



Risk Management Professional – Roundtable discussion Supply chains

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Cracknell: For me, supply chain risk is a wide-ranging subject, but there are three aspects; supply chains, supply chain management and supply chain risk management, and ideally they should be integrated.

Agg: I've been in logistics and supply chain all of my working life and I was disappointed when the 'supply chains' phrase was adopted; I prefer 'supply tube', as links in a chain imply weaknesses. Anyone who is employed and does any meaningful work is involved in the supply chain.

A recent example of risk complexity is the Boeing Dreamliner. Boeing saw outsourcing as the means of spreading risk and development costs, as well as spreading employment and engagement with potential customers. But the complexities involved in manufacturing parts all over the world and not being able to control the supply chain added to the risk and delayed the project. So opportunity can quickly transform into a negative.

Howard: But outsourcing isn't an abdication of risk; you still need to control your supply chains. Your 'invisible' subcontractors are those who could have an impact; while you probably know the people who you deal with, you don't know the ones who deliver to their particular operations.

Wall: I take the point on 'supply tubes', but in the right context 'supply chains' conjures up a useful image. It shows that certain things have to happen at a certain time to deliver to the customer. Many functions within a supply chain benefit from flexibility or additional capacity, which can absorb disruptions within the chain with the end customer being unaware of any problem. So 'supply chain' is a useful term enabling you to identify key suppliers within the business process, both internal and external.

Jolly: In the finance sector there is significant focus on third parties. Supply chains are a necessary part of today's world, and part of risk mitigation. However, at the end of the day the owner of the relationship maintains accountability for risk.

Searle: Outsourcing is very much a choice and often attracts that phrase 'value added'. In some cases a company will conclude 'that's not our core activity', and supply chain management lends itself to such decisions.

It's a brave decision to move away from undertaking supply chain management in-house, and then to an extent turn your back on the issues. The more successful companies haven't entirely done so. They've decided 'this is an activity I don't want to be involved with, but I understand the risks and I'll work with the supplier to create something to add value'.

Devoy: My organisation has a large upstream operation, so focuses on supply chains and key components. In the past couple of years we've devoted more time to supplier relationships. So probably we've not been too scientific about supply chains *per se*, but understanding more about what the supplier does and the issues they face in bringing a product or service to market. Then debating with them the key issues – and potential 'kinks' – in that chain.

We started a programme last year, which focuses heavily on supply chain analysis but not in huge detail – rather getting an overview of key issues and breaking the supply chain into two main areas. These are what the key characteristics of each supply chain are and how we use it specifically; then looking at the inherent risks of that chain. We aim for a balance between these aspects in assessing risk.

Vulnerability

Cracknell: That brings us to supply chain vulnerability. One issue that comes to the fore in recession is the insolvency of organisations. I know of a building products company where 14 significant suppliers went bust, yet it survived through its risk management techniques and carried on business without major interruption. What's Ace's take on vulnerability?

Wall: Last year we carried out research with the Economist Intelligence Unit. We asked around 500 senior executives of global companies in Europe, Asia and North America what they regarded as key factors affecting exposures within their supply chains. One finding was that recession-related

Chairman:		Panel:				
						
Tim Cracknell partner, Jardine Lloyd Thompson and IRM deputy chairman	Steve Agg CEO, Chartered Institute of Logistics & Transport UK	Kevin Devoy manager, procurement and supplier management, Centrica	Paul Howard head of group insurance and risk management, J Sainsbury and chairman of AIRMIC	Adrian Jolly senior risk and business continuity manager IFDS Group	Ian Searle vice president, risk management - emerging markets, Deutsche Post/DHL	Phil Wall senior account engineer, ACE European Group

issues were front of the queue, replacing operational issues, which emerged as key in a similar survey 24 months earlier. So things like unpredictability of demand – which 62% said had become a main issue – exchange rate changes (59%), energy price volatility (51%), and insolvency of suppliers (39%) were top.

We asked about the ability of management teams to cope with these new threats. Over 50% felt their executives and board members were aware of emerging risks, but not doing enough to combat them.

