

# Supply Chain Risk

## uncertain economy

**I**n today's unpredictable economic environment, a clear understanding of an organization's supply chain operations and its inherent risk is imperative

Many organizations, while acknowledging the crucial role that their supply chain plays with respect to their overall success, do little or nothing to quantify the risks associated with supply chain inadequacies. In "Understand Supply Chain Risk: A McKinsey Global Survey," two-thirds of respondents said the risks to their supply chains have increased over the past five years. Of the responding companies, 25 percent have no formal risk assessment, while 39% of executives only feel "slightly capable of mitigating risk."

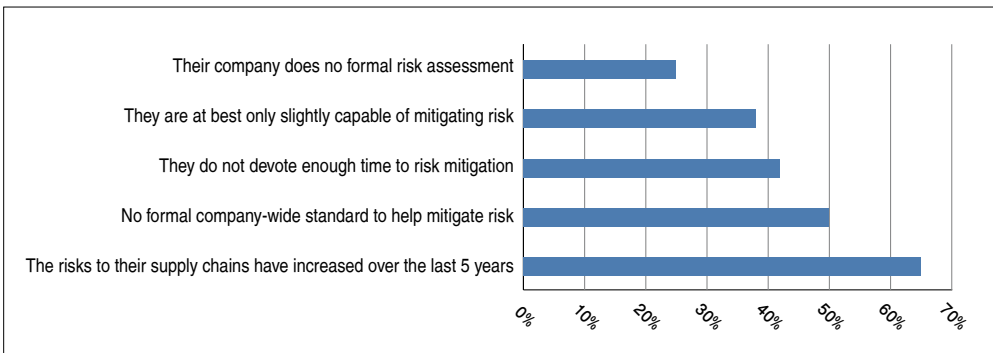
### The State of Supply Chain Risk

Why is this important? What is the impact if your organization has a disruption in supply? According to Paul Michelman in his 2005 article in the Harvard Business Review, "A Framework for Risk Management," 80% of large organizations will face a crisis of 10 days or more every four to five years. Of those affected, 73% will close or suffer a significant long-term impact to business, 43% will never recover sufficiently to resume business, and of those who do reopen, only 29% will be operating

two years later. The result of a 10-day disruption is less than a 10% chance of survival. Consequently, the combination of supply chain complexity, globalization, increases in regulation, and our current economic downturn only exacerbate the challenges corporations face today.

What can be done to mitigate such uncertainty and risk? Best-in-class organizations are assessing their supply chain and are developing the skills, processes and tools necessary to compete in today's unpredictable global

### Understanding Supply Chain Risk



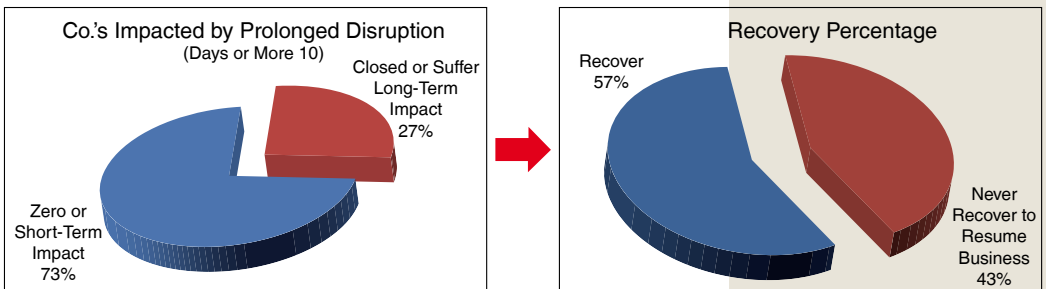
McKinsey Global Survey, Understanding Supply Chain Risk



# in today's

By Andy Schramm and Joe Kelly

## Impact of Prolonged Disruption in Supply



Harvard Business Review, 2005, A Framework for Risk Management, by Paul Michelman

economy. They are asking themselves tough questions and scrutinizing their supply chain from multiple dimensions. These include:

- How do we quantifiably define risk across the organization (Finance, New Product Development, Quality, Manufacturing, etc.) and are we aligned and consistent in our definition?
- Are our suppliers meeting our expectations on delivery, cost, quality, scale and safety?
- Is our spend concentration by category, geography or supplier creating unnecessary risks? Do we look at more

than spend with regard to risk (i.e., quality, reliability, business continuity, etc.)?

- How do we reduce risk from lower-tier suppliers?
- Do we need to enhance the skills and capabilities of our supply chain and procurement staff to meet the complex demands of our current environment?
- Do other departments understand their role in supporting a best-in-class supply chain?
- Have we documented and qualified all of our suppliers against requirements for various regulatory agencies, and do they meet audit requirements?

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Until an organization can answer these questions in the affirmative, the risk of failure remains strong. Through a proactive, unbiased evaluation of all links in the supply chain, the risks can be fully identified and mitigated. This in turn, will allow for organizations to weather the current economic storm and remain a viable business entity.

### **Where to Start**

Regardless of the industry you serve, or the size of the organization you are a part of, there are several steps you can take to enhance efforts that may currently be under way in your organization.

- Audit the financial, operational and balance-of-trade exposure of your most strategic and mission-critical suppliers. Too often the investigation of supplier solvency is

limited to the initial sourcing effort. You need only to open a newspaper or turn on the nightly news to realize that the health of even the seemingly most stable companies can degrade quickly. Have any of your suppliers closed their doors due to the current economic crisis?

