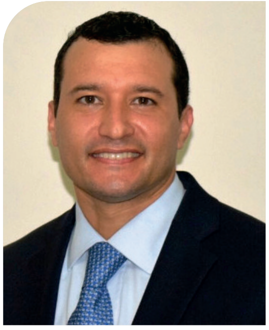

South America

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Could Latin America Benefit from Global Supply Chain Trends?

Although the COVID-19 pandemic has been primarily a public health crisis, its effects have impacted global trade and supply chains at a remarkable speed and scale. As countries around the world locked down, supply and demand shocks resulted in governments, businesses and consumers finding it difficult to procure basic products and materials. While many corporations responded quickly by shoring up supply chains, diversifying suppliers and adapting to changing consumer demand, the pandemic has emphasized the need to build smarter, more resilient and sustainable supply chains, a priority for 93% of business leaders[1]. A key query for many corporations is the role that Latin America can play in this restructuring of supply chains.

The role of Latin America in supply chain diversification and resilience

Companies are taking different approaches to building supply chain resilience and sustainability, whether multi-sourcing, near-shoring or vertical integration (insourcing). In particular, the early experiences of the pandemic illustrated the over-reliance of many industries on China. For example, in March 2020, UNCTAD estimated that the slowdown in China's manufacturing could result in USD50bn in exports[2] Latin America has not been an obvious location for sourcing and supply location for multinational corporations in the past, except for natural resources. Some corporations have had concerns over variable infrastructure and logistical capabilities across the region, and disparate, often less mature, legal, and regulatory frameworks. For example, Latin America's infrastructure spending is currently less than 3% of GDP, in comparison to 8% in east Asia[3]. There has been a lack of progress on major infrastructure projects, with governance issues also damaging investor confidence.

Despite the challenges, Latin America's proximity to the US, the number of free trade agreements in the region, and competitive labor costs offer advantages for multinational corporations seeking to diversify and build resilience into their supply chains. As a result, several major corporations are now exploring sourcing opportunities in markets such as Chile, Colombia, Costa Rica, Brazil and Mexico.

Mexico

Mexico has eclipsed China to become the United States' biggest trading partner, partly due to the US-China trade war. The US-Mexico-Canada trade deal increases regional content requirements to 75% (from 62.5% under its predecessor NAFTA), while Mexico also benefits from its proximity to the U.S. For example, shipping can cost 60% less and take a fifth of the time compared with China[4]. So far, Mexico has not yet been able to leverage these opportunities, partly due to COVID-19 pressures, but also due to limited investor-friendly government policies.

Brazil

Brazil is the only large country that has the conditions favorable to increasing supply at scale. As a result, it has the potential to become the world's number one agriculture/food exporter over the next decade, with positive changes in regulation and public policy opening new windows of opportunity[5].

Digital growth drivers

While there remains some political, regulatory and infrastructure challenges in Latin America, digitization is also enabling fast-emerging opportunities. Digital infrastructure has been limited in many parts of Latin America in the past. For example, although 70% of companies in OECD countries use web-accessible solutions in their supply chain, in Latin America and the Caribbean the figure is only 37%[6]. However, one of the outcomes of the pandemic has been a radical shift in the way that individuals and businesses communicate, transact and consume products and services. In April 2020, e-commerce revenue rose in Latin America by 230% compared with the previous year, with Peru reporting a revenue increase of 900%, and Mexico 500%[7].

The same shift towards digitization of trade has been strongly apparent as trade participants have sought to streamline, accelerate and create transparency in supply chains. As the pandemic struck, moving and reconciling the flow of goods quickly, dealing with staffing disruption and social distancing, and adapting to the rapid adoption of remote working created challenges across supply chains. These challenges were particularly apparent in Latin America where manual processes are more prevalent, and effective home working, difficult. Consequently, while trade digitization in the region was already a trend before the Pandemic, this has become more pronounced as the challenges and risks of manual, paper-based processes hampered trade. Supply chain stakeholders who have had different priorities and pace of digital adoption are now aligning around a common purpose.

Resolving the gap

A number of countries in Latin America already support digital trade mechanisms, such as digital/electronic signatures, real time or instant payments, electronic document lodgment, electronic tax payments, etc. The use of digital technologies from end-to-end throughout supply chains can assist in expediting the flow of goods, services and financing. Furthermore, digitization can help ensure that all trade participants, including small and medium-sized enterprises (SMEs) that have historically been at a disadvantage in global trade, to participate on an equivalent basis. Access to trade financing is a major area of focus. Currently, only around 50 percent of SME trade financing applications successfully meet acceptance criteria, resulting in a $350bn trade finance gap[8] in Latin America alone.

One of the major ways of increasing access to trade finance - and thus increases participation in robust, sustainable supply chains - is supply chain financing. SCF programs are already widely available in Mexico and Brazil from banks, including Citi, and are being increasingly adopted in countries such as Colombia and Peru, offering a tool to target micro and SMEs that represents 99% of businesses in Latin America[9] and 67% percent of formal employment. In contrast, only 17% of small and medium-sized enterprises use bank credit to finance short-term working capital[10].