A high proportion had been able to negotiate lower prices from suppliers. But what are the consequences of this pressure on costs? We see companies cutting corners, running their equipment harder, faster and longer than before and cost-cutting to a level where they can compete and win contracts. Another trend has been to outsource to cheaper parts of the world and move into new territories, whose approach to loss prevention may be less well understood, and also exposing their business operations to new natural hazards.

Howard: In the wider context of risk management, there's an upside to outsourcing which counters the negativity. It's a global market, so organisations seek to bring together their best efficiencies. They may change their margins somewhat. They'll have a certain amount of fixed costs; once covered they can move their prices around. It doesn't necessarily have to involve lowering standards, and companies may win more business if they can be more nimble.

Jolly: The reason for outsourcing is that you're going to centres of excellence. By using a group within that particular sector that does its job well you're almost assuring a better service for clients.

Wall: Nevertheless, there's evidence that some companies are reducing loss prevention budgets and restructuring supply chains to remain competitive – not necessarily improve quality of service. The company you outsource to may avoid investing in installing automatic sprinklers at their main distribution centre. So they may make a short-term decision that they will take that risk.

Howard: Cost is an example, but not the only one. For instance, with clothing you can secure cheap sources of supply provided you don't look too closely at the integrity of their supply chain, or whether they employ child labour.

However, if you want to protect your brand values and maintain the integrity of the organisation you may opt to pay a little more – cost isn't always inevitably a factor.

Agg: But it is in modern times. Once we considered cost and service, but efficacy and environmental issues have become a major factor. Another issue which the recession has brought out is capability. Can you get the right people with the right skills for the job? Transferring to centres of excellence, and to people who know what they're doing – providing a superior level of service – is a positive step.

Devoy: My group's downstream activities have outsourced more over the past five years, as have most companies. That's spurred us to look more closely at how we manage those contracts going forward, and develop process and methodology to identify and manage risk.

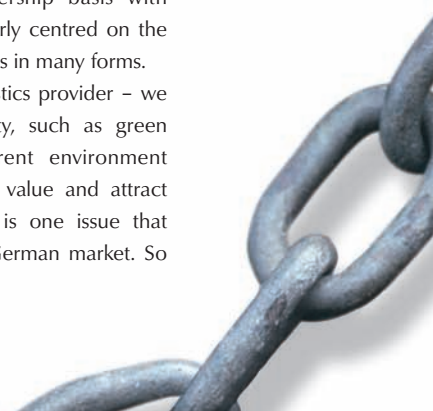
We've also realised that different streams of work activities within our business are related; corporate responsibility, business continuity planning and our supplier risk programme. We've thought hard about how we bring these different strands of work together, to optimise the streams of market intelligence information as well as the ongoing interactions with our suppliers, particularly around the audit process.

That's what the recession and other elements have brought to the party – a more co-ordinated approach to supply chain risk rather than carrying out activities in silos.

Searle: We're working on a partnership basis with customers and see vulnerability particularly centred on the economy. However, "adding value" comes in many forms.

DHL has a key differentiator as a logistics provider – we looked at corporate social responsibility, such as green issues, and realised that in the current environment there isn't much to create shareholder value and attract interest. Corporate social responsibility is one issue that does, particularly in the parent's large German market. So

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we focus on the upside and engage with people who act responsibly – although whether customers are ready to pay for it is a separate issue.

Chain of Events

© **Cracknell:** Moving from vulnerability to experience of real incidents; mundane events can interrupt supply chains. To reference an old JLT case study: we were involved with a downstream technology giant in the Nordic region and looked at the consequences of a lightning strike and minor fire at Philips' computer chip plant in New Mexico.

“We’re learning as we go and it’s a rapidly changing market from a supply chain perspective”

It caused a major issue in the insurance market. The financial consequences were huge and were a catalyst in the way supply chain issues are considered, particularly the wisdom of putting your eggs in one basket.

Searle: Many seemingly small events develop into major supply chain issues. In the UK there are frequent cases of vehicle hijackings that don't reach the public profile. The guy who has 92 separate staged and fraudulent motor accidents makes News at Ten, but not regular incidents where thieves rip open the sides of vehicles to steal mobiles.

