



10 STEPS TO REDUCE YOUR SUPPLY CHAIN VULNERABILITY >>

Over recent years businesses have responded to growth in demand and price pressure by exploiting global manufacturing and supplier advantages. However the drawback of this globalisation agenda is longer lead times, heavy reliance on logistics and weaker single sourced supplier relationships, but in a growth cycle these were accepted.

In the current global downturn, businesses are being hit by falling demand and unpredictable global supply costs which will expose these and other built in supply chain vulnerabilities. The key questions are, do business leaders understand these vulnerabilities and does their supply chain team have the capability to identify them and present the plans to mitigate them? In most cases the answer is no.

In tough times businesses need to focus absolutely on profit, cash flow and eliminating unpredictable events from a declining demand profile. Supply chains have a critical role in delivering this agenda but face vulnerabilities across demand-side, internal operations and supply-side that can have a serious business impact. This article discusses the vulnerabilities and provides ten actions a business can take to counter them.

“US Factory activity contracted sharply in October, falling to its lowest in 26 years as the financial crisis ravaged the world’s largest economy and its trading partners around the globe.”

Demand-side vulnerabilities

In a downturn weakening demand leads to a set of vulnerabilities around the customer interface:

- > **Unpredictable demand** – High demand creates predictability of volumes and some certainty about product mix. As demand softens, the period of demand visibility shortens to when orders are received, which gives the business limited opportunity to react to changes in demand. Unpredictable demand requires a robust Sales and Operations Planning (S&OP) process to provide medium term visibility of issues so timely actions can be taken to forecast volatility.
- > **Customer profitability and cost to serve** – In a growth phase demand is often acquired through volume deals and attracting a wide range of customers, not always profitable, through a range of marketing offers. However, in a downturn these deals can leave businesses vulnerable to low margin business that is difficult to fulfil. Weaknesses in the customer portfolio will drain profitability and distract the supply chain from servicing the core customers.
- > **Customer leverage** – When capacity is constrained by high demand customers have to collaborate to secure supply. As we switch into tough economic times, customers have the leverage to push risk into their supplier base. This results in:
 - Inventory exposure as customers pass cash flow risk onto their suppliers by changing orders within fixed plan periods
 - Penalties invoked due to failure to meet service targets
 - Request for shorter lead times driving up component and finished goods inventory
 - Non-adherence to payment terms and risk of non-payment.

Internal operations vulnerabilities

The internal operations vulnerabilities are a result of the business reacting to the things that they can influence, but without the visibility to understand the impact:

- > **Tactical activity** – To reduce costs, extend payment periods and cut inventory businesses implement tactical actions across functions, which impacts the end to end supply chain.
- > **Performance visibility** – Limited visibility of actual and future performance due to nominal integration of supply chain organisations, systems and processes.
- > **Supply to all** – Lack of leadership process to ration supply to the most profitable, loyal and low risk customers. Profit and cash is therefore given away to weaknesses in customer portfolios.

Supply-side vulnerabilities

The supply side vulnerabilities are difficult to identify but if they happen they have an immediate cost and cash flow impact:

- > **Global sourcing of suppliers**
 - Volatile commodity, fuel and energy costs undermining global supply assumptions
 - As emerging markets experience sharp rises in domestic demand the subsequent high inflation has significantly eroded the cost advantages of manufacturing for export
 - Long lead times increasing inventory exposure and reducing fulfilment flexibility
- > **Supply disruption due to supplier cash flow pressures**
 - Late payment of supplier invoices resulting in disputes
 - Suppliers experiencing cash flow issues due to customer actions
- > **Single source suppliers imposing price rises and new terms**

It is probable that these vulnerabilities exist in your supply chain. Could you identify them and take specific actions to mitigate them? There are ten actions you can take to reduce your supply chain vulnerability.

1. **Tactical vulnerability assessment** – Run a tactical end-to-end supply chain vulnerability assessment to identify the visible vulnerabilities and risks. This must result in a board level sponsored risk mitigation action plan being developed and executed.
2. **On time supplier payment** – Ensure your supplier payment processes are robust and deliver on payment term obligations.
3. **Upgrade S&OP capability** – Re-invigorate your S&OP process to provide medium term visibility and build the capability to simulate Profit and Loss, inventory and cash flow from the demand plan. Make reviewing your risk mitigation action plan a fundamental part of your S&OP cycle.
4. **Rationalise customer portfolio** – Review your customer portfolio to understand who are the most profitable, loyal and stable. Focus your business on them and eliminate the weaker customers which are unprofitable and are probably driving volatility into your supply chain.
5. **Dual source supply** – Move to dual sourced regional and global supply strategies to de-risk the supply base and provide shorter lead times when required.
6. **Focus on the designed-in costs** – Target your designed-in costs around product design and complexity, manufacturing processes and sales channels. These are the largest cost elements and waste can be removed without undermining your supply chain capability.
7. **Rationalise into a future state operating model** – Most businesses will have to rationalise operational capacity during this downturn. Reactionary rationalisation will create further risks for the businesses so any changes must build towards a consolidated and integrated operating model which positions for the future. Your supply chain visibility will then be improved during the downturn and you will be well placed to take advantage of future demand up turn.
8. **Use after sales to boost revenue** – Boost revenue by focusing the business on improving spares availability and investing in after sales support where third parties have operated.
9. **Limit customer flexibility** – Implement strict sales business rules to limit the sales team's flexibility to offer non-standard customer offers that drive additional inventory or product complexity into the supply chain.
10. **Routinely assess supply chain vulnerability** – When you have implemented these nine steps you will have much greater visibility of your supply chain vulnerability. Build on this by implementing a six month rolling strategic supply chain vulnerability review to provide direction and inform business leader's future decision making to ensure these vulnerabilities are not re-created.

Conclusion

The downturn will expose supply chain vulnerabilities but to understand and address them you must consider more than just your own operations. Regular vulnerability reviews incorporated into a robust S&OP process will provide the business visibility to identify risk and react to it. Many organisations do not have this capability but the ten steps we recommend will build this in and focus you on the key vulnerabilities you face.

Next steps

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