



## **Supplier Risks in a Recession**

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In today's economic turmoil the best bargain you negotiate from a supplier could pose the worst possible threat to your company's bottom line. What too many companies have learned the hard way is that today's great bargain could be tomorrow's catastrophic disruption of supply -- resulting in a costly halt in production.

If it wasn't enough to worry about hurricanes, winter storms or terrorists, buyers are now being surprised by vendors suddenly going out of business. With financial markets in chaos and credit tightening, smaller strategic suppliers around the world are unlikely to get the credit lines required to run their businesses. Even large national and multi-national companies are struggling in this environment.

It is time to ask some serious questions. What would happen if one of your key suppliers failed? How long would it take you to respond? What customers of yours would be in jeopardy, and would you be able to win them back if you lost them to a supply disruption?

Managing the risks from a troubled supplier takes three basic steps:

- Assess the strategic importance of your suppliers using a portfolio analysis
- Assess the health of the suppliers that leave your company most vulnerable
- Prepare strategies that mitigate the risks you identify

### ***Supplier Portfolio Analysis***

While it would be great to have a full assessment of every supplier to your company, it's often necessary to focus on those that put you most at risk. A portfolio analysis is a useful tool to identify those suppliers. Set it up by sorting your suppliers into four broad segments based on two factors – the difficulty of replacing the source and the amount of the expenditure:

1. Acquisition segment – you are buying easy-to-replace commodities and they make up a low percentage of your overall spend.
2. Leverage segment – you are buying commodities, but they make up a significant percentage of your overall spend.
3. Critical segment – you are buying specialty items protected by patents or proprietary processes that would be difficult to replace, but they are not a significant part of your overall spend.

4. Strategic segment – you are buying items that would be difficult to replace and they are a significant part of your spend.

Clearly it makes sense to concentrate your attention on the third and fourth segments, because these are the items that make you most vulnerable. As you are doing this analysis it might make sense to consider a third dimension to this matrix – the size of the revenue that each item helps generate. For instance, a patented clutch disk might be a \$15 part, but if you need one to sell every \$150,000 Ferrari from your factory, it's worth putting the supplier on your priority list.

## ***Supplier Health***

It's very rare that a supplier will fail without warning. Listed below are key signs to identify a supplier that might be in trouble – putting you at risk as well.

### **Signs you might notice in your operations**

- The supplier fails to support sales
- Your firm stops getting necessary shipments due to breakdowns
- The supplier begins failing to meet on-time or in-full deliveries for any other reason
- Management's responses to requests for information or service are vague, inconsistent or not focused on the issue
- The supplier begins consistently using your technical support
- The supplier increases the number of consultants involved in your orders or your issues

### **Signs you might notice in your business office**

- The supplier begins asking for price increases
- The supplier constantly requests pre-payment, early payments or accelerated payment terms.
- The supplier engages business turnaround specialists

### **Signs you might notice on a supplier visit**

- The supplier does not appear to be making required investments
- The supplier fails to appropriately cut costs during economic downturns
- The supplier begins using factoring companies or other third parties to maintain cash flow
- The supplier has deteriorating accounts receivable and payable
- There is a big imbalance between payable and receivable days
- The supplier reports successive negative variances from projections.
- The supplier has rapid growth in sales volume.

## Signs you might notice in outside sources

- The supplier experiences loss of business or market share
- Public records report delinquent taxes
- Executives start selling significant amounts of stock.

## *Risk Mitigation Strategies*

If you are paying close attention to those suppliers most crucial to your business, you have already adopted an important risk mitigation strategy, because forewarned is forearmed. Proper due diligence before you buy, and periodic supplier audits during the life of a contract will generally lead you to preventive tactics, which are generally much less costly than mopping up after a disaster.

A good risk management strategy has several components.

- It must identify risks for the entire supply chain of the outsourced product or service the company identifies as strategic – from initial raw material to your customer.
- It must be able to predict the financial impact that a supply disruption can cause.
- It must offer strategies that can mitigate the effects of any disruption of supplies – with costs and benefits associated with each different alternative.

To create risk mitigation plans for a supply chain, assemble a good cross-functional team from purchasing and logistics, operations, engineering and finance – or a mix that makes sense for your company. A full risk mitigation process takes five steps, and the more you put into each step, the better your overall results will be.

1. **Profile your supply base.** Look for the signs of trouble and identify potential alternative sources.
2. **Assess the risks.** Look at environmental, financial, logistics, process, planning and control risks.
3. **Evaluate the implications.** Rank the risks by scoring them on the chances they might occur and the cost of the impact if they do.
4. **Identify possible mitigation and contingency actions.** What could you do? How much would it cost? How long would it take to respond?
5. **Complete a cost/benefit analysis of your plans.** This is especially important if your mitigation plans include major investments in duplicate plants or other significant capital expenses.
6. **Gain management support and implement your plan.** Effective plans usually require investments before anything actually goes wrong, so make your case to top management and prepare your company.

Regardless of the condition of the economy, all companies can benefit from a good program to effectively select and manage suppliers and maintain a current risk mitigation plan. Suppliers can run into trouble at any time, so conduct internal training to assist purchasing agents, accounts payable, quality control, and plant managers in dealing with suppliers and recognizing the warning signs.

Gone for now are the days of a rising economic tide that is floating all boats. As the waters recede during this global recession it takes a good navigator using all the tools at his or her command to steer clear of supply chain troubles lurking under the surface.