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December, 2012, Supply Chain Risk Management: Highlight, Background & Analysis

Supply Chain Risk Management

"Uncertain economic scenario, global competitive pressure, shorter product life cycle, reduced buffers, increased demand for on-time deliveries… risk management is not an option"

Highlight

Turbulent global economic scenario has multiplied the risk of supplier failure at home and abroad, threatening supply chain stability.

Supply chain break down can be detrimental not just to the financial aspects but also to the overall reputation of any company.

For large manufacturing firms supply chain breakdowns not only bring immediate damage to the affected company but can also threaten the long term plans of the company.

A continuous monitoring process that begins with supplier selection relying on 360degree evaluation of critical suppliers is essential to mitigating the impact of supply chain break downs

Background

Supply Chain Risk & Supplier Assessment in Turbulent Times

Risk management is not an option. In today's global business environment, supply chain risk management can no longer be perceived as an optional or expendable part of a corporate strategy. The stakes are too high and the risks are too prevalent to leave to chance. Without a calculated strategy to mitigate supply chain threats, companies run a higher risk of being challenged with lower revenues, higher costs, poor asset utilization and loss of reputation and credibility.

Risk is inherent in every supply chain—a supplier fails to deliver according to contract, forecasts miss the mark, customers change their minds—these are just a few of the basic risks businesses deal with every day.

Now, add hurdles that arise from globalization, outsourcing and emerging markets—such as economic, geo-political, regulatory, environmental, quality and reliability, demand volatility and increased threat of natural disaster. What you have is an extraordinarily complex supply chain that could easily break under all the pressure. And, the exposures have grown exponentially with the globalization of supply.

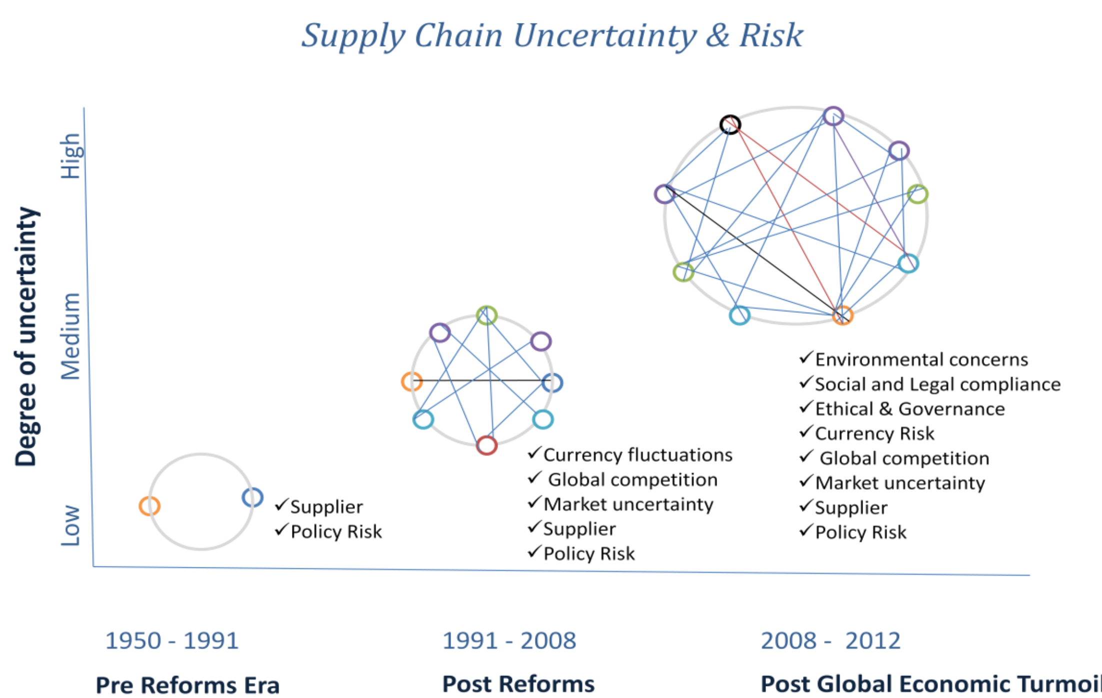
Since the supply chain is intrinsically collaborative, the process of identifying, assessing and prioritizing risks within the supply chain should, ideally, also be collaborative. When players—from a raw materials supplier to an end-product/service provider—actively manage the vulnerabilities within their particular portion of the ecosystem, supply chain risk can be significantly mitigated. When they don't, a relatively minor disruption can easily turn into a major crisis.

