. This tight connection needs to be achieved through changes in many aspects. For example, companies should set up a mechanism or a functional department to enable supply chain staff to participate in market research and planning process of the sales department, and also set up and provide special methodologies, tools and IT technologies, to provide support. In addition, both sales and supply chain teams should review their own mechanisms to ensure that the data from each side can reflect real-time and true market dynamics, not distorted by inappropriate management practices or rules.

2 SYSTEMATIC OPTIMIZATION OF END-TO-END SUPPLY CHAIN

The supply chain is a system that cannot be broken into pieces. Problems occurring in the supply chain are usually not caused by any single function alone, the problems we see in one segment may have roots elsewhere in the supply chain. Take excess inventory as an example. We have seen in previous projects that the issue can result from demand volatility magnified by unreasonable sales model, and we have seen the same issue resulting from poor product planning. Also, improving the overall capability of the supply chain requires an overall design rather than improving individual segments, to ensure all segments are well placed and coordinated in the supply chain. For example, if we want to improve the service of product delivery to customers, only improving logistics (such as network, warehouse and transportation) may lead to limited results. Further improvement should be made comprehensively in inventory strategy, production and sales coordination, and even the optimization of production model. Therefore, the improvement of supply chain needs to be based on a big picture, and achieved through the application of end-to-end systematic methods.

3 SEEK OPTIMAL BALANCE BETWEEN COSTS AND DEALING WITH UNCERTAINTIES (SERVICE LEVEL)

As mentioned above, regardless of whether it is 'internal circulation' or 'external circulation', uncertainties in the supply chain will become the 'new normal' going forward. It will impact various segments of the supply chain and needs to be dealt with properly and comprehensively. However, dealing with uncertainties will undoubtedly lead to additional costs. A supply chain that guarantees 100% stable supply is immensely costly and unrealistic. Companies need to find the optimal balance. This means that companies need to make a trade-off based on their strategic goals and plan in advance – what needs to be guaranteed and to what extent; what can be sacrificed and to what extent. It requires companies to develop corresponding supply chain strategies for their own product and service assortment, which can be made based on overall consideration of factors such as financial impact of products or services, availability of supply, and the target strategic objectives. The optimal trade-off strategy can be achieved through a systematic quantitative and qualitative analysis.

4 CREATE SUPPLY CHAIN RESILIENCE

The resilience of a supply chain refers to its ability to keep operating when facing shocks and its ability to return to normal supply levels as quickly as possible. Global risks such as the COVID-19 pandemic may be a once-in-a-century event, but shocks to supply chains due to factors such as natural disasters, political turmoil, and economic and trade conflicts, occur frequently. These will become more prominent in the 'external circulation' under a complex and changing environment. The building of supply chain resilience includes two aspects: ability to prepare ahead of shocks, and recovery after shocks. The key to preparation lies in the identification of the weaknesses in each segment of the supply chain, which should be categorized to formulate corresponding strategies, then a response plan should be developed against potential risks that may occur.

The recovery capability of the supply chain requires the establishment of 'back-up' facilities or resources. Of course, this often means extra costs. 'Back-up' facilities or resources should be established at two levels: at the strategic level, a network of supply chain facilities or partners, such as production outsourcing, should be properly designed, so that when one part of the supply chain is disrupted, the other parts can compensate for it. This, of course, requires the right balance between cost and 'back-up' capacity; at a tactical level, substitutability and universality of the production facilities or resources should be ensured to maximize the overall utilization of assets or resources while maintaining 'back-up' capabilities. In general, to develop the 'back-up' capabilities, there are high requirements around supplier management and cultivation, the versatility of supply chain facilities, product design, and technology application.

5 REDUCE COSTS AND INCREASE EFFICIENCY THROUGH DIGITALIZATION

The digital supply chain cannot be simply understood as 'digitization of process' like in the past, nor is the same as deploying a set of corporate information systems. Digital tools are only a part of the digital supply chain, what is more important is to reform the business operation model and flow, achieve business goals at a lower cost and faster speed, and even establish new methods to make the impossible in the past, possible. In the future fierce market competition environment, it may even lead to game-changing results. Take product design as an example. Applying Internet technology, users' expectations, suggestions and feedback on products can be collected quickly in a massive scale, and AI technology can be used making in-depth analysis so that such information can be quickly transformed into improved designs or even brand-new products. In this mode, products are more likely to meet the user's demand accurately through rapid iteration. Digital transformation of the supply chain can only be successful through applying the most appropriate tools and innovating in business processes at the same time.

These are AlixPartners' thoughts on supply chain development under the 'dual circulation' strategy. This is our first article of this series. We will address each of these supply chain aspects in more detail in the articles to come.

Stay tuned.

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These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.

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