Tradeshift

The Tradeshift Index of Global Trade Health

Q2 2021

Treading water won't keep recovery on course

Opening remarks from Christian Lanng, CEO and co-founder, Tradeshift

The post-pandemic economy is taking shape and our latest Index suggests the US, rather than China, will set the pace heading into the second half of the year. Economists predict that economic output in the US this year will grow at the fastest rate since the 1980s. Our data shows cumulative transaction volumes across US supply chains have accelerated past China which had been leading the global recovery up to this point.

Global transaction volumes rose by 9% in Q2, but it recovery is far from smooth sailing. Order volumes across retail and manufacturing industries are rising at record rates, but demand-supply imbalances are still widespread. China's factory output has hit rough waters as global supply chain bottlenecks have weighed on production. Transaction volumes between Chinese buyers and suppliers on our platform dropped by a double-digit margin in Q2.

The squeeze on supply chains is complex and multifaceted, but lack of cashflow is a recurring theme among suppliers struggling with increasing demand. Our latest Index shows the gap between new orders and payments to suppliers has increased dramatically over the past quarter.

In a recent article for the Washington Post, Tufts University professor Daniel Drezner claims supply chains are far less fragile than we might think. Supply chain activity has certainly bounced back strongly since the lows of Q2 2020. What Drezner does not say however, is that very few companies got through the past year without making changes in order to build additional resilience to future shocks.

We might be inching back toward normal, but any business expecting to come out of the pandemic the same way they went in is likely in for a surprise. Think about the transformation of working patterns over the past year: offices may be reopening, but our data suggests companies have seen numerous benefits from enabling employees to connect and collaborate with one another digitally.

Preparing for future hypotheticals can seem a bit like buying insurance. But if investment focuses on digitally connecting people and process across the entire value chain, it will pay back in multiples over time — not only minimizing future losses but boosting productivity and transforming the relationship between buyers and suppliers.

