Labor Challenges Disrupt the Fragile Global Supply Chain

November 2021

Summary

- Global labor challenges induced by the pandemic wrought supply chain disruptions that have persisted, even as the pandemic has ebbed, and are currently causing shortages across multiple markets
- While some of the labor shortages were acute and have since resolved themselves, others are proving quite durable and are threatening continued disruption to both trade and logistics networks
- We expect these labor and supply chain disruptions to continue into the new year. While supply chain bottlenecks may more readily be resolved, labor issues in developed countries are resulting in a rise in wages, which will be passed through to consumers, increasing inflationary pressures

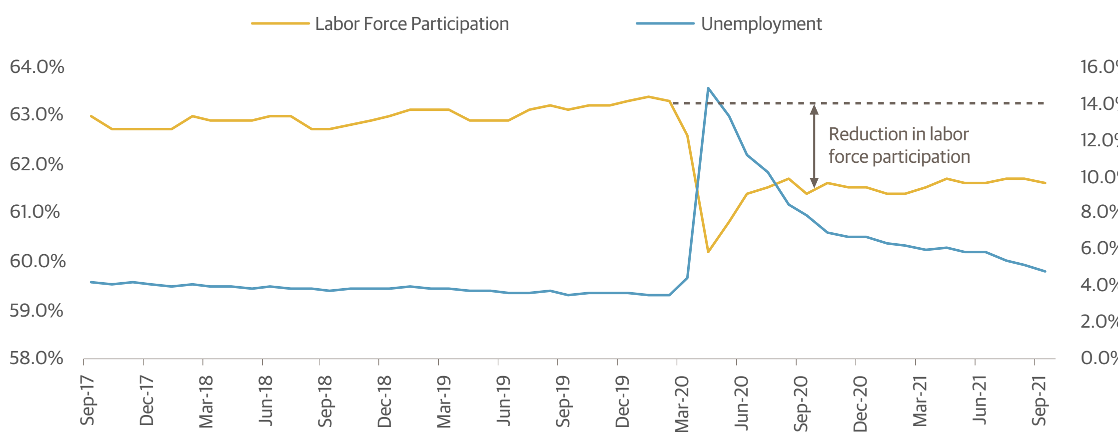
The global labor market has faced numerous challenges over the course of the pandemic, the most recent of which is meeting labor demands. Employees have been reluctant to return to the market either due to health and safety reasons, continuing unemployment benefits, or social obligations, such as childcare. Employment shortages and inconsistencies have been felt strongly in the services and manufacturing industries. As an example, McDonalds has been struggling to hire and retain employees to serve their US restaurants and has increased wages in some locations to $15 an hour. After facing resignations where wages were still lagging, McDonalds is continuing wage increases. McDonalds will not be the last company to face labor challenges as the world economy continues to restart. Increasing labor costs may accelerate adoption of technology, such as robotics or automation, as a means of controlling overhead.

On the manufacturing end of the supply chain, disruptions have come at multiple times, with varying degrees of severity, and in different critical manufacturing centers. At the outbreak of the pandemic, lockdowns in China disrupted manufacturing output, impinging global supply. Future outbreaks of the virus could result in stringent, localized lockdowns with severe manufacturing capacity implications. As an example, Vietnam relied upon similar lockdown measures as recently as September 2021 to control a surging case count, once again impacting manufacturing capacity and reducing supply of goods, and China is currently poised to reimplement lockdowns as cases rise.

Services and consumption-based economies have witnessed their own labor issues. At the height of the pandemic, the US labor market lost more than 20 million jobs[1]. Whilst headline unemployment has decreased markedly since pandemic highs, and is now below 5%[1], employment levels in the US are still lagging expectations, and the economy still has 5 million fewer employed persons as compared to pre-pandemic levels[1]. Labor force participation (share of working-age population either working or seeking employment) witnessed a sharp reduction during the pandemic and has yet to fully recover (grey line in the chart nearby). If individuals who exited the labor force since the start of the pandemic are included in unemployment levels, the unemployment rate would stand at 6.6%[1].

> Employees have been reluctant to return to the market either due to health and safety reasons, continuing unemployment benefits, or social obligations, such as childcare.

LF Participation vs Unemployment Rate



Source: Bureau of Labor Statistics

[1] Bureau of Labor Statistics

Labor shortages have been at the core of the problem on the distribution end of the supply chain in the US. The ports of Los Angeles and Long Beach, which process about 40% of all shipping containers entering the US[2], have been struggling with container queues, which have reached over 100 container ships. Ports are reeling from a lack of longshoremen to offload cargo from shipments, while a shortage of truck drivers leaves onshore goods stranded on docks or in warehouses. These bottlenecks are showing no signs of easing. Ships are being rerouted or parked in the waters outside of the ports, and the Biden Administration has asked for 24/7 operations in the ports to reduce the backlog. While the labor shortages continue, it is unclear when the backlog will be cleared, and it is likely that these supply chain disruptions continue into early 2022, notwithstanding major federal intervention.

Labor shortages have been at the core of the problem on the distribution end of the supply chain in the US.