But of all the risks that chief procurement officers (CPOs) face, the one that is at once both potentially devastating and often entirely predictable is the financial failure of key, strategic suppliers. When it comes to key suppliers, one failed company is one too many. As one Chief Procurement Officer, capturing a fundamental principle of supply chain management, says, every company depends on another business to achieve its own business goals. If a supplier fails, you can replace it, but that can take a significant amount of time.

A supplier failure can also be costly. How costly? One aircraft-engine manufacturer a few years back reported that the cost it incurred when one minor supplier failed was $4.5m. Of course, many companies take great pains to monitor the risks associated with their suppliers. IBM, for example, looks at the potential for a natural disaster near a supplier location, among other things. But for many companies, monitoring the financial health of suppliers and other key stakeholders usually occurs inconsistently and occasionally rather than systematically.

Current scenario of Supply chain risk management in India

Supplier risk in India is often approached inherently from a western perspective where the concerns are primarily issues like how disruptions at different points in the supply chain from supplier bankruptcies, natural disasters or other occurrences can impact the ability of the principal to keep production lines open and customers happy. Yet locally, especially in developing countries like India, supply risk can take on many additional elements. And risk factors can manifest -- becoming disruptions -- more frequently, owing to greater uncertainty and visibility in the overall supply chain and inconsistent levels of infrastructure.



In Indian context the pre reform era supply chain complexity and uncertainty levels were very low primarily because the economy was closed to global players and most of the demand supply mechanism was regulated by the Indian government. The scenario changed moderately post the economic reforms done by the government in year 1991. However post the global economic turmoil of 2008 the level of complexity and related uncertainties have risen many-folds.

Compounding risk related challenges for global companies wanting to sell into the Indian marketplace, the article suggests, are local sourcing requirements that require organizations to patronize local suppliers -- and integrate local and global supply chains together. For organizations not used to managing supply risk factors in developing countries, the facts can speak for themselves. Consider with fresh fruits and vegetables, how "around 30 percent of India's vast...production goes to waste due to a traditional supply network that uses hand-pulled wooden carts more than refrigerated freight wagons and keeps fresh produce highly regionalized."

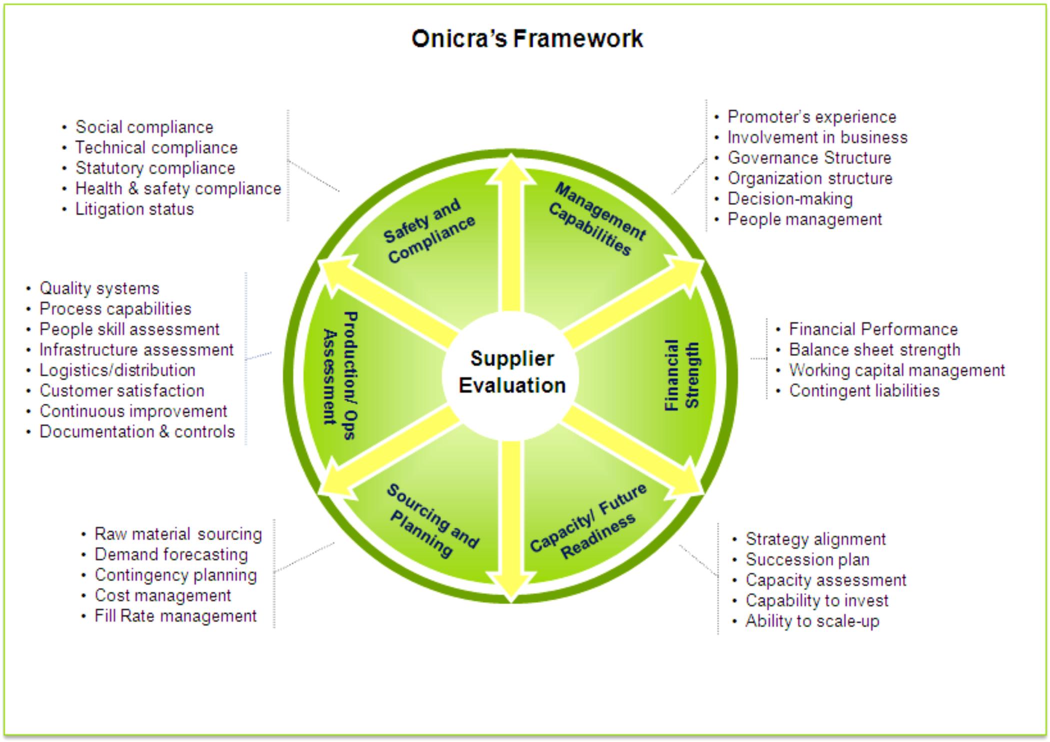
Said another way, if you don't want to end up wiping a rotten tomato off your hands and your books, then it's essential to focus on both global and local supply risk management focus areas.

