

## Maintaining Supply Chain Stability

### Executive summary

The signs are that the economy is improving, but the after-effects of the global economic downturn are still with us. Many companies cut their resources during the hard times and are now operating on thin margins, raising the risk of financial problems and, in the worst cases, being forced out of business.

In a survey of grassroots opinion carried out by Efficio recently we discovered that instability in supply chains was a serious cause of concern among many procurement professionals.

Such instability can cause massive disruption, and in these uncertain times it seems likely this will remain a substantial challenge. In this Viewpoint we examine the problem of supply chain instability and suggest some ways to deal with it.

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### Background

Many companies were inevitably forced out of business in the recent worldwide recession as demand for goods and services fell. The global economy now appears on a better footing but certain problems remain. During the recession, as margins declined, businesses typically reduced investment in plant and human resources, with the consequence that their economic strength was reduced.

This has made many such companies more vulnerable to external economic factors and consequently less reliable as suppliers. The question for procurement professionals who rely on robust suppliers is how to protect their companies from this kind of risk.

### Effects of supplier instability

The kind of financial difficulties many supplier companies face in the current economic climate can create operational challenges leading to, for example, sudden headcount reductions, loss of key personnel, damage to morale, or even bankruptcy leading to disruptions along the supply chain.

Purchasing organisations faced with this kind of disruption can expect to suffer problems which may include interrupted deliveries, reductions in the service level, a loss of guarantees and fluctuating quality levels.

In the worst cases, a supplier may face insuperable challenges and be forced to go out of business, leaving the purchasing organisation with a crisis caused by a sudden gap in the supply chain.

## **Strategies to deal with instability**

There are several strategies to reduce the risks posed by unstable supply chains. All may seem obvious, but it is surprising how many otherwise well-run companies fail to take even the simplest steps to protect themselves.

Every supplier in your supply chain is vital to your organisation's efficient running. So it appears logical that attention must be paid to ensuring that every supply is robust. However, this may be counter-productive. It is not uncommon to come across companies where the prospect of monitoring every supplier is so daunting that, in practice, no monitoring is carried out at all.

The best strategy for dealing with instability, as always, is to try and reduce the risk of a crisis occurring in the first place. Once a supplier has entered a critical phase or, worse still, gone out of business, the price you must pay to redeem the situation is high. Literally so: it is likely you will face a seller's market saturated with other players like you who must sign up a new supplier as quickly as possible. Suppliers in this market are in a strong position and able to call the shots over price and contractual terms and conditions.

First it is essential to understand which categories in your business are the most sensitive to supply chain risk. Using Krajlic's quadrant, it is a simple exercise to identify such categories: they are the ones most critical to your organisation's viability and most difficult to substitute in the marketplace.

Within these categories, consider which suppliers are the most potentially vulnerable. Identify those which present the highest risk -- they might account for perhaps 10 per cent of the total -- and focus on them. These are the companies most likely to face financial problems and therefore cause you the biggest potential damage.

Such suppliers are unlikely to found in an industry sector comprising a small number of well-established, large and profitable companies. They are the least likely to face problems and therefore warrant less attention than those in a fragmented sector made up of small players with low margins. These might include, for example, printers, engineering companies or small IT service providers.

Monitoring the financial and organisational health of these suppliers is a matter of collecting information. Incumbent suppliers may be willing to help with this, because they are likely to want to cooperate to keep your business. It is reasonable to ask for quarterly reports on turnover which will quickly reveal any problems caused by, for example, the loss of a major customer. Similarly, your supplier may agree to notify you of any changes in key personnel.

Credit checks are very easily accessed from the established providers of these services. And, importantly, informal communication channels may prove extremely useful in gaining this kind of information: talk to your suppliers' salespeople.

Finally, it is essential to ensure that you have alternative suppliers in case of a looming crisis. Prequalifying and maintaining a small number of extra suppliers need not be a big investment. A small spend can be allocated to the alternative vendors to maintain their interest in your business.

It may be effective to utilise a supplier already serving some other category or identify and activate alternative vendors during a strategic sourcing initiative: second place bidders are the natural candidates.

**A report on the full results of the Efficio *Grassroots Procurement Survey* is due to be published in early March 2011.**