Cumulatively, these disruptions in labor had obvious adverse effects on the global supply chain: lockdowns limited both raw material production and finished goods manufacturing, which constrained supply; social distancing measures reduced efficiencies at ports, which dilated order fulfillment times and led to dwindled inventories; and continued economic stimulus is discouraging labor from reentering the market in many geographies. Compounding these labor issues and their associated supply chain disruptions is the asynchronous nature of the pandemic. Different geographies saw ebbs and flows of case counts at different points throughout the year, resulting in near constant strain on supply chains geared for just-in-time fulfillment and minimal inventory.

Different geographies saw ebbs and flows of case counts at different points throughout the year, resulting in near constant strain on supply chains geared for just-in-time fulfillment and minimal inventory.

The UK is also facing labor issues, albeit now mostly resulting from post-Brexit immigration policy as opposed to pandemic-induced shortages. Truck drivers who transport petrol have been in short supply as new immigration policies reduced the number of available drivers. Petrol prices escalated to unexpected levels and are now up 25% over last year's price[3]. Container ships are similarly being sent away from British ports as the shortage of drivers in the UK is also causing a distribution bottleneck. A more permanent solution to this issue needs to be introduced to manage inflationary effects. This issue, however, does not appear to have a quick fix, as any legislative solution will take time.

These labor and supply chain disruptions put inflationary pressure on the economy. Many employers have resorted to wage increases to attract talent. These higher input costs will be passed through to customers via price increases. Lower supply of goods coupled with historical levels of demand will put additional upward pressure on prices. The US is already witnessing reduced discounting as the country heads into the holiday shopping period,

[2] ABC News "Ports of LA, Long Beach to fine firms over container backlog" 26 October 2021

[3] RAC Foundation

indicating higher prices will be paid for the same goods as compared to prior years. Supply issues have, in some instances, delayed revenue, as scheduled projects are pushed due to supply unavailability. While these delayed projects lower expected revenue in the near-term, we are confident these projects will return as bottlenecks ease and the revenue will ultimately be captured. The delayed (as opposed to canceled) activity is particularly true for mission-critical products and services.

Disruptions to labor, and thus supply chains, in manufacturing-dominated economies are likely to be acute but short-term in nature, resulting from flares in case count. However, disruptions in services and consumption-based economies are more systemic. Hence, inflationary effects in these economies may be more enduring.

Due to the nature of our tech enabled and asset-light corporate investments and operationally passive real estate investments, our portfolio overall is generally insulated from these issues. Nonetheless, we are focused on guiding our investments through these labor and supply challenges. First, we are being diligent to ensure any increased costs are passed through to customers, where possible. We are also shifting from a "just-in-time" to a "just-in-case" procurement model by ordering excess inventory and engaging additional suppliers in multiple geographies. Additionally, we recognize that technology and automation are natural hedges against labor pressures, and we are focusing on further utilizing existing technologies and adopting new technologies that will increase efficiency. In the diligence process, we are focusing on business models that are insulated from these issues in addition to having pricing power to ensure any increases in cost can be passed on to consumers.

US Supply Chain and Labor Concerns Countered by Multiple Long-Term Tailwinds

Strong Tailwinds	Near Term Issues
General Growth Tailwinds	Supply Chain Disruptions
Improving Employment	Labor Market Shortages
Improving Consumer Sentiment	Inflation Concerns
Strong Housing Market	Potential for Covid Flare-ups
Low Interest Rates	
Stock Market at Record Highs	

ARCAPITA

Arcapita Overview

With two decades of experience, Arcapita's management has built a global investment platform to access the opportunities that exist in our core markets of the US, Europe, Middle East and Asia.

Arcapita is a global alternative investment manager offering diverse investment opportunities, focusing on private equity and real estate. At the center of one of the fastest growing wealth markets in the world, Arcapita's management has been serving an exclusive group of investors in the GCC region over the past two decades. With offices in Bahrain, Atlanta, London and Singapore, Arcapita's management team has completed over 90 transactions with a total value of approximately $31 billion and possesses a footprint to invest on a global scale. Arcapita focuses on defensive and counter-cyclical sectors supported by long-term macroeconomic and demographic trends.

www.arcapita.com

Disclaimer:

While every effort has been made to ensure that the data quoted and used for the research behind this document is reliable, there is no guarantee that it is correct, and Arcapita Group Holdings Limited and its subsidiaries accept no liability whatsoever in respect of any errors or omissions. This document reflects our considered opinion and is not intended to constitute investment advice, nor to solicit any investment.

Arcapita Investment Management B.S.C.(c)
Arcapita Building
P.O. Box 1357, Manama
Kingdom of Bahrain
Tel: +973 1721 8333

Arcapita Investment Management US Inc.
1180 Peachtree Street
NE, Suite 2280
Atlanta, GA 30309
United States of America
Tel: +1 404 920 9000

Arcapita Investment Advisors UK Limited
The Shard, 32 London
Bridge Street
London SE1 9SG
United Kingdom
Tel: +44 207 824 5600

Arcapita Investment Management Singapore Pte. Ltd.
24 Raffles Place, #16-03
Clifford Centre
Singapore 048621
Republic of Singapore
Tel: +65 6513 0395