Analysis

Risks and Vulnerabilities of Suppliers & their Impact on Principal's business

Evaluation of supplier risk must involve a 360 degree view on the sources of risks and vulnerabilities with an Indian perspective. Thus the evaluation must be comprehensive; however the process of evaluation must not take too much time. The essence is that the accumulated loss of opportunity often outweighs the cost of assessing the risk at an early stage and putting the necessary checks and balances. Therefore, any approach to managing risks from a supply chain perspective must not take longer time still must have a broader scope to include all the pertinent aspects.

A broad framework for the purpose must look in to the following areas of suppliers business



Most of the areas especially in case of small suppliers are highly contextual and industry specific. Thus the evaluators must be professionals who understand the thumb rules, best practices & the industry specific compliance regulations.

FAQ's

Q. Should my company assess financial risk for every supplier?

A. No; this could prove expensive and time-consuming. Companies should prioritize this effort from a risk-based approach and focus on their most critical supply chains, requiring assessment of their suppliers' value contribution.

Q. How does Onicra assess the risks & venerability of private suppliers?

A. Onicra evaluation framework is a 360 degree view on the sources of risks and vulnerabilities with an Indian perspective. The assessment covers pertinent areas like financial performance, production capacity and scalability etc and various qualitative aspects like process capability, management capability and compliance & safety issues.

Q. My company already uses various other stress scores to evaluate suppliers. Why is that not enough?

A. Generic limitations current approaches suffer with are that most of the stress scores rely on data that is old. They are limited to quantitative data selected from public company financial reports. These methods don’t consider qualitative operational information that affects financial performance. Additionally, such scores do not provide information on privately held suppliers.

Q. What is the return on investment from supply chain risk assessment?

A. While it may be difficult to quantify the returns from such an exercise however the objective of any such exercise is not to maximize returns but to prevent damage. Risk assessment helps in reduced damage to finances and reputation by enabling companies to manage potential supply chain disruptions proactively before they grow into full- blown crises. Advance planning can ease communication, shorten downtime, and speed remediation in case of contingency. Additionally the assessment also uncovers inefficiencies in the supply chain, such as lack of standardization and duplication of services, and helps identify companies’ most valuable resources.

Q. After conducting a risk assessment, how can I continue to monitor the stability of my suppliers?

A. Companies often develop a reporting dashboard of quantitative and qualitative key risk indicators customized for their business. These key risk indicators will give early warning of potential disruptions.

Q. My company already monitors suppliers for delivery & quality aspects. Other than the risk of financial failure, what are the most important risks in the supplier relationship?

A. Companies should monitor a broad range of operational, financial, environmental, ethical & social risks in their supplier relationships.