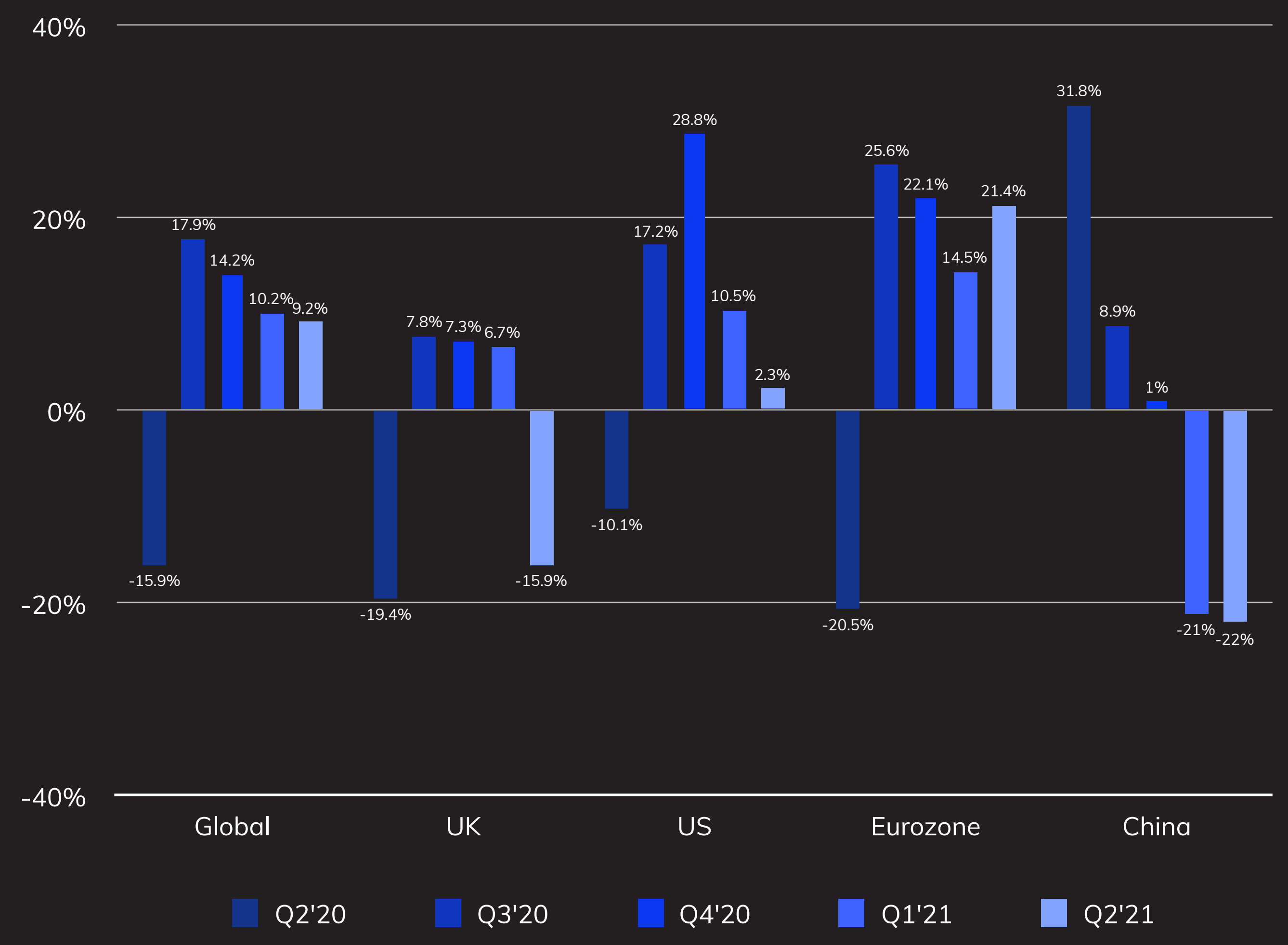
What happened

Q2 index highlights at a glance

- Global transaction volumes rose 9% in Q2, a slight slowdown compared to the previous quarter, suggesting supply chain activity levels are becoming less volatile.
- Trade activity levels in China appear to be slowing however. For the second quarter in a row, transaction volumes in China dropped by more than 20%
- The US is now leading the recovery in trade activity globally having surpassed China in Q2. Quarterly transaction volumes in the US have risen 145%, cumulatively, over the past year, compared to 125% growth in China.
- In the Eurozone, transaction volumes rose by 21% in Q2, more than double the global average.
- The UK recovery appears to be lagging. Quarterly transaction volumes dropped 15% in Q2, and cumulative growth is 59% below the pre-COVID level in March 2020.
- The global liquidity crunch on suppliers is turning into a chasm. Total order volumes on Tradeshift surged 35% in Q2, but the total volume of supplier invoices processed rose just 2%.
- Manufacturing and retail transaction volumes remained unusually high in Q2 amid concern that the current demand-spike is putting pressure on suppliers.
- Business travel spend is recovering, but is still 30% below the pre-COVID level . Corporate hospitality spending is 81% lower than it was prior to the pandemic.

Global transaction volumes hold momentum, but China and UK hit trouble

Transaction volumes - Quarter on Quarter Growth



Total transaction volumes on the Tradeshift network rose 9% in Q2. The slight slowdown compared to Q1 follows the pattern which has emerged since the end of 2020 and suggests overall trade activity is returning to normal, pre-pandemic levels.

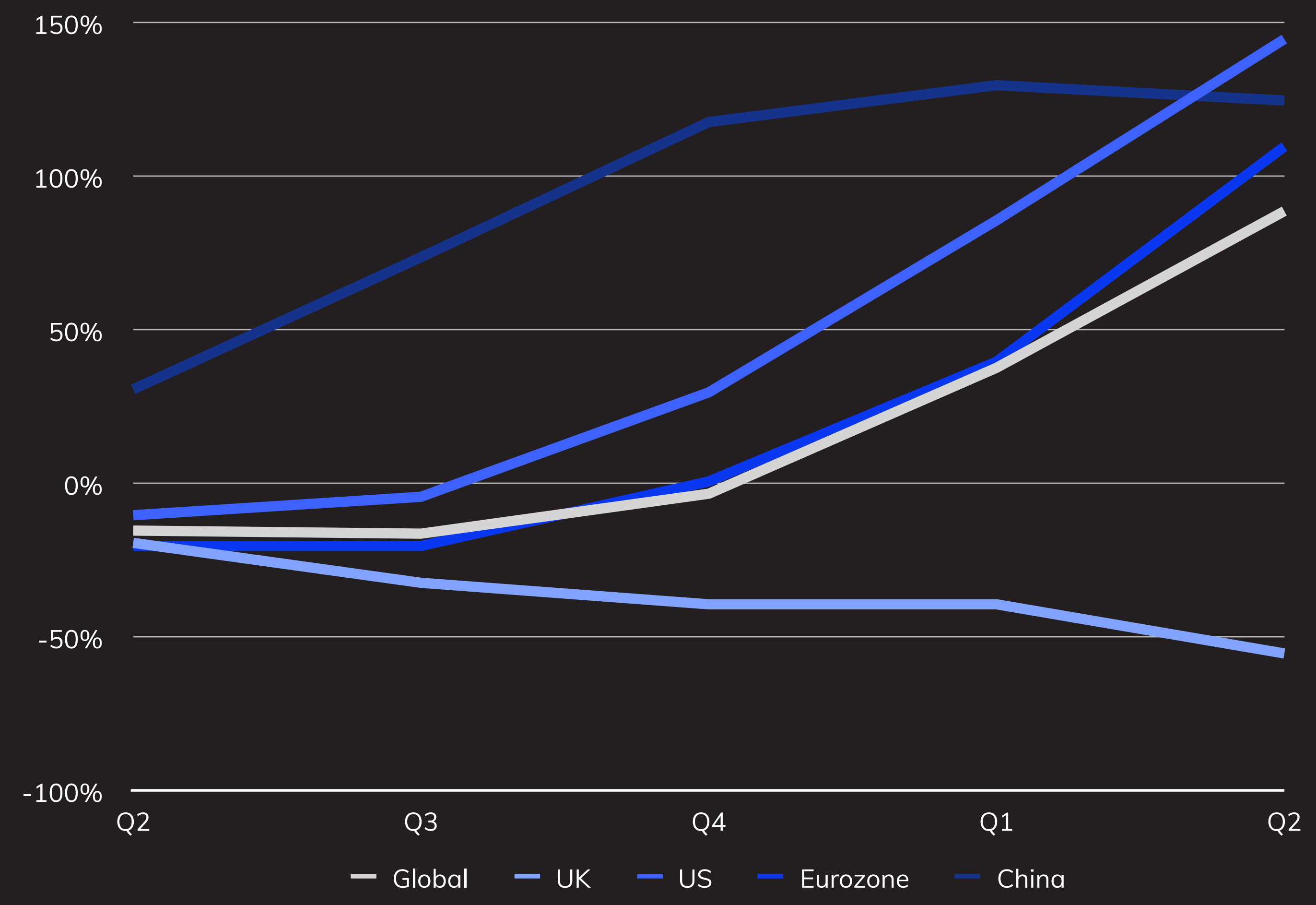
However, growth remains uneven, particularly in China. Our data revealed that trade activity across the region suffered the second successive double-digit drop in quarterly transaction volumes; this is likely linked to the high material costs reported by China's National Bureau of Statistics which drove a drop in factory outputs in May and June.

