WHITE PAPER

HITTING THE MARK:
SUPPLY CHAIN RESILIENCE

Examining how the financial health of your suppliers can lead to a more resilient global supply chain

RapidRatings

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SUPPLYCHAIN
MANAGEMENT REVIEW

Introduction

As an interconnected set of organizations or entities, the supply chain bridges the gap between a product source and the ultimate end user. By collaborating in a horizontal fashion, these entities work in concert to serve a fundamental purpose: to create a product or service that will benefit a group of users.

> **"Without a well-defined recovery plan, the probability that an organization will be able to operate in the aftermath of a supply chain interruption, natural disaster, or other event decreases significantly."**

But what happens when a critical link in that supply chain goes down due to business failure, natural disaster, or an issue within its own supply chain? This is a question that more and more companies are asking themselves as high-profile supply disruption cases involving Apple, Chipotle, Nissan, and other notable organizations come to light.

The answer lies in supply chain resilience, or, the ability to adapt, change, and respond quickly to threats as they arise. After all, it's no longer a matter of "if" your organization will be impacted, it's a matter of "when" the event will occur.

In this white paper we'll explore the concept of supply chain resilience, explain its tie to greater financial health, and outline some key recommendations for developing and honing a resilient supply chain for today and the years to come.

Uncertainty is the norm

In a business environment where uncertainty has become the norm and disruption is commonplace, resilient supply chains allow companies to remain agile, adapt to change, and respond very quickly when threats arise. And while responding effectively to supply chain threats isn't a new discipline—after all, companies have been facing business continuity threats for decades if not centuries—the interconnectedness of companies across the supply chain has become tighter in recent years.

Add the global nature of the modern-day supply chain to the equation and the need to focus on attaining and maintaining supply chain resilience becomes even greater. Not all companies recognize this fact, nor do they connect the dots between their own financial health and the strength and resilience of their global supply chains.

Focused largely on risk management (i.e., identifying potential risks in advance, analyzing those problem areas, and then taking precautionary steps to reduce the risk), organizations don't think about what they'll have to do to recover from the risk and continue operating in a productive and profitable manner.

"Risk management as a standalone discipline is extremely important, but it's only one piece of the business continuity puzzle," says Rose Kelly-Falls, senior vice president, supply chain risk for Rapid Ratings International, Inc. "Without a well-defined recovery plan, the probability that an organization will be able to operate in the aftermath of a supply chain interruption, natural disaster, or other event decreases significantly."

Companies that are paying attention to this issue quickly learn that a continuity plan is only as good as the suppliers that drive and support the organization's business. Much like both Chipotle and The Centers for Disease Control and Prevention learned recently, not only is pinpointing the specific culprit difficult, but going through the motions of investigating multiple suppliers around the country can be a futile exercise.

That's not to say that it can't be done, but it does require a thorough review not only of Tier 1 suppliers, but also Tier 2 and Tier 3—and their suppliers as well. This is a critical point because if something should go wrong with a supplier's downstream suppliers, the ripple effect will extend all the way to the top.

"You can't do this without software," says Murphy. "There's just too much to know, it's too widespread and it's too intricate of a process. A company using spreadsheets, checklists and clipboards wouldn't even know that they had a problem until it was too late to do anything about it."

According to Kelly-Falls, organizations that are serious about supply chain resilience must put a detailed plan in place for identifying potential supply chain disruptions and the related recovery strategies.

"This takes time, resources, and cross-functional input from legal, manufacturing, finance, IT, logistics, and everyone else who is involved with strategy development," says Kelly-Falls. "Supply chain resilience can't just be lip service, everyone has to be involved, onboard and sharing input for it to work properly."

How resilient are our supply chains?

When companies like Chipotle or Target make the headlines with their major business disruption problems, the rest of the business world thinks, "Wow, what a shame. It really stinks for them." And then it moves along in its day-to-day activities without much worry over exactly what went wrong and why.

Although some events—natural disasters, for example—make an impact on multiple organizations, the smaller, less ubiquitous supply chain disruptions can also bring a company to its knees within a fairly short timeframe.

"Supply chain risk is usually near the bottom of the list of what risk managers are talking about today," says Renee Murphy, Forrester's principal analyst of risk and compliance. "It's not that supply chain risk isn't important to them, but it's part of a larger subset of issues that companies are dealing with."

