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A Changing World Poses New Risks for Supply Chains

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ISG WHITE PAPER

INTRODUCTION

Supply Chain professionals have traditionally addressed supply chain risks as part of their due diligence process when identifying and qualifying potential suppliers. This approach has served them well in the past when extreme events were less frequent and the consequences of such events were less immediate and far-reaching.

Today, with clusters of suppliers located in specific regions to gain operational efficiencies and information flowing in real time, a new dimension to risk has evolved and – most companies find themselves in a reactive mode. As companies large and small become less vertically integrated and more dependent on third party suppliers, the nature of supply chain risk management has changed dramatically, requiring new approaches to designing and implementing risk mitigation strategies.

This ISG white paper examines how the nature of supply chain risks faced by business organizations is changing, and outlines elements of a strategy designed to effectively assess and mitigate risk in a dynamic and inter-dependent global economy.

EVOLVING FACTORS

Supply Chain Velocity: Virtually all aspects of supply chain now operate in a high velocity mode. Orders are placed to manufacturers in real time using point of sales systems. Packages are tracked real time from point of origin to point of delivery. Service providers schedule resources based on predictive models. All these processes assume no disruption in order to achieve optimum efficiency, lowest cost and customer satisfaction.

Any delay in processes or in the pipeline, due to any reason (bad material, manufacturing defects, transportation delays, etc.) affects the final output.

This increased velocity has allowed companies to take pockets of inventory out of the system. Previously, companies had different amounts of inventory throughout their processes, warehouses, in transit etc. Today, lean manufacturing processes and Just In Time (JIT) production methods have eliminated these pockets of inventory. As a result, any delay in processes or in the pipeline, due to any reason (bad material, manufacturing defects, transportation delays, etc.) affects the final output. Services face similar increased risks as optimum staffing models cannot respond quickly to customer demand in the event of a risk occurrence or a disaster.

The advent of social media has changed everything.

Rapid Access to Information and Speed of Communication: A related game-changing issue is the unprecedented speed and ease of access to information, coupled with the exponential growth of communication channels. Traditionally, public opinion was developed through shared personal experiences and through the public media; as a result, the needle of public opinion generally moved at a relatively slow pace. The advent of social media changed everything. Now public opinion of a company can be shaped or altered almost immediately on the global landscape by a single influencer. An event can happen anywhere and any individual with internet access and either a laptop or smartphone can state an opinion – supported by photos and videos– regarding your product or service. Put simply, bad news – whether true or not – travels fast, far and wide, and one bad product or one less than acceptable service interaction can spark a public relations and reputational crisis for businesses ranging from hotels to insurance companies to manufacturers to restaurants. Similarly, price volatility becomes increasingly risky, as markets respond immediately to changes in demand or preference.

Ubiquity of Risks: The range of risks faced by any enterprise has increased in type, frequency and impact. Organizations have to worry about weather, terrorism, cyber attacks, crime, disease and other factors. In many cases, the triggers to risk can be as simple as a single individual with criminal intent and/or poor judgment. As a result, supply chain executives who attempt to track and address discrete risks on a one-off basis quickly end up like the circus performer struggling to keep multiple plates spinning on poles.

Concentration of Suppliers: The increasing specialization of service providers has led to geographic concentrations of suppliers in certain functional areas. In locations such as the Philippines and Cost Rica, for example, customer call centers proliferate. While this allows businesses to leverage the language skills and specialized expertise of workers in those countries, centralizing critical services in one geographic area increases exposure to risk.

Political Unrest: An increasingly globalized and integrated economy, characterized by critical suppliers in disparate geographic regions, by definition increases risk from social and economic unrest, since any hot spot of social or political turmoil is likely to represent a link of some kind in an organization's supply chain.

Regulatory Risks: Monitoring regulatory conditions in all countries where outsourced operations are located is critical. Changes in regulatory mandates regarding labor, environmental safety and impact, intellectual property, taxes and other factors are all central to the economic viability and sustainability of an outsourcing initiative.

If products are involved, duties and logistics also need to be monitored for negative impacts. (For additional information on this specific topic, download an ISG white paper on regulatory compliance).

Intellectual Property: Any company that outsources critical processes to a third party is frequently required to pass on intellectual property to that provider in order to successfully execute that process. In the United States, intellectual property can be protected by either patents or copyright. These means of protection provide the authors/originators with legal rights of ownership. In most advanced countries, the judicial systems provide the mean of recourse against those violators of owners' rights.

Different countries have different terms related to the various types of ownership protection they provide, and companies have to understand the legal systems where their suppliers reside – including the degree of oversight and enforcement – to ensure adequate protection of their intellectual property.

A NEW APPROACH TO RISK

Global businesses today need to develop a fundamentally new approach to assess, prepare for and mitigate these risks.

In today's global business environment, supply chain management risks are increasingly urgent, ubiquitous and multi-faceted. Risks can come seemingly from any source at any moment, with significant and lasting consequences for a business. A seemingly innocuous event in a remote corner of the world can quickly cascade throughout an enterprise. Deeply integrated teams of multi-tiered providers are increasingly vulnerable to breakdowns at any point in the delivery chain.

In light of these challenges, global businesses today need to develop a fundamentally new approach to assess, prepare for and mitigate these risks. Key elements of such a strategy include:

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1. A “dashboard” approach to assessing the global landscape. Businesses need tools to keep a bird’s eye view on the global landscape, and keep track of multiple risk areas – be they related to terrorist threats, weather events or crime trends. The dashboards need to be integrated to processes that escalate responses and readiness to heightened risks in any particular area.

2. A clearly defined supplier management strategy characterized by stringent and frequent audits of suppliers. This oversight is essential as companies continue to outsource critical internal and customer-facing processes to third-party providers. Specific components of this strategy should include:

   - Visibility into what suppliers are responsible for what tasks, as well as what responsibilities sub-contractors are taking on that the business may not be aware of.

   - Defined processes and actions to take in the event of a supply chain risk – who does what to contain the risk and mitigate the damage, who is notified when, who is responsible, and so forth.

Businesses also need to view supply chain risk management as an ongoing process.

3. Businesses also need to view supply chain risk management as an ongoing process – not a one-and-done exercise. Typically, enterprises focus effort on due diligence and financial and capabilities analyses early in the process of sourcing and contracting with suppliers. However, with today’s three-year contracts with one-year options, all the data collected at the outset of a relationship has a limited shelf life, and three to six months in, those early days assessments are outdated – and of little use when a potential crisis arises.

4. Over the short term, businesses need to assess their environment and identify their top priorities in terms of where the risks lie and where the immediate solutions can be found and how they can be implemented. Over the long term, they need to move away from viewing supply chain risk management as a tactical exercise that addresses discrete problems when they arise, to a holistic view that assesses interrelationships between and within suppliers, as well as the cause and effect linkages throughout the supply chain.

5. A key characteristic of this holistic perspective is the standardization of reporting and taxonomies around supply chain risk management and governance. Today, however, the onus of defining mandates generally falls on the client – the result is a hodgepodge of processes and frameworks that accommodates each client, to the detriment of all. Service providers have a significant opportunity here to proactively drive standardization, and many clients would welcome providers who came to them and said, “Here’s the standard way of doing things.”

While business organizations can’t guarantee that a crisis of some sort will not occur within their supply chains, a well-managed supply chain and a sound risk mitigation strategy can help a business prepare and limit the damage when a risk event occurs.

ABOUT ISG

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