Insights

Willis

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SUPPLY CHAIN DISRUPTIONS

When Just-in-Time is Not Enough

Just-in-time manufacturing processes, single suppliers and other "lean" techniques may help you strip costs out of the supply chain, increase productivity and improve profit margins, but they're also making your company vulnerable to unexpected supply chain disruptions. And that can be catastrophic to your future.

When a Philips chip manufacturing facility was destroyed by fire, cellular phone giants Nokia and Ericsson lost an important link in their supply chains. How the two companies responded has become a classic example of what works and what doesn't in managing disruption risk. According to a BusinessWeek article, Nokia was able to meet its production goals and even boost its market share substantially. Ericsson posted a nearly $1.7 billion loss for the year, and ultimately had to outsource its cellular handset manufacturing business to another firm.

As this example illustrates, supply-chain disruptions can have a profound impact not only on your manufacturing operations but on your market share and future as a business. The risks of disruption, including your ability to meet contractual commitments, have been escalating as companies wring costs out of their supply chains. Just-in-time inventory management, "lean" manufacturing and preferred supplier relationships may remove costly redundancies, but redundancies actually provide some margin for error. It's important to balance risk with cost savings.

Additionally, manufacturers rely on supplies from around the globe, so variables like bad weather or political unrest in some distant country could lock down ports, ground planes or halt production of critical components. Unforeseen and intangible risks – like changes in regulations or currency exchange rate volatility – can tie up deliveries as well. All these variables can impact simple, local supply-value chains as much as the big multinationals. As such, it may be time to reevaluate your entire supply-chain – from critical processes and equipment to manufacturing and warehousing sites, and from technology to transit, distribution and storage.

Successful trade in the 21st century will be more focused on reliability because technology and globalization have increased access to and competition for suppliers and customers. Failing to deliver products and services on a timely basis could have a huge impact on earnings. That's why planning the right set of preventative and contingency measures to protect your operation from extended interruption has never been more important.

Five Ways to Protect Your Business Against Supply Chain Disruptions

1: BIA Plan/Supply Chain Mapping

To fully address senior management concerns about supply chain disruptions – and to understand how much insurance you may need – it's important to accurately assess the financial risk and costs of disruption. A business impact analysis followed by a business continuity plan tailored to your particular business is essential. One key tool of this effort is supply chain mapping, which enables you to understand the more complex national and international interdependencies you're dealing with, the hazards and risk levels, and your agility to shift processes. With such mapping, you'll not only be able to visualize the supply chain, but improve supply chain knowledge and collaboration among your key managers and departments.

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2: Sourcing/Distribution/Financing Options

Many companies spend a lot of time working with their top 10 suppliers and top distributors to drive out cost, but often pay little attention to remaining vendors or alternative sources. In an interconnected world, where vendor location has a big impact on your ability to deliver the goods, it's wise to cultivate secondary sources to turn to when primary sources are disrupted.

3: Professional Business Continuity Support

Consider enterprise risk management experts, forensic accountants and business continuity consultants who can provide expertise outside the traditional risk management skill set. They have specialized knowledge that can help develop a comprehensive and efficient continuity plan that addresses tangible and intangible variables like pricing and volumetric risk.

4: Insurance

Underwriters won't often provide blanket coverage arising from supplier losses, because it's difficult to understand and quantify. But innovative insurance options are available and it's important to discuss these with your insurance professional. Consider Trade Disruption Insurance (TDI), a hybrid product, which focuses on the consequential loss potential – a loss of earnings, extra expenses, and contractual penalties – incurred from trade flow delays or disruptions. TDI does not require a direct physical loss to the goods or conveyances that you find in standard business interruption coverage.

5: Manage Expectations

The process flow that produces your products and services – seemingly effortless to your customer – is always much longer, more complex, and riskier than understood from the outside. Smart companies create supply chains that are agile, adaptable and aligned so they can respond to sudden and unexpected changes. This may include carefully segmenting your products and product lines in order to understand which ones are more time-sensitive and critical than others. It's quite possible that, in a volatile world, marketing your reliable and agile business continuity capabilities can give you a competitive advantage.

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"A Case for Fatter Supply Chains," Marie Leone, CFO.com, February 9, 2006

"Just-in-Time to Just-in-Case: Managing A Supply Chain in Uncertain Times," Charla Griffy-Brown, Graziadio Business Report, Pepperdine University, 2003, Volume 6, Issue 2

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Quick Facts

- Companies experiencing supply chain disruptions suffer 33-40 percent lower share-price returns than industry and general-market benchmarks. Share price volatility was 13.5 percent higher in these companies in the year following a disruption than in the prior year.[1]
- 80 percent of 180 companies surveyed experienced supply disruptions within the past 24 months, and more than 75 percent of the participants expect supply risk to increase over the next three years due to "supply market instability, new regulatory requirements, natural disasters, and terrorism attacks." [2]
- Companies reported an average 12.9 supply disruptions or outages during the past year, with poor quality or damaged goods being the most often cited problem (50 percent), followed by missed or late deliveries (49 percent), unexpected increases in supply costs (47 percent), longer lead times (33 percent), and supply capacity constraints (32 percent.)[2]

Sources for Quick Facts:

[1] "The Effect of Supply Chain Disruptions on Long-term Shareholder Value, Profitability, and Share Price Volatility," Kevin Hendricks and Vinod Singhal, June 2005.

[2] "The Supply Risk Management Benchmark Report," the Aberdeen Group.

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