The opposite appears to be happening in the Eurozone. Manufacturing outputs across the region hit a new record high in June and, according to our data, transaction volumes grew by more than twice the global average.

The UK remains the outlier across Western economies. Transaction volumes dropped by more than 15% in Q2. Part of this could be the residual impact from the UK's strict lockdown in Q1 and Brexit may also be a factor. Thomas Sampson, associate professor at the London School of Economics, claims Brexit has had a -15% effect on UK trade, which sits very much in line with what we're seeing.

The US is setting the pace heading into Q3

Transaction volumes - shown cumulatively against Q1 2020



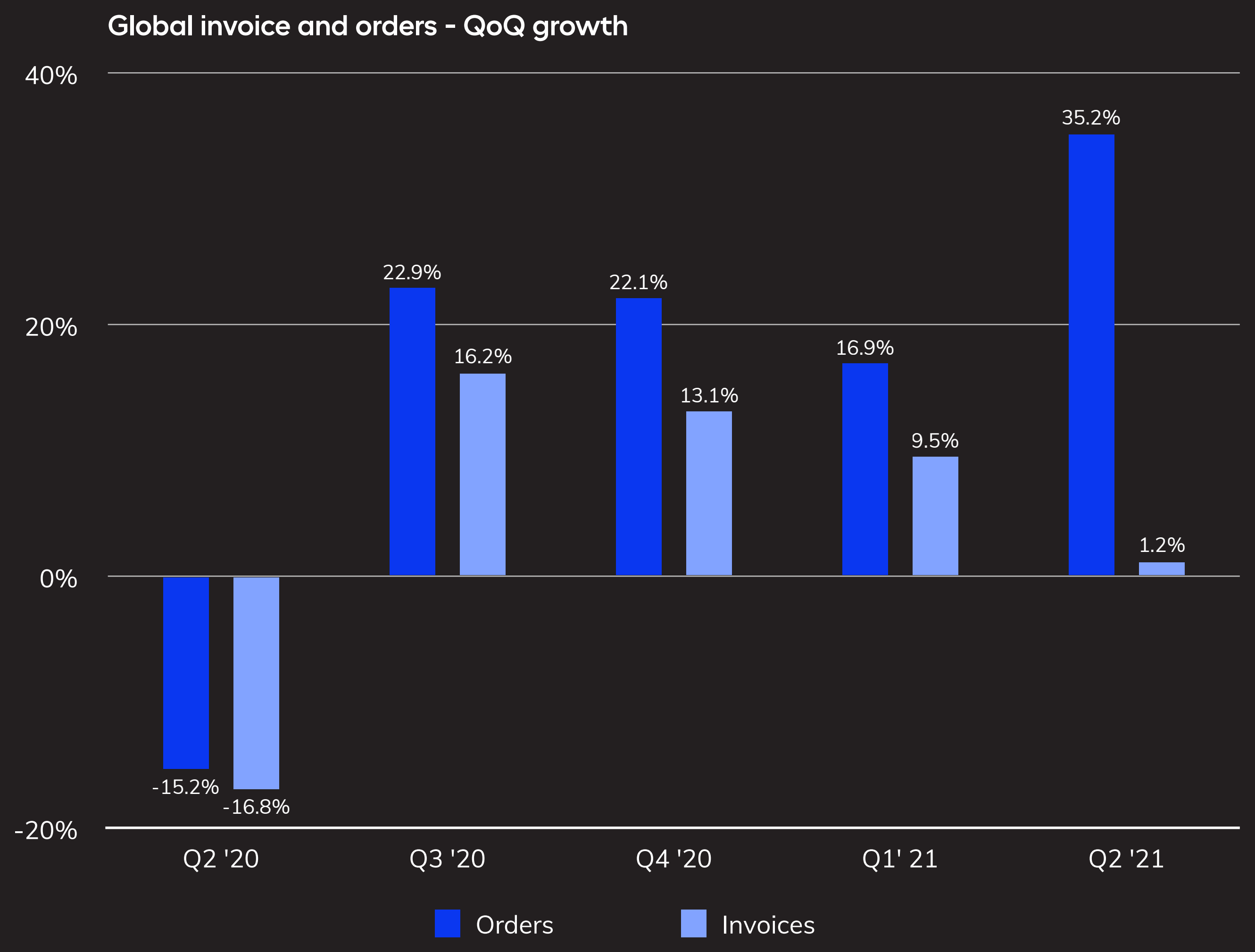
Trade activity in the US is running hot. According to Oxford Economics, the US economy is set to be a bigger contributor to global economic growth than China for the first time since 2005.

