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The Hidden Risks in the Supply Chain

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On reading the title of this article, one might assume it refers to 2nd, 3rd or even 4th tier suppliers in our ever expanding, global supply chains. In a way, this assumption is not far from the truth, as a supply chain, to adopt an overused expression, is only as strong as its weakest link.

Globalisation has created complex supply chains, requiring diligent collaborative management of the numerous contributors and partners: from the actual sales process to final acceptance, procurement, distribution, fulfilment and final payment. Managing supply chain risks has always been a serious and comprehensive matter as it involves financial risks, which letters of credit aim to reduce, as well as physical risks, involving global logistics and product quality and quantity issues. Events such as the tsunami in Japan, the fallout from the Eyjafjallajökull ash cloud and most recently the Grimsvötn eruption have prompted business leaders around the world to weigh financial risks more carefully and avoid direct impacts on inventories and order fulfilment.

On the financial side, the risks involve cancelled orders, non-payment for delayed inventory, immediate shortfall in cash flow, etc. while on the physical, or logistics, side, they involve cargo delays, loss of market or brand confidence, to name but a few. Buffer stock, alternative suppliers and supply chain visibility are successful measures to counter cancelled orders, maintain brand integrity and keep supply chains fluid.

Supply chains are increasingly in the spotlight and as such under scrutiny in the areas of cost cutting, efficiency optimisation and risk mitigation. In some industries, for example retail, supply chain costs are the single largest expense to the business, so naturally, managing and mitigating as many risks as possible is a top priority. According to a 2009 Economist Intelligence Unit survey of 500 executives responsible for risk management, “Among most respondents, supply chain risk management is a strategically important issue – more than one-half say it merits high or very high priority at board level in their organisation”[1].

Managing risks means identifying them in the first place and employing best-in-class visibility tools with bespoke key performance indicators (KPIs) and event management, reporting exceptions back to 3rd and 4th tier suppliers. Complex supply chains often involve multiple levels of suppliers and logistics providers. As such, it is important that companies have processes in place to ensure visibility throughout their entire supply chain including auditing quality, quantity and financials. There is no point buying or selling to a company that either can’t perform or is on a financial tightrope and may collapse mid-contract. Unfortunately, with global supply chains, these obvious measures are sometimes not executed with the same vigour and flexibility as domestic trades and the consequences of apathy can be disastrous.

One of the key challenges for executives is how to process and understand the vast amount of real-time information required for effective management of their supply chains. In a 2010 study, 91% of supply chain managers were found to be using spreadsheets to keep track of changes across their companies’ supply chains rather than using automated methods[2]. It is clear that such manual processes are no longer appropriate in a business environment where accurate and timely

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[1] “Managing supply chain risk for reward”, The Economist Business Unit Limited, 2009
[2] ”Supply Chain Information: The Weakest Link?”, Dynamic Markets Limited, 2010

information about the supply chain is a key to mitigating risk. The UK-based standards and solutions organisation GS1 estimates that UK grocery retailers and suppliers can realise savings of £1bn over five years, provided they can achieve accurate supply chain data[3].

Best-in-class methods, including supply chain execution and visibility software, can automate various risk mitigation processes. When combined with supply chain insurance, such risk management measures can result in significant benefits in the area of, for example, funding because financial institutions are able to embrace this level of security with risk-weighted loans, in some cases without recourse. This enables global traders to offset the cost of supply chains without leveraging their balance sheets as collateral.

If we now go back to the opening statement that most risks are spread between 2nd, 3rd and 4th tier suppliers within global supply chains, it is obvious that a best-in-class risk mitigation management can create real-time and comprehensive visibility. Integrating the various partners and geographical sites along with bespoke milestones and processes, provides transparency and control of inventory in-transit, greater value in buffer stock management, improved stock turnover, and thus increased cash flow and better usage of working capital. In reality it is the control and flow of information that mitigates risks, strengthens global supply chains and reduces costs. So, what are the truly hidden risks?

