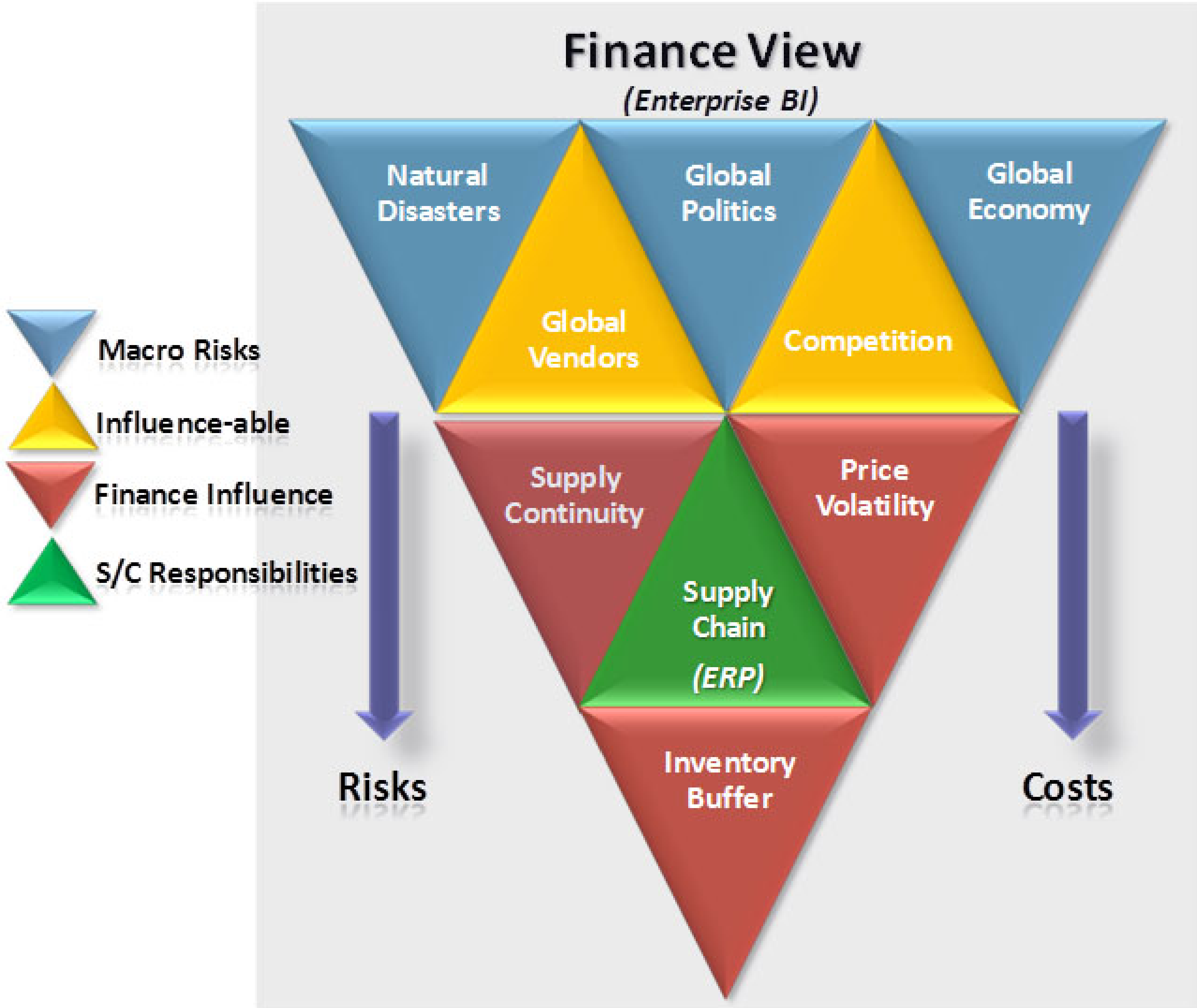
Global Supply Chain’s Impact on Finance: Managing Risk and Cost

Today’s complex global supply chain places greater demand on companies to manage both risks and costs, both at their supplier’s organization, as well as within their own enterprise. While the supply chain organization focuses on sourcing of supply, managing supplier relationships and the costs incurred from manufacturing to customer delivery, Finance should play a value-added role in providing a comprehensive view of risks and costs.