While Tradeshift's data shows only modest quarter-on-quarter transaction volume growth in the US, a cumulative look at the same data suggests the level of growth in activity across US supply chains surpassed China in Q2 and is setting the pace for recovery globally going into Q3.

Trade activity across the Eurozone had lagged behind the US and China, but after two strong quarters transaction volumes across supply chains appear to have found another gear. The European Commission predicts a strong second half to the year across the region, and our data suggests another strong quarter could see cumulative transaction growth pass China in the second half of 2021.

The UK has been left with a mountain to climb following a relatively disappointing Q2. According to the OECD, the UK's recovery is lagging behind every G20 nation. Data for the first three months of the year suggests economic output was 8.7% below pre-pandemic levels.

The cash flow imbalance is reaching dangerous levels



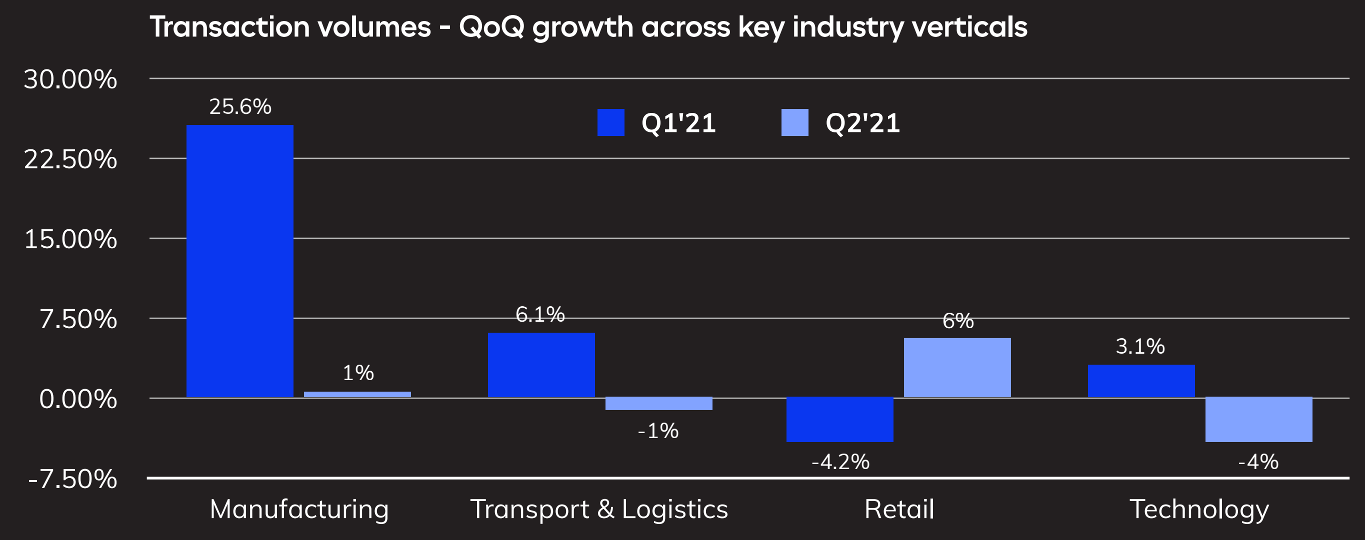
Order volumes continue to surge on the back of vaccine rollouts across many major Western economies, but invoices are simply not getting paid quickly enough for suppliers to meet demand.