Well, hidden may be a moot point, but if we look at the creative processes that start a supply chain, the risks begin right there and, as small as they seem in the beginning, the consequence of "taking one's eye off the ball" can be catastrophic. The flowchart below illustrates various functions that constitute a commercial transaction, and while the closing of a deal is the start of any commercial process, it is also one of the key points where an entire sequence of "hidden risks" can start. For example, prospecting and marketing may lead to a request for quotation, which is clearly the focus of the effort, but very little emphasis is usually on analysing prospects, their suitability, the efforts and risks involved in potential projects and essential comprehensive pre-market checks. How frequent are communication flows between buyer and vendor, what do they constitute, how many stakeholders or personnel are playing an active role in executing this or any potential transaction? These seem to be common sense questions, but each time a corporation amends or edits a file, quote, spreadsheet or calculation, it also presents an opportunity for error and introduces unknowns along with accompanying risks.

[3] "Data Crunch Report: The Impacts of Bad Data on Profits and Consumer Service in the UK Grocery Industry", GS1, October 2009

Supply Chain Risk Analysis

Preshipment	Task	Risks
Tender Enquiry	RFQ	First Check: Incorrect Calculations, Product Information, Quotas, Language, Terms, Legality, Currency, Counter Parties
Order/Pro-forma	Order Entry	L/C Conformity, Quantity, Lead Times, Inventory, Product Numbers, Batch Numbers, Item Numbers, HazMat, KYC
Order Status	Order Confirmation	Confirm RFQ, Values, Stock Availability, Logistics Information, KYC, Letter of Credit Status, Customs Regulation, Incoterms, Credit Limits
Packing and Export Preparation	Picking	Security, Airfreight/Seafreight, Incorrect Pick, Packaging, Barcoding, Carrier Nomination, Content, Address Details, Labelling, NES
Packing List/Manifest	Loading	Incorrect Consignees, Weight/Volume, Pallets, Labels
Carrier Management	Transport	Incorrect Carrier, Documentation, Weight/Volume, Manifest, Customs Documentation
Broker and Warehouse Facility	Goods In	Inbound Customs, NCTS, Deferment, SKUs, WMS
Document Correlation	Invoices	Incorrect Invoices, Weights, Forex, Vat/Duty,Freight Charges, Intrastat, Terms of Sale
Order Completion and Payment	Payment	Payment, Credit Terms, Incoterms, Duty, Deferment Limits

Questions such as “Can we trade with this company?” do not only involve a currently robust financial status of a potential business partner, but also, for example, a comprehensive 2-year trading history. This is normal due diligence of course, but what about questions such as “Who do they trade with?” and “Are we at risk?” This is just the start of “off-the-radar” questions, which are frequently overlooked. This sounds simple enough, but can be critical and as such, is often underestimated. Over 70 percent of companies engaged in the global supply chain as either buyers or vendors do not have an automated and comprehensive flow of information from procurement to

fulfilment[4]. While software solutions to support these end-to-end supply chain processes are continuously improving and gaining importance, companies often still underestimate the need for risk mitigation at points in the process, such as at RFQ stage, or even when executing a shipment.

The flowchart above shows a series of “back office” functions, which, if error-prone, can have the same calamitous effects on supply chain efficiency as would any physical disruptions such as delays in transport, in production or at Customs. Why? Because this represents an area which is often accepted or understood to always operate with minimum automation and usually involving various operatives working across different business functions. It is, however, these routine, “non-threatening”, basic tasks that can cost a company the business - be it a lost account, lost order or a lost tender - and create exceptions and disruptions. It is crucial, therefore, that companies recognise risk in all areas of their supply chain, whether they be related to physical movement of goods or “back office” functions, and that they automate these functions as much as possible to reduce the possibility of errors introduced by manual work. Software can play an important role in, for example, checking orders against restricted-party lists, picking and packing operations, labelling and transport documentation, and Customs declarations, to name just a few.

Risk exposure can include working with a party that appears on a global sanctions list as part of an RFQ, or a mistake in a letter of credit, or using incorrect batch numbers, or running into quotation expirations. This sounds simple yet again, but a high volume of simple tasks, without automation, especially in areas that are subject to high staff fluctuation as well as peak seasons, provide ideal grounds for a number of small errors that ultimately can result in devastating impacts. The illustration shows that all identified functions can easily be automated. Benefits include – but are not limited to – eliminating manual errors, reducing payment defaults, protecting brand integrity and offering a seamless audit trail.

So, while the risks behind all these functions tend to be underestimated rather than being hidden, they are still very real and pose a constant threat. More and more companies are recognising, however, that by introducing automated processes and information exchange throughout the supply chain they can add value to their businesses, increase efficiency, reduce costs and mitigate these risks.

[4] ”Supply Chain Information: The Weakest Link?”, Dynamic Markets Limited, 2010