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Keeping control of your supply chain

Global economic uncertainties and the growing complexity of many corporate supply chains mean greater risks for companies taking advantage of outsourcing opportunities. **By Sue Copeman**

Supply chain outsourcing has become a global phenomenon. But, as Tim Cracknell, Partner at Jardine Lloyd Thompson, warns, while there may be economic and other benefits for an organisation, losing a tight rein on the supply chain produces some significant risks. Crucially, these risks are heightened in today's economic environment.

Why outsource?

Maximising profitability is the main driver for outsourcing. "Reducing your costs may mean lowering your production prices," says Cracknell. Chris Maurice, Risk Financing Manager, BT Group Risk Management, agrees: "Many managers assume that it is cheaper to outsource, although that is not necessarily the case."

Cost is not the only factor. Maurice explains that many organisations want to focus on what they do best. "They look to outsource functions that don't fit into the organisation's core deliverables even if traditionally they've been done in house," he says. It makes sense to use a specialist third party for some functions to provide a more professional and cost-efficient service.

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> Alan Braithwaite, LCP Consulting and Cranfield School of Management

Capability can be a driver. Some organisations struggle to recruit in areas where trained personnel are scarce. "It can be more cost effective to buy that expertise in from a supplier than to create capability organically," says Maurice. Improved communications and IT developments also mean that it is now possible to efficiently outsource more functions than even three years ago.

Growing complexity

Global economic trends have raised new issues and risks. While few companies may be outsourcing production to Iceland, Cracknell points out that, if an 'Iceland situation' occurred in an Asian country where outsourcing is common, that would certainly raise questions about continuity of supply.

There are risks much closer to home for many of the UK's largest companies, as their domestic suppliers suffer from the punishing overdraft and loan rates being imposed on SMEs by the high street banks. As the number of small businesses set to collapse is expected to rise to 100 a day, risk managers need to ensure there is as little disruption to the supply chain as possible. Indeed forward-thinking companies are pre-empting problems and urging suppliers to talk to them, rather than to their banks, if they face financing difficulties.

It is no longer a matter of producing goods in another country and then shipping them back for distribution. Developing markets, originally hungry for manufacturing opportunities, have become consumers in their own right. "Typically a lot of organisations are getting their products assembled, packaged and distributed in the same or similar location," explains Cracknell.

Control is also lessening as companies and their suppliers seek cheaper sourcing. Earlier this year, the US Baxter pharmaceutical group was forced to recall supplies of its anti-coagulant heparin. The raw material used – sourced in China – was contaminated. More than 100 other companies also issued recalls linking back to supply points in China. This cautionary tale highlights a danger that could increase as new outsourcing »»

SUPPLY CHAIN RISK ANALYSIS

Supply chain risk management can be difficult because of the amount of data and the management processes required to extract it.

Catherine Geyman, Director of InterSys Solutions – which developed supply chain risk analysis tool SCAIR™ – says the key is to focus on the critical points in the physical supply chain. "You then need to assess the disruption impact in terms of immediate and continuing financial loss, and thereby quantifying the value at risk associated with the loss at that point in your supply chain," she explains.

Doing this analysis product by product, and then looking at loss across the products to see where single point suppliers coincide, enables an accumulation of risk to be identified.

This is particularly important for companies with a supply chain involving higher value and long lead-time products, helping them to design their supply chain rather than simply predict the outcome of risks that occur. "Considering the value at risk with existing partners will influence whether you outsource further products to them or seek alternatives," says Geyman. "It has a practical application, it's not just a theoretical exercise."

It can also help to produce a cost–benefit analysis to justify possible expenditure, or potential savings where supply chain issues are not critical.

»» partners emerge in countries like Vietnam and Laos.

Neil Campbell, Head of Life Science and Chemicals at Jardine Lloyd Thompson, believes companies have been slow to react to increasing complexity in their supply chains. He cites a recent McKinsey survey, 'Managing global supply chains', which found that supply chain risk is rising sharply, with the greater complexity of products and services, higher energy prices and increasing financial volatility being key causes. However, relatively few respondents said their companies were translating the importance they placed on these factors into corporate action.

Knowledge-based decisions

Managers can only make the right decisions about supply chains if they have got all the information. This means conducting a study, analysing exposures and showing where accumulation risk exists. "Taking the results back to your board gives them the opportunity to decide whether they are prepared to accept the exposures," says Cracknell.

Procurement departments and product managers are generally aware of the need to ask potential suppliers questions around issues like under-age labour or dubious ethical activities. Few probably focus on physical loss of a facility or supply, or on non-damage related issues, such as regulatory intervention or loss of intellectual property, that can have an impact on supply.

"That is where the risk manager should be able to bring his perspective in, talk about catastrophe zones around the world for example, and work with supply chain managers about what risk management they should put into place," explains Cracknell. "Part of conducting a supply chain business interruption review is discussion with procurement so that we understand their viewpoint."