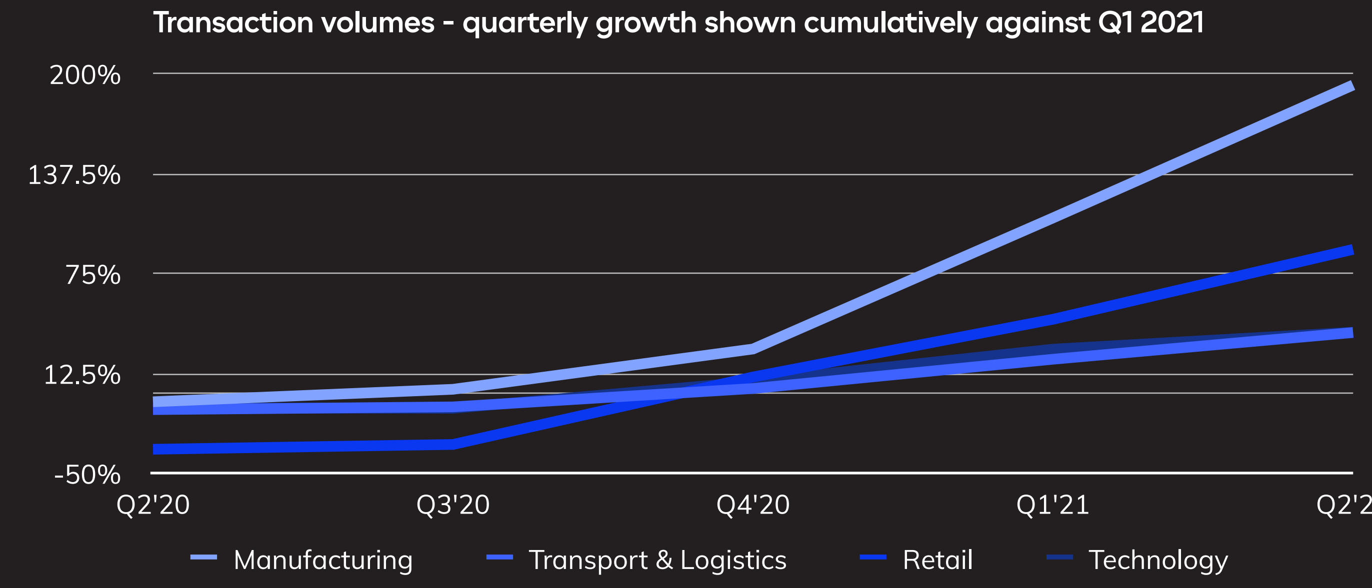
According to the US Federal Reserve the overall ratio of business inventories to sales fell to 1.23 in March, the lowest level since records began in 1992. Our data suggests rising order volumes are responsible for much of the growth in overall transaction volumes throughout the Q2.

As companies rush to replenish inventory, pressure falls squarely on suppliers right across the value chain. This pressure is being magnified by a steep decline in cash flow relative to order volumes, as evidenced by the alarmingly low level of invoice volume growth we saw during the quarter.

The same pattern is playing out across virtually every major economy with the gap widest in the Eurozone, where order volumes rose 62% in Q2 while the total number of invoices rose just 8%.

Momentum in manufacturing and retail industries remains strong, pressuring suppliers