The task for risk managers is to take on board this information and spot similar weaknesses in their businesses.

Howard: The point is to learn from these lessons and ensure they are well publicised, because sometimes you get sidestepped into 'business as usual' mode. There are many examples you can use that really make a difference; people then ask 'could it happen here?'

Searle: Attacks by Somalian pirates are an example, and one that has quickly morphed. No longer is it just a rag bag collection of individuals with guns. They now access intelligence and ransoms are being paid. That fuels the fire and they seek better targets – individuals, oil companies, even governments who they know are likely to pay ransoms.

Cracknell: It's good to talk about such incidents and the positive effects. Too often risk management is regarded in a negatively. If we show the good effects and give it a positive spin, the discipline will have greater mainstream appeal.

Wall: I previously worked in the pulp and paper industry, which was closing plants in Western Europe and buying existing ones in Eastern Europe to reduce costs. There was a rush to buy these factories, but management didn't always realise the loss prevention and cultural issues they were

also buying into. One more example; a major warehouse fire affected one of the country's major retailers, caused by problems associated in the control of aerosols.

Howard: That last example also led to new standards being set for aerosol protection though; so while painful for the company, the incident led to advantages for the industry.

Wall: We're learning as we go and it's a rapidly changing market from a supply chain perspective. Many emerging risks are coming through; the question is can we recognise them quickly enough before they cause a major loss? Ace strives to use our loss prevention services to help customers identify these potential exposures and avoid damaging losses.

Searle: There was a big reaction – and it took a long time to bottom out – by companies on the issue of composite panels. Supply chains faced huge additional costs to remedy 'defects', yet they couldn't raise additional funds from customers. It took years to resolve as there were so many conflicting opinions. It involved a huge amount of money and insurance companies were pivotal.

Howard: There was a knee-jerk reaction initially, which was 'we won't cover this' until it became clear that would take out the entire food industry. So the view became 'let's take a look at this and how people are actually managing it – what housekeeping standards could make an acceptable risk?'

Agg: The difference now is that inventory is focused in a smaller number of mega warehouses, with more just-in-time deliveries, which has changed the risk. The trend has been driven by the retail sector to drive down costs. This has brought with it incidents such as Asos's problems at Buncefield. So while we might learn lessons, they can often be lost over time as cost pressures re-emerge.

The Benefits of Effective Risk Management

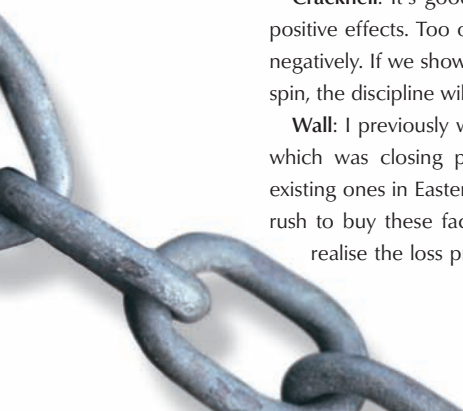
Cracknell: Perhaps not enough is done to publicise the positive aspects of effective risk management, as it goes against what is regarded as newsworthy.

Jolly: Without commenting on specific cases, the impact of this has generally been positive, though. It has made us look more closely at our third parties and understand how their impact, although I agree lessons learned can soon be lost again. Our role is to ensure that it stays top of peoples' agendas.

Cracknell: Maybe we need more British risk management-related standards, so companies raise their game.

Wall: Although Ace has seen a trend of cutting budgets allocated to security and maintenance staff. Yet many losses come from kids breaking into unoccupied sites and setting fire to combustibles stored close to buildings. That's a regular loss event – a simple one, but nonetheless problematic.

Cracknell: So what are the key challenges going forward? Supply chain studies JLT carries out with clients show that a major difficulty – particularly FTSE 100/FTSE 250 companies – is getting the right people to address the issues.