Digitising trade finance can be a major way of increasing participation in SCF programs and can help to close the trade finance gap. For example, by leveraging Citi's digital onboarding tools, which are available in parts of Latin America, to join Citi Supplier Finance programs, and the use of digital signature and tools such as Docusign and TAOS where available, suppliers no longer need to exchange physical documents. They can onboard our programs quickly and easily and therefore gain access to cost-effective short-term financing. The use of mobile applications in some Latin American countries also enhances the supplier experience, and therefore encourages participation in SCF programs. In 2020, Citi released a mobile app in several markets in Latin America that enables suppliers to access liquidity and discount receivables using their smartphones.

Crucially for Latin America - given the prevalence of SMEs - digital capabilities help companies to extend the reach of SCF programs further into supply chains. This can be instrumental in increasing supply chain resilience and de-risking supply chains, thus making firms in Latin America more attractive supply chain partners. For example, Citi is supporting one of Latin America's largest beverage bottler companies to connect c. 2,500 small suppliers in Mexico into its SCF program, providing them with access to liquidity.

Collaboration to accelerate digitization and enhance client experience

We are also seeing collaboration and involvement from non-traditional players across the trade and trade finance industry, including regional and global financial technology (fintech) partners. This is often a positive development in driving end-to-end digitization and improving the client experience. However, the introduction of new players may create new risks that must be clearly understood and addressed, such as ensuring adherence with financial regulations around anti-money laundering and protecting supply chain participants from cyber risk, amongst others. In addition to organisations performing their own due diligence on new technology partners, governments and regulators in Latin America are challenged to consider how best to reshape regulation and supervision, in order to encourage innovation whilst containing these risks.

Extending sustainability across supply chain ecosystems

Corporations are not only seeking to increase financial resilience and sustainability across their supply chains, but also social and environmental sustainability. The more extensive and more complex that supply chains become, the less transparency that the corporation – and its customers – have over suppliers' environmental, social and governance (ESG) practices. This is becoming an increasingly important point in Latin America as consumers prioritise environmental and social issues in their purchasing decisions. Sustainability is also a priority for Citi and is pivotal to our solutions and decision-making; in July 2020, we launched our 2025 Sustainable Progress Strategy with the ambition to be the world's leading bank in driving the transition to a low-carbon economy.

Both sustainability and transparency are becoming more important to business leaders across Latin America. Creating environmental transparency is particularly important to achieving ESG objectives, not only in companies' own operations, but also their supply chains. Global environmental disclosure non-profit CDP has calculated that carbon emissions from a company's supply chain are, on average, 5.5 times greater than emissions from its direct operations[11]. As a result, a growing number of companies are working proactively with their suppliers to create more sustainable supply chains.

Harnessing Latin America's supply chain potential

COVID-19 has highlighted the vulnerabilities in corporate supply chains but has also accelerated a major transformation in operating models and reset corporate and consumer priorities. While a number of challenges remain, the reasons why corporations would consider locating parts of their supply chains in Latin America – and the enablers of this – are increasing. Trade and supply chain participants are motivated to collaborate on digital trade initiatives, but this needs to be underpinned by government support and a supportive legal framework.

By reducing digital barriers, easing restrictions on the goods and services on which digital networks are based, streamlining and digitising controls and encouraging trade innovation, Latin American governments and regulators can help fuel digital trade and encourage corporations globally to engage and do business with companies across the region. Working with a financial partner with local knowledge, experience and digital technologies across the region to support the implementation or expansion of an SCF program is important in understanding the evolving regulatory and business environment in each market, and in identifying supply chain opportunities. It is also a valuable way of harnessing these opportunities; shaping robust, sustainable supply chains that can meet the expectations of the wider stakeholder community.

1 *McKinsey Global Payments Report, 2020. Chapter 3: Supply Chain Finance: A Case of Convergent Evolution? www.mckinsey.com/~/media/mckinsey/industries/financial%20services/our%20insights/accelerating%20winds%20of%20change%20in%20global%20payments/chapter-3-supply-chain-finance-a-case-of-convergent-evolution.pdf*

2 *https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=2297*

3 *The Economist Intelligence Unit. "Will Latin America Take Advantage of Supply Chain Shifts." www.eiu.com/n/campaigns/will-latin-america-take-advantage-of-supply-chain-shifts/*

4 *Ibid*

5 *Brazil 2020. Opportunity Tree. McKinsey. www.mckinsey.com/br/~/media/McKinsey/Locations/South%20America/Brazil/Our%20Insights/Brazil%202020%20Opportunity%20Tree/McKinsey2020OpportunityTree.pdf*

6 *United Nations ECLAC. Universalizing access to digital technologies to address the consequences of COVID-19, August 2020. https://repositorio.cepal.org/bitstream/handle/11362/45939/5/S2000549_en.pdf*

7 *www.statista.com/statistics/1116604/change-e-commerce-revenue-coronavirus-latin-america/*

8 *www.pymnts.com/news/international/2020/closing-latin-americas-350b-smb-trade-finance-gap/*

9 *https://idbinvest.org/en/solutions/advisory-services/micro-small-and-medium-sized-enterprises#:~:text=MSMEs%20represent%2099%20percent%20of,operation%20and%20Development%20(OECD).*

10 *ibid*

11 *www.cdp.net/en/research/global-reports/global-supply-chain-report-2019*