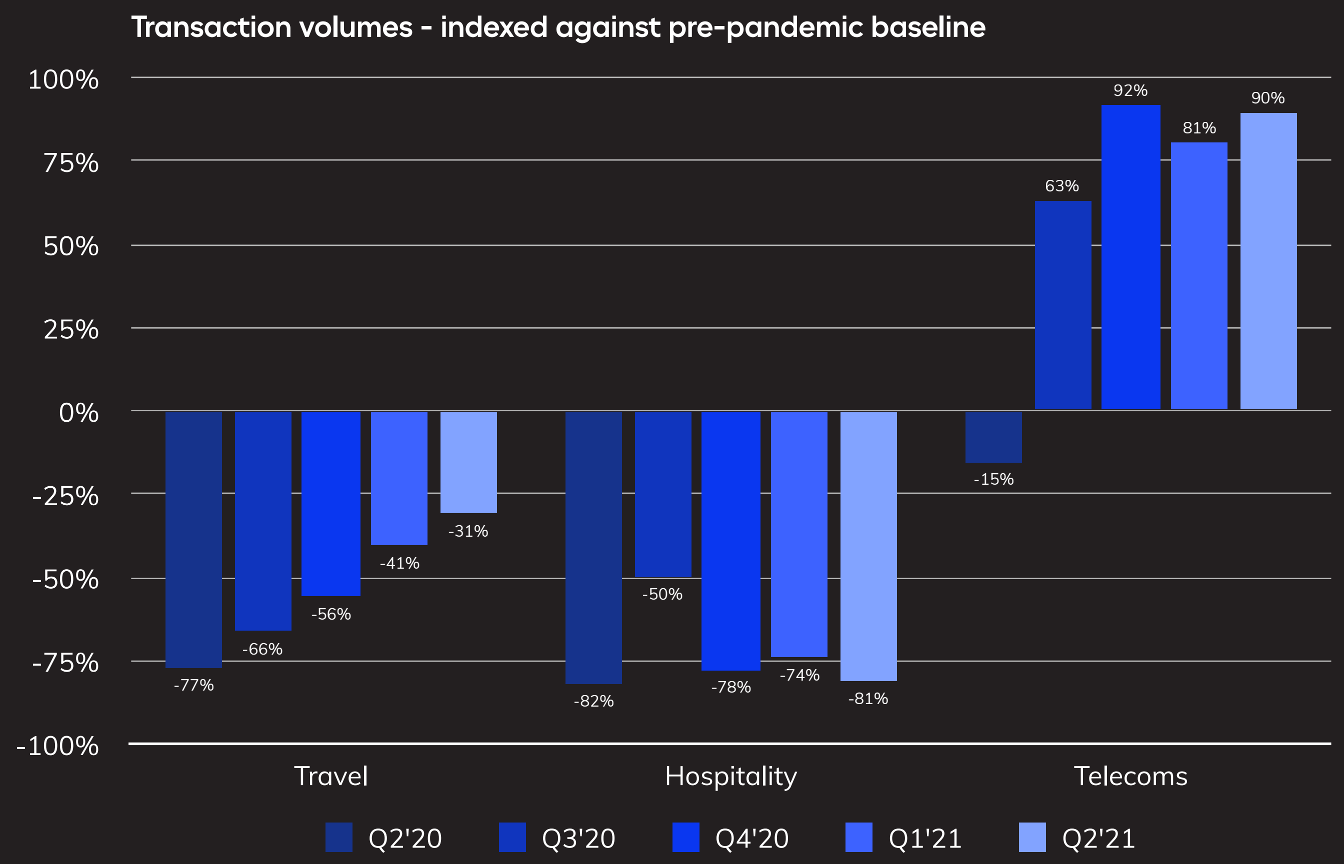


Manufacturing transaction volumes grew by a relatively modest margin in Q2 compared to the previous quarter, but when the same data is expressed cumulatively it is clear that momentum across the sector remains extremely high. Data from IHS Markit suggests that manufacturing output broke records across a majority of the world's largest economies in June.

A similar picture is emerging across the retail sector where transaction volumes rose 6% in Q2. Cumulative analysis shows a steep and consistent rise in momentum since the beginning of 2021. Having been hit hard by lockdown restrictions early in the pandemic, this uptick in activity should be a positive, but sustaining that level of momentum puts extreme pressure on supply chains.

In our Q1 Index we reported that one-in-five suppliers were struggling to keep pace with demand. Lack of cash flow was one of the major obstacles to an effective ramp up, and our latest data suggests the 'liquidity crunch' has deepened as orders outpace payments to suppliers by a margin we have not seen before.

Remote work isn't going away anytime soon



Trade activity may be inching towards normality, but there is very little evidence to suggest a return to pre-pandemic working practices will follow. Tradeshift's data shows a dramatic rise in telecoms spending since the first lockdown. Transaction volumes across the sector are 89% higher than prior to the pandemic suggesting the use of virtual collaboration tools is here to stay.

So is working from an office dead? The answer is a little more nuanced. According to one recent report 65% of pandemic remote workers said they wanted to keep working from home—but in a separate study 83% said they missed the human contact they got from in-person meetings.

Likely, a hybrid solution that significantly decreases the amount of time employees physically spend in the office, yet still gives options for in-person collaboration, is what companies will aim for.

Business travel was 30% below pre-pandemic levels but the volume of transactions processed by Tradeshift has been increasing consistently since the first lockdown eased. Corporate hospitality spending dropped 82% in Q2 2020. A year on and it's tracking at the same level suggesting client entertaining and networking events will remain virtual, at least for the time being.

While it's still too early to make a definitive prediction over what the future of work will look like, businesses that do not have the digital infrastructure in place to accommodate the transition to a more flexible, distributed workforce will struggle.

What's next?

Do the economics of resilience stack up?

We might not see a full pendulum swing, but digital must become the default for supply chains

Q&A with Rob van Ipenburg, Managing Partner, Quyntess

What characteristics of modern supply chains make them vulnerable to the kind of volatility we've seen over the past year?