Jolly: A key challenge lies in understanding the supply chain from both an upstream and a downstream perspective, and the impact on you as a company. Does that service involve data confidentiality and integrity issues?

From understanding the impact of the chain, then work out how you manage and mitigate risks. What levels of due diligence do you want? What's your risk appetite? What business continuity plans do you have, and what do you expect your suppliers to have? When you've contracted to a supplier, who has he outsourced to in turn?

Agg: The fundamental word is 'communication'. Do I know whether my supplier has problems? Will he tell me? This brings in trust issues. Availability of information – which, for example, allows Sainsbury's to see over Heinz's supply chain – means greater supply chain visibility.

Howard: On another point, in carrying out a scenario analysis how many 'stupid' things do you consider? For example, would you have imagined the Gate Gourmet episode having such an impact on BA?

Cracknell: Should we then have greater tolerance to events such as snowfall, fuel shortages and pandemics?

Howard: Again it comes down to communication. We're in the media age so there are regular 24-hour reports on such events. Anyone with a camera phone can take pictures – so a fuel queue immediately gets publicised.

“Do I know whether my supplier has problems. Will he tell me? This brings in trust issues”

Cracknell: It sounds as though Centrica has a good process in place for understanding and assessing risk, and a mapping process as well. Has that been powerful within the senior management team?

Devoy: The challenge of raising the profile of this issue is still there. We've focused on it in the past year, although we have more work to do. We're setting up a supply governance group to regularly review key risks, and look at how we can exploit synergies and achieve consistency.

The other major challenge is in resourcing. I benchmark with other organisations; in some a lone individual tries to pull everything together, while others have thought more about it and invested in appropriate resource and systems.

Cracknell: We have a software application to enable organisations to track and manage supply chain risks. When a business has blockbuster products with tiered suppliers, the programme comes into its own as it extends across the supply chain, including the so-called 'invisible' supplier, who may

feature in the third tier across several key products.

Agg: Although the point is that they shouldn't be invisible. That's the real weakness.

Devoy: So how to achieve that visibility? At points during the supply lifecycle you have increased leverage, allowing more opportunity to gain information from your partners. Risk can occur – or be identified – at numerous milestones, not just when you sign the contract. Benchmark suppliers in the same category areas; it helps identify differences in the supply chain between suppliers in that category and what potential weaknesses are inherent.

Wall: That approach requires resource and the lead needs to come from the top. The EUI survey found those resources lacking in many organisations – 50% of respondents said they were happy with those available to them, but 50% were not. It's a time-consuming process to map out the supply chain and understand where those critical points are.

Cracknell: A good example is Baxter Healthcare, which had a major problem with the drug Heparin. They took a knock when it emerged that a supplier was producing one component in really poor conditions. This led to a huge amount of publicity when there was a product contamination issue, loss of market share and loss of shareholder value.

Wall: The salmonella contamination that affected Cadbury's is another example. It was a major issue.

Cracknell: Are DHL's clients asking about the supply chain risk and how they can map it?

Searle: We're in a strong position. We know warehousing and transportation isn't core to our customers, so we take on their whole logistics requirement. And communication between customer and supplier is good.

The real challenge is contract governance. In a perfect world the contract should reflect the activity, and we're spending much time and effort in ensuring that loophole is closed. Communication is vital, so everyone takes time to check 'is that what the contract says?'

Cracknell: Does Sainsbury's pay close attention to its supply chain? Or are you not too concerned if one product doesn't make it to the shelves?

Howard: As a retailer we possibly have it easier than, say, the aircraft manufacturer as we don't actually manufacture products – we just buy them in. It comes back to where we get that product from. If, say, Heinz experiences supply problems we're not the only organisation affected. So we look at it slightly differently depending on whether it's an own-brand or a proprietary product. Another difficulty that has arisen is consumers' growing preference for local and regional products.

A key area is in working through partnerships, which requires buyers to determine who your key suppliers are. We expect them to work with us in developing contingency plans. Those suppliers' own suppliers – and so on – are still an issue, but in some areas we're lucky to have a ready source of

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alternative products, or alternative suppliers.

