RISK MANAGEMENT ALERT
RISK MANAGEMENT ADVISORY
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Managing the Risk of Supply Chain Disruption – Part 1 of 2

The world has come a long way from the days of pioneering motor tycoon, Henry Ford, and his Model T. With one design, one color and a vertical ownership structure ranging from raw materials to the final product, Ford had control of his entire operation. Today, so much has changed that most businessowners no longer have a centralized operation. The global reach of supply networks and the outsourcing of many business functions mean that firms are dependent on a broad array of business partners exposed to a wide spectrum of possible disruption at all levels of operation.

The causes of a disruption could range from a large-scale natural disaster, widespread power outage or a national product recall, to something more localized such as a technological or equipment failure, a building fire or even a burst water pipe. Consider these disruptions in light of the fact that many businesses rely on just-in-time deliveries, maintain limited inventories, and may not be prepared for market changes that result in a spike or drop in use of the goods or services they provide – and it's obvious why supply chain risk management is a hot topic.

To respond to this growing concern, the Institute for Business & Home Safety (IBHS) added Supply Chain Risk Management as one of the newest tools in the Open for Business® program, which helps small and mid-sized businesses plan for interruptions that may threaten the bottom line.

The success or failure of just about any product depends upon relationships between the players in the supply chain – their ability to communicate and collaborate, and ultimately to move a product or service to its final destination as seamlessly as possible. Supply Chain Risk Management can and should be incorporated into this process, with each party taking responsibility for building its capacity to better respond to interruptions and to restore and recover operations whenever a disruption occurs. The communication and collaboration is even more important as the supply chain becomes longer and more complex. A firm's resilience, or capacity to return to an acceptable level of operation, within an acceptable time frame, depends on its supply chain. The chain is only as good as its weakest link.

Supply Chain and Supply Chain Management

Managing the supply chain is a critical function for businesses of all sizes, not just major chains and international operations. If your company makes a product from parts purchased from suppliers (upstream), and those products are sold to customers (downstream), then you have a supply chain.

Upstream dependency involves everything you rely on to design, produce and supply your products or services to customers or clients. The downstream dependencies are simply your customers and clients (or the individuals and companies that purchase your products or services). Management of your supply chain is essential to create a smooth and seamless operational environment.

Your supply chain not only includes the product or service you purchase or sell, but also involves the flow of information (e.g., transmitting orders or status of delivery) and finances (e.g., purchasing agreement, credit terms and payment schedules) necessary to complete the transactions. The chain also consists of your inventory of raw material or parts for use in production, as well as storage of your finished product. The complexity of the supply chain will vary with the size of the business and the intricacy and numbers of services produced.

Because the supply chain extends to external infrastructure, such as transportation, shipping and logistics, planning for business interruption solely within your four walls is not enough. With Supply Chain Risk Management and Business Continuity you can visualize the relationships between your business and these interdependencies in terms of a domino effect. If one dependency is interrupted, there will be a ripple effect. Supply Chain Risk Management should be an integral part of your business continuity planning process.

Prioritize Your Supply Chain Risk

Prioritize your supply partners in terms of risk, based on their critical roles in your business. As you begin, ask yourself these questions:

1) Which products or services are most critical for your success – for profitability, reputation and competitive advantage?

2) Do you have any mission-critical or time-sensitive activities, services, devices or systems whose failure or disruption in normal business hours would result in severe interruption of business operations? If so, are you assured the suppliers for these activities will be able to deliver?

3) Would a supplier’s inability to deliver goods or services cause a “choke point” or bottleneck in your operation(s)? If so, can you find an alternative supplier, preferably before a disruption occurs?

4) Do you have any suppliers that are sole-source providers of goods or service, i.e., you can only get what you need from that one supplier? If so, can you accept the risk? If not, what is your alternative?

5) What is potential for infrastructure failures that could affect your suppliers’ ability to provide goods or services (i.e., electric power, telephone service and Internet)? These failures could be triggered in geographical areas prone to severe winter weather, tornado outbreaks, hurricane activity, etc.

6) In your normal daily operations, have you experienced fluctuations in demand caused by supply constraints or demand spikes (e.g., during a holiday season or as a result of a successful promotion)? If you have planned for those contingencies, the same strategy could apply in planning for a natural disaster (e.g., spike in demand for building supplies).

Information obtained from Institute for Business & Home Safety, Disaster Safety Monthly, September 2010 Edition.

Part 2 of our series will tell you more about gauging supplier preparedness and proof of resiliency.