Most manufacturers are heavily reliant on labour, so lockdown restrictions had a significant impact when many factories were forced to close. Demand from OEMs dropped off. On the supply side the same thing happened and this made materials sourcing even more challenging.

Market forces dictate that modern supply chains are often long and complex. Longer supply chains tend to magnify the impact of disruption, but companies with more distributed supply chains can also absorb fluctuations more easily. In some cases that might mean a company invests in diverse sourcing options. It's also increasingly common for companies to invest in facilities with more flexibility to produce different products in stead of concentrating all volume in one site for economies of scale. For CPG companies, where this approach is now fairly common, fluctuation levels were around 10%, whereas in the industrial sector where distributed supply chains are less common, fluctuations could run up to 80% above typical levels. The higher the level of fluctuation, the more pressure that exerts on the supply chain.

Lockdowns are easing and economies seem to be opening up. But the situation across supply chains still seems volatile. Is that something you're seeing?

Demand from OEMs is very strong, with the possible exception of automotive and aerospace. What we're seeing right now is partially a catch-up from missed sales in 2020 and the first quarter of 2021 and there are some pretty strong V-shaped recoveries. On the supply side, instability is still high with significant shortages of key parts. And while order volumes are back up are fluctuating at around three times the normal level, with order volumes being revised several times from when the order is issued and when the material is shipped.

The shortage of ocean transport is also causing a lot of unpredictability when it comes to the physical movement of goods. Even when materials are dispatched from a supplier there are no guarantees it will arrive on schedule. That triangle of collaboration between the supplier, logistics service provider and buyer is far more important right now than it might have been previously when there was plenty of spare logistics capacity.

There are some fairly radical opinions being shared about how to build resilience across supply chains. How dramatic are the changes we'll see to supply chains likely to be post-COVID?

Industries like aerospace and automotive simply would not have room at their sites to move away from just-in-time manufacturing systems. A lot of businesses are looking towards multi-sourcing and distributed supply chain models however. Transitions like this are more subtle, but they also demand far more collaboration across the supply chain as organizations look to spread demand across a number of different suppliers and locations.

Experiences of the past year have flipped the conversation around resilience. Whereas before companies based decisions primarily on cost, they're beginning to ask questions over whether low cost is always the best protection for overall margins and overall revenues.

Are there other ways to build resilience without such a drastic reconfiguration of business models?

Digital must become the default for every business. Volatility is not going away. Keeping a handle on the kind of fluctuations that come with even minor disruptions is simply not scalable manually. Even if you had limitless resources at your disposal you'd still face enormous issues gaining a real-time view of the flow of materials across the supply chain, or collaborating with more than a handful of suppliers.

A majority of businesses seem to accept now the need for digitalization - what has taken them so long?

Businesses have benefited from a very prolonged period of stability. When you have low volatility it's easy enough to rely on a limited number of people to get the job done. Now that the level of disruption has increased, businesses are finding they cannot simply adjust the number of people they have addressing these issues.

Organizations have not been blind to these risks, but when times are good, other things tend to take priority. The investments businesses have previously sunk into legacy systems also breeds inertia. A lot of businesses made significant investments in EDI systems and supplier portals. That brought them a certain level of digitalization among the top 20% of their supply chains, but that's still 80% of supplier relationships that are built around manual processes. Adherence to this old paradigm has prevented a lot of businesses from making the next leap. Businesses are recognizing they won't get to where they need to be by doing a little bit more of what they've been doing over the past ten years.

What are some of the things that businesses need to consider as they look to digitize?

Businesses have tended to look at risk from a volume perspective. That means focusing on the biggest suppliers and building connectivity with them first for efficiency reasons. What they really need to be analysing is where the highest level of change might come from. More often than not that will be a smaller supplier somewhere further down the chain.

We also need to move beyond the focus on features and functions. It's all very well looking for a product that meets a certain set of specifications, but that will count for nothing unless the entire ecosystem is incentivized and willing to adopt the processes. A lot of businesses are too focused on what a product does for them. They need to be zooming out and considering whether suppliers will see an equivalent level of value from adopting the same system and come on board.

Building resilience to unpredictable events can feel a little like buying insurance - you know you need it, but it's not something you value unless the worst happens. Is that the right way to look at this?

Organizations in the direct procurement space are under mounting pressure to provide a digital footprint that shows they are operating in compliance with regulatory requirements. Take the medical device industry, where there is a very heavy emphasis on traceability through the supply chain. Digital twinning is also becoming more important to maintenance and production cycles. Before we start to talk about these technologies we first need to ensure that the full configuration of inbound material is also digital. If you need to start entering and typing that information manually then the whole process will break down very quickly. Resilience is much more than an insurance policy, it's becoming a license to operate in the future.

Can you give us some examples of ways in which Quyntess is working with organisations to help them react to changing environments in real-time?