Cracknell: Is Ace seeing an upturn in enquiries about supply chains and are studies being developed?

Wall: Yes, and we have products to help customers analyse their supply chains and identify potential exposures. As a 'top three' issue, awareness at management level is increasing.

Our products include supply chain mapping, and natural hazard reviews for companies that plan to move into new territories and may not understand exposures such as earthquakes they're potentially opening themselves up to. Prequalification visits review loss prevention standards at facilities our customers are considering purchasing.

Howard: The economic environment provides plenty of opportunities for acquisitions that maybe didn't present themselves before. It may appear a cracking purchase on paper, but how well do you carry out due diligence on that particular supply chain? That's an area where not all organisations do a robust enough job.

Wall: We present ourselves as a service, to help clients with that due diligence process. So we'll complete flood studies, look at natural hazards, review the culture towards loss prevention, the human element procedures and how loss prevention is managed on-site – all this hopefully before they sign on the dotted line. It's frustrating when you're asked to review loss prevention standards after the deal is done.

Cracknell: Turning again to communication, what are the cultural issues? As an example, the earthquake in China two years ago saw a lack of information from a supplier with plant in the affected zone. The parent resided outside the range of that earthquake, but the flow of news was particularly poor.

Jolly: Doesn't this come down to supplier management and your relations with them? Are you being diligent in your process of meeting the right people? Do you know who they are and where they are? If so, do you talk to them regularly? It's a case of building up rapport; not just a 'you're working for me' relationship but working together to an end goal.

Agg: Let's say you subcontract manufacturing – you might be well advised to subcontract management of your supply chain too, giving it to someone with specialist knowledge and expertise so you mitigate the risk of cultural issues.

Searle: DHL prides itself on having global representation, and also a disaster relief team – we currently have people on the ground in Haiti. It's good press, but also demonstrates good corporate social responsibility. Not everyone can afford to have representatives in 257 different countries and that's the strength and resilience of the business! You have to be a global player to effectively manage the supply chains of global customers. As mentioned, the more you sub-contract – and your sub-contractors in turn sub-contract – the weaker the chain becomes.

Mitigation

Cracknell: Moving on to mitigation, you can achieve much through risk management, but there's still a remaining degree of exposure. With a blockbuster product, the values at risk are enormous. So in addition to risk management, a business may look to have risk finance or insurance solutions in place.

Howard: I'd question whether insurance offers much of a solution. It provides a backstop for a limited amount of risk, but unless you also risk manage it'll never provide everything you require. Many surveys are issued about risk and, out of the usual 'top ten', no more than a couple are insurable.

So mitigation needs to come from the management side. Better quality decision making comes from organisations that consider risk not just from a risk management perspective.

Cracknell: Insurance is useful to have from the profit and loss viewpoint. You've always got analysts looking over your shoulder, expecting certain returns.

Howard: It's got a part to play, but not a huge one. The key is the reputation of the company – you're looking to manage that as you see fit.

Jolly: It's about understanding the impact to you and what's acceptable to you as a company. By understanding the impact that third party has on you, you can plan which risk mitigation actions you employ – is it through contractual arrangements, contingency planning, due diligence etc?

Cracknell: Could contracts be too loaded in favour of one party? Are risks being counterproductively loaded on those with weaker bargaining positions to the detriment of the larger organisations' supply chain continuity?

Howard: We'd obviously say not. But it comes back to the point that contracts tend to be negotiated, with operating agreements setting out how things will work on the ground. The contract might cover the basic details. The other area you'll look at is counterparty risk. If you're going into different jurisdictions, how will that contract stand up?

Agg: I don't know the maturity level of risk management as regards supply chains, but it seems to be a relatively new topic for senior managers to get involved with. They may look at what would constitute a disaster, but at fewer scenarios that fall short of that. Many companies take the view that they'll look at risks when they have more time.

Searle: We said every employee needs to be a supply chain manager, but they also need to be a risk manager. Risk mapping logs all involved in the supply chain and becomes an audit tool. It ensures continuity of supply through constant refreshing and review.

