When it comes to supply risk, advanced procurement organizations are most in danger because the actions they have taken to generate savings and results have increased their risk as an unintended consequence.

The Winner’s Curse: Why Procurement and Supply Chain Market Leaders Face the Greatest Supply Risk

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Executive Introduction: Breaking the Curse

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When long-time sports teams fail to win a professional championship for nearly a century, commentators often refer to the losing streak as “a curse”. But once a team breaks a curse—especially if they break it in a dashing way—the expectations rise for continued high performance. One might refer to this new expectation as a secondary curse, a “winner’s curse”, as a team is expected to repeat and possibly even surpass their previous success.

Over the past decade, many procurement organizations broke their curse, moving from the back office to the pages of annual reports. Even skeptics would agree that it has been a banner time for procurement and operations organizations. New technologies and processes enabled previously unheard of savings and results. From strategic sourcing initiatives that drove down cost on a category basis to lean and supplier rationalization initiatives that reduced inventory and administrative complexity and rework, procurement moved far beyond its transactional roots in creating new levels of value for the business. This elevation led to greater influence and responsibility inside organizations, and even came with an updated mandate: supply management. In this new purchasing age, companies chartered procurement leaders with not only unit cost reduction goals, but also with generating programs to create new levels of value. Some of these initiatives included partnering with suppliers such as manufacturing outsourcing, vendor management inventory (VMI), just-in-time (JIT), and collaborative design programs.

But the success that these programs generated has led to a secondary curse—one that goes beyond just expected, continued savings. This new curse is based on the added risk and decreased visibility that procurement organizations have created for themselves by raising their own performance and results. In today’s economic downslide amidst slowing demand and the credit crunch, this risk is even more magnified.

For example, as savings from strategic sourcing and inventory management programs has gone up, the commensurate risk has increased as well. At the same time, many advanced supply management groups have scoured the globe looking for new sources of supply. But the diversity they introduce into the mix through these initiatives often brings potential weaknesses. In part because the anecdotal evidence used to gain insight on local suppliers from such activities as tradeshow attendance, discussions with competitors, and through recruiting and other initiatives, decreases as suppliers become further removed geographically and culturally.

In this new environment, few companies have equipped their teams with the visibility and insight to manage the new risks generated from advanced procurement and operations programs. But industry leaders are beginning to realize the potential that proactive supply risk management can bring. Not only can supply risk management provide a relatively low-cost insurance policy that locks-in the savings and results that an organization has achieved, it can also generate additional savings and results for the bottom—and even top—line as well. This is because as procurement organizations build a new level of continuous insight into their supply base, they can improve ongoing decision making and proactively take action to mitigate risks and develop suppliers that would benefit most from such activity.
Using Supply Risk Management to Drive Supplier Development Programs

A global, diversified industrial manufacturing company implemented a supply risk management solution after investing significantly in lean, eProcurement, strategic sourcing, reverse auctions, and other related supply management programs. As a result of these programs, the company saved hundreds of millions of dollars from unit cost reduction efforts, increased inventory turns by 28%, and reduced the cost of non-quality by 32%. Before embarking on its supply risk management transformation, the company monitored less than 5% of its suppliers, but today, is actively monitoring 23,000 global suppliers for financial stability, quality and delivery, debarment, suits, EPA and OSHA compliance, and natural disasters. 1400 users in the company deploy the system to predict financial and quality risk and on which suppliers to focus development initiatives. Based on the supply risk management system’s predictive analytics, the company selects suppliers for development initiatives focused on lean training and knowledge transfer. In the case of a small, women owned business that the manufacturer chose to develop, these programs resulted in perfect quality delivery following training completion, while also lowering the supplier’s operating costs, averting financial risk that the manufacturer’s supply risk management system had predicted at the outset.

Savings or Short-Sightedness: Are the Savings Really Worth the Added Risk?

To understand how supply risk has increased exponentially inside many advanced supply management organizations, it is essential to understand the types of initiatives that leaders have carried out in recent years, making themselves more vulnerable, not less. Consider, for example, how strategic sourcing programs that create a standardized competitive process for category sourcing initiatives can enable significant savings, but in reality, also add significant risk. By focusing on reducing supplier’s margins in a climate of high commodity and demand volatility, procurement organizations have, in fact, doubled-down on the added risks such activities bring. Indeed, the 80/20 rule does not apply to risk. Even procurement organizations that have identified those categories which are true “partner” segments from a strategic sourcing perspective—and have implemented risk management programs for this specific group of suppliers—expose themselves to risk from the rest of their spend. Consider the implications of supplier operational or financial issues in categories which procurement groups have tagged “leverage” or “automate”. Quite often, many of the categories in these groups are just as critical to keep a production line moving, and if goods fail to arrive—or arrive late or with defects—they can severely impact a company’s overall financial performance.