- Monitor for early warning signs from suppliers. Frequent requests for early payment, changes in sales and support personnel, and a drop in quality or shipment delays can be indications that the supplier has cut too deep into its operations.
- Increase the frequency of supplier performance reviews. Aberdeen Group research finds that, of those companies doing regular performance reviews with suppliers, more than two-thirds conduct these on an infrequent basis

— quarterly, semiannually, or annually. In the face of highly volatile markets where credit is tight, you should consider performing these reviews at least quarterly with your most strategic and mission-critical suppliers, and semiannually with your next tier of suppliers. When it comes to measuring performance of your suppliers, don't limit yourself to the top percentage by spend. The more suppliers you measure, the less likely you are to be caught off guard.

- Automate your supplier management process. Leading spend-management organizations are simplifying this process by leveraging supplier management tools that combine self-service portals for suppliers to publish and manage their own profile information, score-carding and performance measurement

utilities and project-management capabilities for corrective action management. Use of such tools can improve visibility, control risk and enable you to extend supplier management to a broader portion of your supply base.

### Where to Stop

As organizations develop their internal risk-mitigation abilities, many find themselves overwhelmed by an ever-increasing number of audits, reviews and action plans. Therefore, it is imperative to have a process for identifying what risk-related activities need to stop in order to meet new risk-attribute needs.

The reasoning here is simple: All organizations have a finite amount of time and resources to address supply chain risk. Risk-mitigation activity provides an ever-diminishing amount of return. In today's competitive marketplace it is critical that firms understand exactly how much each type of supply disruption will cost them and strategically determine the amount of investment needed to prevent each scenario.

Once you have successfully determined the appropriate areas to expand your risk-mitigation activity, the team should review the entire process and look for opportunities to reduce the burden on your organization:

- Identify suppliers who are underperforming and evaluate the need to replace them. Suppliers who pose a risk,

take time to audit and correct whatever can negatively affect your operation.

All of this is reducing focus from finding your next area of risk. Identify the cost of switching to an alternate supplier and take action based on the resulting business case. If you find the cost of switching suppliers is too high, reduce the number of opportunities for your supplier to cause issues for your operation: increase inventory buffers, increase order sizes far in advance of required usage dates, offer assistance if they are a critical and strategic supplier and/or move to more reliable logistical arrangements.

- Review the previous six months of audit data and identify areas being measured that have provided no actionable results from their capture. Many companies begin their risk-mitigation activities by copying a best-practice manual. The problem with this method arises from measuring criteria that may have no bearing on your operation. Take the opportunity to stop including such metrics in your review and shift your focus to issues that can potentially result in a serious hit to your bottom line.
- Eliminate unnecessary department participation. The ideal supply chain risk model has a cross-functional team from each major stake-holding area within your firm. There are times when this may reduce your ability to react to risk instead of making improvements. In some compa-

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ries, risk is unevenly distributed across departments, or in extreme cases an entire department poses no functional risk to the results of your firm. In the latter case, you can accelerate your reaction time to major issues by removing low-risk departments from your risk-related activities. As you continue through your evolutionary journey with risk management, it is worth reviewing not only the risks posed to your firm but the process of risk mitigation. In doing so, you will ensure that you are generating an appropriate level of mitigation for the investments made by your team in both time and energy.

### What to Expect

Are your risk processes an evolutionary system or do you find the same activities being performed each year resulting in the same types of problems? How you answer this question will determine what you can expect to achieve with these activities. Traditional methods of identifying and dealing with supply chain is-

issues have focused exclusively on cost-avoidance benefits, which are expensive activities.

Best-in-class organizations are finding that supply chain risk management can become the cornerstone of many cross-functional strategic initiatives. These initiatives provide a competitive advantage far in excess of the marginal cost of each project. To find additional benefits within your own organization:

- Identify dramatic cost reductions in your product before it is prototyped. According to Niezen, Weller, and Deringer in the Winter 2007, MIT Sloan Management Review article "Strategic Supply Management," up to 80% of product cost can be defined during the design stage. In addition, firms that involve their supply chain departments in design activities realize improvements of nearly 18% in costs and 10%-20% in time-to-market cycles.
- Prevent competitors from accessing the technology that

provides you with market-changing advantage. According to the 2009 PPI survey of Tier 1 automotive suppliers Honda and Toyota, leaders consistently receive the greatest benefit from their suppliers in a variety of areas including lower costs, higher quality, and innovation.

- Give your operations facilities a boost. A number of risk drivers in the supply chain also increase costs significantly and reduce productivity. By focusing on smoothing demand patterns, understanding the importance of level loading demand and integrating statistical forecasting methods into your sales and operations planning cycle, you can reduce the risk of exceeding supplier capacity while reducing the overall cost to meet demand.

Modern supply chain risk management is a blend of art, science, intuition and statistics. Through careful evaluation and critical strategic consideration, you can rapidly move your firm toward a best-in-class position of competitive advantage.

For additional support on this topic, contact Tefen at: [TefenSCM@tefen.com](mailto:TefenSCM@tefen.com)

Andy Schramm,  
Partner, Tefen USA

Joe Kelly,  
Director, Tefen USA