By taking a more focused approach to those potential risks, and by classifying suppliers by the severity of the impact on your business, holding them to their contract commitments, making sure that they're passing the necessary inspections, and visiting them on-site when it's feasible to do so, companies can gain better footing on the supply chain resilience front.

Murphy says that technology is playing a key role in this supplier oversight process. "You can't do this without software," says Murphy. "There's just too much to know, it's too widespread and it's too intricate of a process. A company using spreadsheets, checklists and clipboards wouldn't even know that they had a problem until it was too late to do anything about it."

Linking supply chain resilience and financial health

By building flexible, intelligent supply chains that enable quick responses in today's rapid evolving business environment, companies can effectively hedge against risk while being able to respond to the global market's complex requirements.

The most successful procurement organizations have learned that financial health is a critical Key Risk Indicator in their sourcing and ongoing supplier management process. A company's ability to assess supplier financial health is paramount to identifying and mitigating supply chain risks that can affect their business operations, reputation, and ultimately their bottom line.

Understanding the financial health of their global supply chain helps companies prepare well in advance for possible disruptions, and shore up their chances of bouncing back from even the largest crisis. As a starting point, companies should be asking themselves questions like:

Regardless of industry, company size, or business model, all companies will experience a risk management event that results in possible disruption. "It's no longer a matter of 'if' it will happen, it's a matter of 'when' it will happen," Kelly-Falls points out.

- Where are the potential vulnerabilities in our extended supply chain?
- Are we aware of all of the potential risks in that chain, or are there hidden threats lurking?
- What potential risks are our Tier 1, 2 & 3 suppliers facing?
- How much of our revenue and/or profit is at risk from possible disruption?
- Are we ready to respond fast when an event occurs?
- Do we have a formalized supply chain risk and resilience plan in place right now?
- How quickly will we be able to bounce back if one or more of the identified risks becomes a reality?

The answers to these questions are of particular interest to companies' boards of directors, which want to make sure risk management plans cover continuity *and* resilience. They're also of great interest to companies that rely heavily on outside vendors to supply their raw materials and other goods.

To see whether these entities are working to minimize their own risk, allocating resources to this issue, and developing continuity plans, companies can investigate their suppliers' financial health using a rating system.

On Rapid Ratings' scale of zero to 100, for example, any company with a 39 or lower presents a definite financial risk, while most organizations with a 20 or lower have a very slim chance of ever bounding back from a major event. In most cases, a company with a financial health rating of 85 or higher is well positioned to manage a major event, while one that's hovering in the 55-60 range will "probably" bounce back.

"The financial health of a company is a very good indicator of supply chain resilience," says Kelly-Falls. "And while financial health is just one major component across the big picture, it's a solid indicator of whether or not a company has the resources it needs to support that event—be it a natural disaster or the loss of a large contract."

It's not a matter of "if"...

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The event itself could be market-driven, financial, reputational, geopolitical, or due to regulatory non-compliance—whatever the root cause, the bottom line is that the company with the stronger financial health will have greater continuity and resilience. It will also experience less disruption and financial loss than the companies that lack financial strength and wherewithal.

For supply chain and logistics managers, this further supports the need to look deep into a company's supply chain to find the sources of potential problems. That large, multi-national Tier 1 vendor may be supplying the most critical components for your company's end products, but those lesser-known, less financially stable companies could be the ones that wind up creating the biggest disruptions.

"Pay close attention to their business continuity and resilience strategies," Kelly-Falls advises, "for they could be the ones that most significantly impact your own firm's supply chain resilience and, ultimately, it's bottom line." ■

About Rapid Ratings

Rapid Ratings is the creator of the proprietary FHR® (Financial Health Rating), the industry's leading assessment of public and private company financial health. Our disruptive methodology, scalable solutions, and unparalleled support enables businesses to effectively manage and price risks associated with the financial health of third-parties including customers, trading counterparties, suppliers, vendors, and investments.

Hundreds of leading organizations across industry verticals rely on the FHR's® data visualization and detailed reporting tools to provide visibility and early warning of financial deterioration. Rapid Ratings is the only company to rate public and private companies, globally and with the same depth of analysis.

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