In addition to pursuing strategic sourcing programs as part of reducing spend and improving supplier performance, many procurement teams have embarked on supplier rationalization initiatives as well. The theory behind supplier rationalization is that by right-sizing the supply base—which almost always implies concentrating spend with fewer suppliers—it is possible to drive down unit cost as well as ongoing supplier management costs. One often hears the positive spin on the impact of supplier rationalization programs, but it is also important to understand the added risk that such programs can introduce. For example, consider how concentrating spend often implies having fewer alternative suppliers if performance or supplier financial issues arise. As a case in point, a large automotive company has spent the past decade rationalizing pieces of its supply base, negotiating further savings by leveraging its spend, but in the process, has driven many of its suppliers to the brink of financial ruin. Perhaps even more important, supplier rationalization programs often prove all consuming for procurement organizations, as supplier development programs for the chosen group take priority over other activities. This reduces the time procurement has to focus on other activities such as mitigating and managing supply risk. In addition, supplier rationalization programs can often lead to situations where competitors often concentrate their spend categories with the same providers, creating added strains on suppliers that want the additional business, but take on the added risk of ramping up production and volume without fully notifying their customers of the challenges involved.

Procurement organizations are certainly not the only groups within companies that have created additional supply risk by tackling advanced activities designed to cut costs and improve internal efficiency. Operations and quality teams certainly share responsibility for risk as well. By introducing lean manufacturing programs designed to free up working capital and avoid investments in inventory that could rapidly become
obsolete based on new market demands or products, these groups add to the cumulative supply risk of other programs. This is because lean initiatives involve the transfer of responsibility from an internal organization to an external one. Just-in-time (JIT) and vendor-managed-inventory (VMI) programs might reduce the amount of inventory on the shop floor necessary for production, but they actually increase risk to organizations by decreasing visibility into forward supply. Lower safety stock always increases risk by making companies more vulnerable to supply disruptions. For example, what happens to a production line if a supplier—or a supplier’s supplier—cannot deliver quality goods on-time? With little buffer stock on-hand, supply risk increases exponentially, especially in markets with high demand variability.

At some point, the advanced supply management approaches that we have just discussed will spell at best, added supplier management headache and costs, and at worst, supply risk disaster for organizations. The only way of avoiding the inevitable is to take a new, proactive approach to supply management by using new types of information and insight to mitigate and manage risk on a continuous basis. Figure 1, below, depicts how companies can begin to think about the right approach to proactively manage the five major types of supply risk: strategy, market, implementation, performance, and demand.

Figure 1: Understanding Supply Risk Types and Proactive Management Approaches

<table>
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<tr>
<th>Supply Risk Type</th>
<th>Mitigation and Management Approach</th>
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<tr>
<td>Strategy Risk: Choosing the wrong supply management strategy</td>
<td>Define the right up-front strategy, and identify and qualify the right global suppliers, locating reliable market intelligence to drive decisions</td>
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<tr>
<td>Market Risk: Brand, compliance, financial and market exposure</td>
<td>Pinpoint potential quality problems before they hit your company and wreak havoc with your firm’s brand, reputation and bottom line</td>
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<tr>
<td>Implementation Risk: Supplier implementation lead-times and production/performance ramp</td>
<td>Ramp new suppliers more quickly, ensuring visibility into any risk factors that might hinder production, lead-times, initial performance, etc.</td>
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<tr>
<td>Performance Risk: Ongoing supplier quality and financial issues</td>
<td>Continuously monitor all of your suppliers to avoid supply disruptions due to bankruptcies, performance issues, ownership changes, labor strikes, etc.</td>
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<tr>
<td>Demand Risk: Demand and inventory fluctuations and challenges</td>
<td>Watch your suppliers and receive alerts when they may become overwhelmed with new business. Don’t let their success affect your deliveries</td>
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When companies undertake strategic sourcing and supplier rationalization programs, they need current, actionable information to make the best possible decisions throughout the lifecycle of a supply contract. When embarking on a sourcing initiative, for example, it is essential to identify the right set of suppliers to bid on the contract. By considering past supplier performance information—as well as the ongoing viability of the supply base—it is possible to winnow down the potential supply base to the best possible set of participants. After an award decision is made, proactive insight into supplier operational and financial performance can reduce risk on an ongoing basis by making the supply risk management process proactive. At this stage, it is critical to ensure that the supply risk management approach is based on exception management rather than labor-intensive data crunching and analysis. This type of proactive information—as well as the ability to
drill-down on supplier performance and financial-related issues—can help organizations to prioritize supplier development efforts. And it can also provide information to make more informed supplier development and total cost decisions to further reduce inventory levels, improve supplier quality, and take additional cost and waste out of the supply chain.

