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Protection

Strategies for reducing risk and staying ahead of your competitor

by Catherine Bolgar / 10 May 2010

Companies routinely invest large amounts of money in research and development to deliver the best products and beat the competition. While the latest technology, sharpest design and lowest cost are important, there's another secret weapon that many companies overlook: the supply chain.

A disruption in the supply chain can delay production or delivery of products, which can derail sales and deflate profit. The company that expertly manages risks in the supply chain will avoid some disruptions altogether and will bounce back quickly from others that are inevitable.

"For a supply chain strategy to provide competitive advantage, companies need to understand and manage the disruption risk," says David Martin, head of customer and distribution management for Zurich Financial Services's global corporate division, based in Zurich. "If they don't, a strategy designed to ensure sustainable profits may actually make them less resilient."

Consider that most of your competitors use at least some of the same materials and same suppliers. That means disruptions in the supply chain often affect not just one company but an entire sector. Amid adversity comes opportunity. "Competitors who are more agile and more flexible can gain market share at the expense of those who can't," says Yossi Sheffi, director of the engineering systems division and the center for transportation and logistics at the Massachusetts Institute of Technology (MIT), in Cambridge, Mass., and author of "The Resilient Enterprise: Overcoming Vulnerability for Competitive Advantage."

In the textbook case on the topic, mobile phone makers Nokia Corp. of Finland and its Swedish rival Ericsson both bought microchips from the same supplier. In 2000, the supplier's U.S. plant caught fire. Based on assurances that production would be back up quickly, Ericsson waited. Nokia, however, quickly worked with the supplier to get chips from other plants, lined up other suppliers and adapted its phones to use other makers' chips. Nokia secured its place as market leader while Ericsson suffered the ultimate blow to shareholder value: it got out of the mobile-phone manufacturing business.

The need for managing supply-chain risk has grown along with the dual trends toward globalization and outsourcing. The first makes supply chains longer, requiring more time for shipping and affecting the time needed to end a disruption. The second makes companies more dependent on outsiders — external strategic suppliers who deliver ever-more-complex and more critical products that once were done in-house.

"The trend of recent years has been to reduce supply costs by buying from fewer and often more remote sources. But this can substantially increase risk, and in outsourcing supply you might be insourcing a problem when a strategic supplier encounters a disruption," warns Mr. Martin of Zurich Financial Services.

"Clearly many organizations have thousands of suppliers, or even hundreds of thousands of suppliers," says Jon Hughes, executive chairman of Future Purchasing Consulting Ltd., based in Guilford, U.K. "I ask clients, 'Tell me exactly how much resource and full-time equivalents you've got focused on supply-chain risk.' That will stop 99% of chief procurement officers in their tracks. Many organizations are still in a crisis management mode. Resources are deployed when there's a problem, rather than saying that managing risk is a business activity like any other."

Companies have many options for protecting the supply chain, allowing them to tailor responses to various suppliers. Simple strategies, which might not be appropriate for all parts of a company's supply chain, can include adding multiple suppliers or postponing customization — for example, putting on labels in different languages as close as possible to the store shelf so that in case of a disruption, such as a closed port, unlabeled products can be rerouted to other markets to fill the gap. That flexibility also can protect a company from getting stuck with unsold goods customers in one market don't want, while allowing a company to jump on spikes in demand elsewhere.

Another simple strategy for certain supplies can be increasing inventory. Just-in-time processes, with their extra-lean inventories, make sense when conditions are right — such as when a process is highly predictable, says George Zsidisin, associate professor of management at Bowling Green State University, Bowling Green, Ohio, and co-author of "Supply Chain Risk: A Handbook of Assessment, Management and Performance." "Not every product or process should have a just-in-time system set up," he says.

More complex strategies include building in redundancy and flexibility. The resulting ability to quickly match supply and demand not only helps a company pick itself up after a disruption but also to quickly jump on fickle customer tastes. "If we build in flexibility, it means by and large we not only are able to respond to disruption, we also are able to respond to market changes. This is where competitive advantage lies," Dr. Sheffi of MIT says.

Companies that really take risk management seriously consider the supply chain right from the design stage of the product or process. Early supplier involvement can reduce the overall product development cycle time," Dr. Zsidisin says. Companies have been on a cost-cutting spree, but many mistook low price for low cost. Not all costs — including those associated with risk — were captured. "We are starting to see a shift away from lowest price toward looking at suppliers that supply the best value to your firm," he says.

This collaboration with suppliers also allows companies to know early when a supplier is having trouble. There might be labor unrest at one of their suppliers, or a shortage of materials farther down the chain. "Maybe their managers won't tell you, but if your engineers are talking with their engineers, it's likely to come up. That gives you time to take action," Dr. Zsidisin says. "And if you have trouble, a collaborating supplier may go out of its way to help you."

In protecting the supply chain from unexpected risks, successful companies also allow their people close to the disruption to take action. "The front line is where the disruptions happen," says Dr. Sheffi of MIT. "In a disruption, the usual rules don't apply. First, you don't have time. Second, there's confusion from a lack of communications and information. You have to fall back on the general corporate culture and act quickly."

A culture of empowerment allows managers and even line workers to take corrective action on the spot. To actually make this happen, employees have to be assured that "if they did it with the best information available at that time, they won't be punished," Dr. Sheffi says.

How well a company protects its supply chain from risk is a measure of its overall performance, says Mr. Hughes of Future Purchasing. "If you're not doing sourcing properly, then you don't have operational excellence embedded in your day-to-day management. Either you have risk under control and are giving it the attention it needs, or you're ignoring it and hoping for the best. It goes right to the DNA of the organization."

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