Even though insurance is an accepted mechanism for transferring risk, the cheque you receive does not necessarily repair your business or enhance your reputation, so managers should deal with risk management first – insurance is a backstop.

However, insurance has evolved to meet some supply chain concerns. Jardine Lloyd Thompson's recently launched non-damage business interruption programme is tailored to meet the needs of specific industries; the programme for life science organisations, for example, has five triggers. Those most relevant for safeguarding supply chain risk exposures are interruption from regulatory risk – where a regulator closes an organisation or its supplier down until requirements are met – and insolvency – where a supplier goes bust.

Campbell stresses that the probability of things happening, and the benefits of mitigation investment, need to be assessed. "It has to be a value proposition so you need to start with the proper methodology for managing the risk," he says. This means a good set of tools or techniques to look at the supply chain on an individual product basis, right back to raw material supplies through to end-user distribution, and properly mapping out that supply chain and assessing what might happen.

Determining credible scenarios entails a multidisciplinary approach because of all the risks involved. It is necessary to assess the effects, both downstream and global. "Companies tend to look at individual assets – what goes in and comes out – without understanding the broader implications. If the whole chain falls down, the mitigation implemented may be ineffective."

A second pitfall is not looking at the aggregation of issues, says Campbell. "You may have 20 products and understand each supply chain but unless you look at where common assets or supplies are involved and understand that more than one product could be affected you are not going to be able to envisage a worst-case scenario."

In some businesses it is relatively clear where key 'pinch points' are in the supply chain. In others, there are question marks, particularly if you are sub-contracting with various suppliers providing different components. "A fundamental mistake is to focus on whom you spend the most money with," comments Cracknell. "That's not necessarily where your key risk lies. With a complex product, there may be one tiny relatively inexpensive part that is only supplied from one source."

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This highlights another potential issue: the range of alternative suppliers to switch to if one has a problem – they could all be using the same supplier for a particular component. "Do you know who your supply chain partners are? Can you track your supply chain back to your raw materials supplier?" asks Cracknell. Ideally, total supply chain visibility is required.

This transparency can be helpful when looking to insure. Cracknell explains: "Business interruption policies generally have a low limit for suppliers of suppliers – the exposure is unknown. Analysing your supply chain means they may come up with higher limits."

Clear positives

Supply chains are becoming increasingly high-profile issues in company reports. "As global business becomes more complex, anything from insolvency of a critical supplier through to regulatory intervention or just plain physical damage loss can have significant consequences," says Campbell. "Shareholders will be unforgiving if you have a supply chain failure as a result of poor management."

Aside from avoiding the negatives, there are some clear positives. Alan Braithwaite, Chairman at LCP Consulting and Visiting Professor at Cranfield School of Management, believes that supply chain management improves customer service and reduces cost. "Companies applying supply chain management principles generally do things better. Whether this correlates through to financial performance is less clear because of other factors such as brand strength and, certainly at present, general economic market performance."

It seems likely that those organisations that have gone through the process of understanding their supply chain detail, determined weak points and established resilience or alternatives will have a competitive edge. However, Braithwaite says there is no statistical evidence to support this. "It isn't clear whether formal supply chain risk management increases competitiveness. Companies that have a disruption get a massive hit in share price. However, currently, markets are the dominant factor rather than individual companies' experiences."

Are companies willing to invest time and money on supply chain risk management in the current economic climate? "Much depends on how bad it gets and on their priorities," says Braithwaite. He believes that "coming out of difficult times depends more on how you operate, rather than just 'slashing and burning' to take cost out, which is likely to increase risk".

Pressurising your suppliers to reduce costs could put them out of business – leaving you with a bill for far more than the saving you negotiated. 'Savvy' companies now recognise this, to the point of strategically investing in a key supplier that has financial problems. RS

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RISK MANAGEMENT GUIDELINES

1. **Responsibility cannot be offloaded.** Your supplier's interests are not the same as yours and your own internal interface is required to work with them.
2. **Understand and communicate** objectives and deliverables to your suppliers. Provide the right contract incentive to achieve them.
3. **In a multi-tiered supply chain,** leaving a key supplier to handle those further down the line means losing visibility of the lower level and increasing reliance on someone else's expertise to deliver your product.
4. **Actively risk managing** the supply chain requires a joined-up approach. Procurement departments generally focus on cost reduction, which will almost certainly increase a product's risk profile in terms of quality, delivery, price, etc.
5. **Check out potential problems.** Is a key supplier based in an area prone to disasters? Does the plant have more than one transport link? Does the supplier meet your organisation's corporate social responsibility standards?
6. **Be aware of regional constrictions.** The United States and European Union have restrictions on what, where and how products and information can be used outside their territories.
7. **Finally, remember** that the only control you have over a third party comes down to what is in the contract – enforcing it can be a struggle.