We're helping a number of organizations to handle forecasting and variations within the supply chain through automation. This means linking real-time data to production plans and inventory so that businesses have an accurate understanding of how fluctuations in demand may impact their ability to continue production.

Shipping is another area where we provide significant support. Even at the best of times the relationship between suppliers, buyers and logistics providers is a delicate dance. When you add fluctuating demand and limited logistics capacity into the mix it becomes very challenging to manage, particularly if the process is partially paper-based. With a network like Tradeshift we replace parallel 1:1 exchanges with suppliers and carriers with an orchestrated three party collaboration which makes the businesses much more nimble and gets things moving.

Finally, and linked to all of this, is risk dashboarding. Increasingly we're seeing an appetite for more metrics that relate specifically to the vulnerability of a certain supplier to a disruption. The fact that we have those dashboards available on the Tradeshift platform makes it much easier for buyers and suppliers to define and collaborate on contingency plans.

Harnessing the resilience dividend

Mikkel Hippe Brun, co-founder, Tradeshift

Workers at the Port of Copenhagen are playing an increasingly precarious game of Tetris right now as a squeeze on shipping capacity leaves an ever-increasing number of containers with nowhere to go. It serves as a very visual reminder of both the intricate dance global supply chains perform to provide us with everyday goods and what happens when the music suddenly stops.

Supply chain experts predict that the current disruption could last until 2022 -- and that's providing we avoid further disruption along the way, which is far from certain. Consensus is forming that a 'return to normal' simply won't cut it when it comes to supply chains.

According to Mckinsey, 93% of supply chain operators are planning to take steps to make their supply chains more resilient. Interestingly, respondents were split down the middle over whether to sacrifice short-term profitability in order to prioritize resilience planning. Companies may have underpriced the risk associated with extreme scenarios, but a move too far in the opposite direction could be just as devastating to future business models.

COVID exposed the folly of 'just-in-time' supply chains in areas such as healthcare and food supply. The economics of building more resilient supply chains in these areas might not stack up right now, but governments have calculated that risk of doing nothing far exceeds the cost of investing in localised manufacturing capacity.

For many businesses however, such wholesale reconfiguration is neither practical, nor economically viable. Revolution is coming however, and technology will be the catalyst. The combination of automation, robotics and 3D printing is already having a profound impact, not merely on where manufacturing capacity is located, but also what factories are able to produce.

Gone are the days where factories were set up to produce a single item at the lowest possible cost. Instead, a new generation of highly automated facilities can now be reconfigured in hours to produce a broad range of products according to real-time demand inputs. The same flexibility also makes it far easier to accommodate specifications from a variety of suppliers into production cycles.

Resilience need not end up an extra line item in the debit column of company balance sheets. Thanks to advances in technology, businesses can look forward to a future where supply chains are as cost-efficient as they are resilient. Make no mistake, however, revolution of this magnitude will only be achievable if the foundations we are building on are fully digital. If that means getting rid of paper-based processes once and for all, then frankly that feels like the deal of a century.

About Tradeshift's Index of Global Trade Health

Purpose

Many of the world's largest buyers and their suppliers use Tradeshift's trade technology network to exchange digitized purchasing and invoicing information. The data these transactions yield provide us with a unique awareness of trading activity between businesses.

Tradeshift's Index of Global Trade Health analyzes anonymized data flowing across our platform to reveal a timely perspective of how external events are impacting business-to-business commerce around the world.

Methodology

The Q2 Index shows business-to-business transaction volumes (orders processed from buyers and invoices processed from suppliers) across the Tradeshift network during the period of April 1, 2021 through June 30, 2021. We've also provided retrospective analysis of data for the previous 12 months

We looked at quarter on quarter measurements for total transactions on our platform to provide a sense of how different regions and industry sectors are performing against the patterns we're seeing globally.

The pandemic has been a key part of the narrative for our Index. To help visualise this we looked at cumulative growth in transactions to understand the degree to which different regions have been successful in addressing the shortfall in transactions caused by lockdown restrictions.

We acknowledge that there are limits to how accurately our view of what is happening on our network can reflect how complex global supply chains are reacting to a variety of external factors. What our data does provide is a useful snapshot that provides clues as to what might be happening to the global economy. The patterns we see in our data become more valuable as we combine them with other third-party data and expert insight, something which you will see us draw on throughout this report.

About Tradeshift

Tradeshift is a market leader in e-invoicing and accounts payable automation and an innovator in B2B marketplaces and providing access to supplier financing. Its cloud-based platform helps buyers and suppliers digitize invoice processing, automate accounts payable workflows and scale quickly. Headquartered in San Francisco, Tradeshift's vision is to connect every company in the world, creating economic opportunity for all. Today, the Tradeshift Network is home to a rapidly growing community of buyers and sellers operating in more than 190 countries. Find out more at: Tradeshift.com