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Supply chains: It pays to keep your ear to the ground

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As the credit crunch continues to bite, companies are not only anxiously monitoring their own financial health, but are also spending increasing amounts of time looking down the supply chain – first to asses the solvency of their outsourcing suppliers and then to form closer relationships with business partners. Some, however, argue that the companies with the most robust, risk-free supply chains are those that took measures to shore up their resilience long before the onset of the bad times.

Certainly, due diligence activity throughout the supply chain is increasing. “A good proportion of CPOs [chief procurement officers] or supply chain officers are focused on assessing supplier health right now,” says Narendra Mulani, managing director of the supply chain management practice at **Accenture**, the consultancy. “It’s one of the biggest issues.”

In a November survey of 40 CPOs or equivalent executives, Accenture found more than 70 per cent were more closely monitoring the financial stability of their suppliers. Almost three-quarters were increasing their focus on supplier relationship management.

Even for companies such as **Intel**, the US semiconductor manufacturer, which outsources only about 10 per cent of its production, stepping up the level of scrutiny of its external suppliers is an important strategy. “We’re having to watch our supply line and make sure of their financial health and whether they can stay in business and are financially sound,” says Brian Krzanich, vice-president and general manager of manufacturing and supply chain at Intel.

“Due diligence is taking on new significance,” says Yossi Sheffi, Massachusetts Institute of Technology professor and director of the MIT Centre for Transportation and Logistics. “We see well-known companies saying that they are developing metrics for the health of suppliers.”

The first step companies need to take is an internal one – assessing their exposure to risk based on the amount spent with each supplier and the importance of the procurement or the part to their business.

Signs of danger, says Mr Mulani, include, for example, the fact that a large percentage of a supplier’s business depends on industries that are affected by the downturn. And changes in suppliers’ performance – with, say, different lead times – or reductions in their research and development or IT investments can also be indicators of trouble.

However, detecting the warning signs in the supply chain is sometimes easier said than done. “Even if suppliers are in trouble, unless there’s a hand extended out – and often because of communications and cultural issues – they’re probably not going to tell you about the difficulties they’re having,” says Jay Swaminathan, professor of operations, technology and innovation management at University of North Carolina’s Kenan-Flagler Business School.

For this reason, he says, communicating with suppliers more regularly is essential. For many companies, having their own individuals or teams on the ground in the facilities of their business partners is the most effective way of finding out about the real status of their operations, particularly when it comes to smaller companies in emerging markets.

Companies working with big suppliers, such as Chinese companies **Foxconn** or **Flextronics**, will get reasonable levels of transparency and information from them, says George Appling, a principal at Katzenbach, the New York-based consultancy.

“But when you’re working with small Chinese companies, they may move their factory from one place to another without telling you,” he says. “So if you’re on the ground, you can at least see everyone putting their stuff in boxes.”

While exercising due diligence is a big part of supply chain risk management, companies are also grappling with the essential strategic sourcing question of whether to outsource to a wide range of suppliers, spreading the risk, or to shrink the supplier base and work more closely with one or two organisations.

“That’s something that procurement officers wrestle with every day of every year,” says Mr Appling. “But with the economic crisis, the intensity and frequency with which they make that decision has increased.”

There is evidence that companies are taking the middle ground by diversifying their supplier base. But they are

doing so with a handful of partners – generally the larger, more established operators – with whom they can build close relationships.

Mr Krzanich confirms this trend. “Sometimes we’ve had to move product [from one supplier] and go and get a second source, because we don’t know how long they’re going to be around,” he says.

There is evidence, however, that for some companies, measures to shore up the supply chain have not been taken early enough. The Accenture survey found nearly 20 per cent of respondents reporting that their suppliers were unable to meet their supply levels or needs and for almost 15 per cent, suppliers had been put out of business or forced to merge with other companies. “Lots of companies are waking up and doing things that they should have done long ago,” says Prof Sheffi.

Mr Appling agrees. “A lot of big companies do have their noses on the ground – and they’re sniffing more and paying more attention to what they smell,” he says. “But for companies that don’t have folks on the ground, they need to get out there.”

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