Health and safety, security; all need to be put on the table as routine issues to be considered. So if breached someone, hopefully, puts their hand up and says 'we don't do that!'

Howard: Provided they know what they should be doing – it's the 'would you do this at home?' approach.

Cracknell: Is sufficient investment made in mitigation?

Devoy: There's always this balance of probability versus the amount of investment put in. My impression is that there hasn't been sufficient. That's not to say that you throw money at it wholesale – one way is working smarter.

Tools, techniques and templates; a toolkit is needed by which companies can assess risk and ensure it is embedded in the governance framework going forward. There's much you can do in increasing peoples' skills to gain that awareness, even at minimal cost.

“Do we spend too much time worrying about major events, at the expense of more likely ones?”

Howard: And you give people the eyes; for example this includes giving them regular briefings on competition law.

Devoy: We've started what we call a 'risk refresher' course, focused on evaluating financial issues. But there are non-financial indicators you can look for and which can be your eyes and ears – such as contract management community and/or business continuity.

It's all down to constant reinforcement and increasing awareness. It's about tracking or reporting where issues have come through and how you deal with them. And it's about consolidating learning into best practice, so if somebody learns to do something right in one part of the business it's shared with others.

Cracknell: Do we spend too much time worrying about major events at the expense of the smaller, more likely ones?

Wall: There's a tendency to look at the largest exposures. On communication, we mentioned the huge task in establishing relationships with vast numbers of suppliers, the suppliers of those suppliers etc. That misses the point. The first task is to identify key players in the supply chain and concentrate on these few individuals and those relationships. Mapping the chain and understanding what can hurt you allows you to concentrate resources on those critical areas.

The Economic Outlook

Cracknell: Turning to the economic outlook, the next few years will see the financial squeeze continue. We can expect regular issue such as strikes affecting the transport systems and there will probably be more bouts of severe weather. You know they'll only last days and we can live with that – but anything more significant will cause problems. What do you see coming up on the horizon?

Devoy: Our sector – and several others – sees continuous commercial pressures on businesses to open up to more

outsourcing, and thus a greater focus on supply chains and how risk is mitigated. The challenge is, from a framework and methodology perspective, to get the supply chain risk agenda hard-coded into their DNA.

Agg: It's not just the big things that happen infrequently, it's also small everyday things such as congestion. There's a danger that under constant pressure, cutbacks in public funding and poor investment – because there won't be much available for maintenance – the basic infrastructure we rely on will deteriorate badly. If and when we pull ourselves out of recession this could crumble even more quickly.

Howard: Another issue with significant impact – and which could prove revolutionary in managing risk and supply chains – is the use of open source software. We haven't even begun to contemplate the potential issues that could emerge from using some of these shareware solutions.

Jolly: Outsourcing will increase because it cuts costs and mitigates risk on multiple levels. But it will be subject to greater scrutiny than before due to recent events.

The key is that word 'culture'. I agree we should all be risk managers in understanding what risk is, its impact and ensuring you have the required governance, so those accountable for the service understand when risk may be realised.

Wall: Protectionism is another issue we hear about with increasingly. If you're a global company, there are potential exposures caused by countries battering down the hatches to help local businesses. The G20 has set out anti-protectionist guidelines, although a recent survey by Global Trade Alert identified that many members break them almost daily.

There's also fuel price volatility. Every \$50 on a barrel of oil can impact the bottom line by about 3%. Predictability of demand – will we face a double dip recession, or just grind along with limited economic growth for some time? People don't know what the demand for their products will be; this has huge implications for decisions taken to re-engineer supply chains.

Searle: And they are ultimately driven by customer spend. If that stops there will be a decline in demand for the supply chain. So much depends on how global economies develop or stall.

Cracknell: So, in summary, supply chains are getting more complex but by good risk management, organisations will get through, and in particular if we can build supply chain resilience 'into the DNA' and embed this whole process into the local framework. Culture, collaboration and building relationships are important, as are communications although where protectionism arises, this threatens to slow things down.

Overall, we have to recognise that a host of issues must be dealt with simultaneously if we are really going to manage our supply chains effectively. ■

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