It is not just procurement and supply management organizations that can benefit from taking a proactive approach to reducing supply risk. Operations and quality teams can also take a proactive approach to supply risk management to ensure the ongoing success of Lean, Six Sigma, and other programs already underway. Consider how when a manufacturer embraces a lean philosophy, it becomes critical to increase reliance on intellectual property about suppliers while reducing physical inventory levels as a means of reducing supply risk. It also becomes critical to invest in supplier development initiatives with suppliers to ensure that risk does not increase. Figure 2, below, depicts how when an organization decreases its dependence on physical assets, it must increase its intellectual assets as a means of maintaining supply risk parity.

To be effective, risk information about suppliers must be current, accurate and actionable. And it must take into account all—or the vast majority of—a company’s supply base to be effective. Merely focusing on the largest suppliers—or those in the “partner” category—is not enough.

For many years, supply risk management was an art. The only approach companies could take to managing it was to combine anecdotal and quantitative information—if available—in an ad-hoc manner. But today, it is now possible to take a scientific approach to supply risk management, one that is not only continuous and proactive, but also holistic and encompassing. To start down this path, it is essential to realize that supply risk management requires more than monitoring supplier performance and quality and analyzing information in a business intelligence platform. While this type of internal information is important, the most critical information about your supply base comes from outside the four walls of the organization. And getting at this intelligence requires more than just software.

Scientific, data-driven approaches to supply risk management require information and analysis about suppliers from multiple sources, including but certainly not limited to, the buying organization. Predictive analytics which are learned over time, providing more accurate insight and information, as well
as industry specific support and analysis, are also critical. This intelligence must correlate the relationship between supplier operational and financial performance from multiple sources to provide as much proactive warning as possible if a supply risk issue could impact a company’s operations. Next, it is essential to assess the intelligence and create an appropriate action plan. In some cases, this might involve sending in a supplier development team; in others, it might involve switching suppliers as quickly as possible. This is why early warning is so essential in effectively managing supply risk. Figure 3, below, describes an ideal Supplier Lifecycle Risk Management process that delivers the focused and predictive insights necessary to evaluate and act on changes in a supplier’s business before they impact the buying company’s business.

**Figure 3: Supply Risk Management is a Science—Not an Art**

**Taking Action**

When it comes to supply risk, it is clear that advanced procurement organizations are most in danger because the actions they have taken to generate savings and results have increased their risk as an unintended consequence. As a result, near-term savings can ultimately result in long-term disaster unless supply management executives take a proactive approach to managing risk. But market leaders are not sitting around, waiting for the inevitable to happen. They are taking action today. AMR Research, an industry analyst firm, wrote in their brief *Supply Chain Risk Management Hits Mainstream* that: “Managing risk is not just about reducing or eliminating effects of disruptions or problems; managing your supply chain risk profile makes good business sense to help win new business and more profitably respond to demand … one firm won a part of the Boeing 787 program based on the fact that its supply chain risk management practices were more developed than its competitors, making it more able to deliver on its commitments.”

In today’s environment, it is becoming increasingly critical for CPOs and procurement leaders to take on the additional responsibility of managing risk in addition to cutting costs, lest they put into jeopardy all of the work they have done. And as AMR Research cites, supply risk management practices are now helping companies to differentiate themselves as lower risk providers on the sell-side—hence, not only can these efforts complement and provide “insurance” for existing supply management programs, they can also help companies to win new business. So perhaps “breaking the leadership curse” is even more important than it first appears. But recognizing such a hex exists and defining a sustainable, scientific approach to tackling supply risk are critical first steps in tackling the challenge. There’s not much time to wait.