Supply chain organizations work to ensure goods that are produced arrive at the customer destination on time and in good condition. Often, they are operating within a fiscal year budget and are busy managing the inverse relationship between cost and risk in the short run. Examples of these near term trade-offs include:

- Cost of quality control (by way of audits and checkpoints)
- Cost of assuring availability of supply (through engaging multiple suppliers)
- Cost of out-of-stock (via higher inventory “buffer” stock levels)
- Cost of transportation (by selected geographic locations)
- Cost of inventory (through “just-in-time” practices)

In contrast, Finance organizations are able to view the “bigger picture” with greater consideration for longer term consequences, given their multi-period responsibility for the P&L and Balance Sheet. They are also more likely to have access to broader decision support information than the limited supply chain transaction data in an ERP system. The Finance executive’s areas of concern that can add value to a global supply chain include: Supply Continuity, Price Volatility and Geographic Risks *(See Figure 1 below).*



Supply Continuity

A&M interviewed Finance executives who believe that a broader view of the supply chain ensures all risks and costs are considered. In one example, John Sullivan, VP of Finance at JDS Uniphase, opted to run a Z-score financial analysis on suppliers to gauge the risk of financial failure that could result in an interruption in critical components. While credit rating has become a critical factor in supplier selection and to the continuation of relationships, it is first used as a flag to get Finance involved in discussions with the supplier to understand their true financial situation. In some cases, a supplier could be a subsidiary of a larger, more stable, parent company and would receive the parent company's support, if needed.

For technology companies, availability of components becomes a challenge when the economy begins to improve, as it did in 2009 and 2010. Managing "just-in-time" supply chains can result in lower inventory levels (and higher cash flow), but can also result in supply shortages when demand suddenly increases. Since more supplier chains are outsourced, a key factor is negotiating "upside / downside" flexibility clauses in contact manufacturing contracts to manage spikes in demand.

Disasters, natural or otherwise, can also interrupt the continuity of supply. In the case of European cell phone manufacturer, Ericsson, supply was halted for months when a common component supplier lost a plant to a fire. The cell phone company's competition, Nokia, had a more rigorous supplier contingency plan, as well as a more collaborative relationship in place, allowing it to maintain capacity.

Price Volatility

For companies distributing commodities, price volatility can be a difficult risk to manage. Oil and gas companies report on barrels of oil produced and avoid basing their business decisions on revenue as much as possible. In essence, they are stating that they have no control over the price of oil.

In the case of Wilbur-Ellis, a privately held agricultural product, animal feed and specialty chemical distributor, the risk of price in the products they distribute is part of what they manage for their customers. Wilbur-Ellis' CFO, Michael Hunter, told A&M that in recent years the price of fertilizer has fluctuated within a given annual season. Wilbur-Ellis' Finance team is deeply involved in the buying strategies to ensure price risk is being managed appropriately.

Geographic Risk

Most companies depend on suppliers in other parts of the globe. Manufacturing may take place in their plants in the Philippines, Eastern Europe or Mexico. They could also contract for manufacturing in China, Japan or Thailand. In addition, companies can outsource to service centers in Argentina, Hungary or India. As many have learned after the earthquake and tsunami in Japan in 2011 or the floods in Thailand in early 2012, predicting the extent of the impact of a disaster upon the supply chain is extremely difficult. Taking responsibility for understanding all of the risks at a remote facility's plant or the possible ramifications of political unrest (e.g., Libya's barring of the oil supply to Italy in 2012) is within a Finance executive's oversight.

Sometimes third-parties can help identify and mitigate risks. JDS Uniphase works closely with their insurer, FM Global, specializing in engineering risks. The insurer may recommend that JDS Uniphase exit a plant in Thailand on a flood plain and move manufacturing operations to higher ground. In one particular case, after the floods ravaged Thailand, JDS Uniphase experienced minimal interruption to the flow of its components (30 days) instead of incurring a complete loss in the previous plant. Their insurer also identified the failure of a contract manufacturer's plant in Mexico to install fire sprinklers, and in the fact that it was costing JDS Uniphase additional insurance dollars each year. The company's finance organization is now involved in persuading the supplier to install fire sprinklers, noting that there is a strong business case for doing so.

Conclusion

A key to reducing risks and costs, as noted in the above examples, is the close collaboration between Finance and Supply Chain Operations. Certain organizations have established an official enterprise risk manager role to help bridge the two groups, and focus on identifying the opportunities to reduce costs and risks, as well as drive implementation of improvements. At Wilbur-Ellis, the manager of enterprise risk reports to the CFO's office.

For Hunter at Wilbur-Ellis, "You can outsource the job, but not the responsibility." The Finance organization should view the dependency upon global suppliers as an extension of its own supply chain. The same standards for risk management, quality assurance and cost containment should be adopted by upstream suppliers. If they cannot, the company should consider bringing the operations in-house. For instance, Wilbur-Ellis often invests in its own operation of warehouses in Asia when an outsourced supplier cannot live up to its standards.

The Finance organization must collaborate with the Supply Chain organization to help consider and manage all risks and costs bringing a broader perspective. Whether the role of Finance in managing supply chain risks and costs is formalized, Finance executives have a duty to get involved.

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