riskmethods
Supply Chain Risk Management

Making the Case for Supply Chain Risk Management

Executive Summary

Most executives within procurement and supply chain management (and in other senior roles) understand that supply chain risk is an important issue. The topic has moved up the agenda in recent years, and many firms have made investments to support their activities. Nevertheless, to bring the topic of supply chain risk management to the forefront of your organization, it may be necessary to present a compelling business case as to why you need it.

In this riskmethods Read, we'll propose ways to help you do just that. We start by looking at the challenges that exist around making the convincing case for investment and consider how those can be overcome. We then look at the five key steps in building your business case. Throughout the briefing, we note how tools and technology can greatly assist in managing supply chain risk and will explain how you can build a powerful and persuasive business case for investment in supply chain risk management resources and (particularly) tools and technology.

Why Do You Need a Business Case?

Many organizations have invested in supply chain risk management, whether that is in the form of internal resources, training, tools or technology. However, we often see executives who understand the need, yet still struggle to create the business case and get approval for the appropriate levels of investment. Why is that?

In terms of procurement and how an organization looks at its suppliers and supply chain, value comes from two fundamental activities. Organizations look for opportunity: how their suppliers and supply chain can help generate value that ultimately leads to competitive advantage. That can come from a low-cost strategy or even savings through cost avoidance, contributing to greater efficiency in the business. It can also come from driving revenue growth through innovation that originates with the supply chain; for example, via strategic sourcing to make better total value decisions by awarding business to a new, innovative supplier.

The other side of the value equation is risk management. Opportunities are important, but so is managing the risk inherent in any supply chain. Smart organizations and smart executives understand that in terms of the supply chain, both risk and opportunity management are critical to a sustainable success. However, many companies and executives focus more on the obvious opportunities. A discussion about an acquisition, an exciting new product or a technical innovation is perhaps seen as more exciting for the board than an analysis of key strategic supplier risk.

A Hackett Group report[1] identified some of the reasons why procurement has struggled to address supply risk, leading to an unsatisfactory picture in many organizations. A survey found that 94% of respondents agreed with the statement "procurement is held responsible for supply risk but lacks a mandate or resources to address the issues." Another 78% said that procurement "mostly reacts to risk to ensure regulatory compliance rather than get ahead of the problem."

"In terms of procurement and how an organization looks at its suppliers and supply chain, value comes from two fundamental activities: realizing opportunities and managing risk."

[1] Hackett Group, "Integrated Risk Management: A Playbook for Procurement"

Fundamentally, investment in risk management is designed to avoid something happening, rather than to make something happen. Investments in marketing, new factory equipment or even research and development generally have tangible outputs—a new chocolate bar, more output, a social media campaign. On the other hand, an investment in improved supply chain risk management means that something does *not* happen—the firm does not have a reputational risk crisis, factory shut-down or supply shortage.

While that is clearly important, it lacks the tangible nature of many other investment outcomes, which is one of the issues that must be overcome. Linking the improvements to risk management through to business outcomes or measurable benefits—such as better customer service or more efficient operations—can be challenging. That means the business case has to be very explicit about the potential impact on the business arising from supply chain risk; it is not necessarily just a simple numerical return on investment calculation.

Nevertheless, the evidence for professionalizing supply chain risk management is overwhelming, and the growth of powerful and effective tools—often cloud-based and using the latest technology (such as artificial intelligence)—makes it easier than ever to create a persuasive business case. But the case still needs to explain in appropriate business language the situation, the problem that needs addressing through the investment, and how the situation can and will be improved. It must be persuasive, robust and professional to motivate the organization to act and to invest.

"BDO's 2017 Manufacturing RiskFactor Report reveals how manufacturers are confronting a wide array of supply chain risk. The report examines the risk factors in the most recent 10-K filings of the largest 100 publicly traded US manufacturers in the food manufacturing, transportation, fabricated metals, machinery, plastics and rubber segments; the factors are analyzed and ranked by order of frequency cited. The number one risk for the past two years has been supplier, vendor or distributor disruption." [2]

"The evidence for professionalizing supply chain risk management is overwhelming, and the growth of powerful and effective tools — often cloud-based and using the latest technology (such as artificial intelligence) — makes it easier than ever to create a persuasive business case."

[2] Material Handling & Logistics, "Number One Risk for Manufacturers Is Supply Chain Disruption"

So how do you do it? We recommend these steps:

1. Explain the supply chain risk facing your organization.
The goal of this step is to make sure that stakeholders understand exactly what supply chain risk is. This involves asking some key questions to highlight where risk lies, and can also involve bringing in past examples of risk incidents.

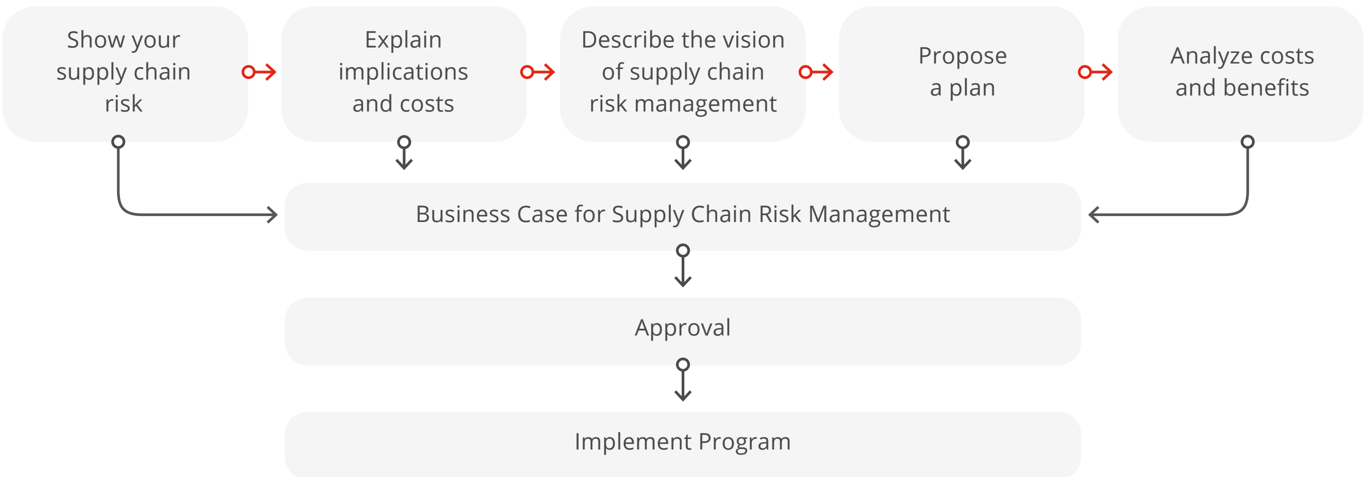
2. Explain the implications and the cost of the supply chain risk facing your organization.
The goal of this step is to make sure that stakeholders understand the need for supply chain risk management. This is when you create the burning platform that justifies the investment.

3. Explain what supply chain risk management should look like.
The goal of this step is to describe the promised land of supply chain risk understanding: up-to-date market knowledge, rapid information and alerts and planned mitigation/ preventive actions—all of which will be in place after the investment.

4. Explain the plan: how to achieve the supply chain risk management vision.
The goal of this step is to describe the proposed solution (presumably a technology solution) and what is required to establish it (in other words, a high-level adoption plan).

5. Explain the costs and benefits.
The goal of this step is to explain the investment and the return on investment, with financial and non-financial costs and benefits explained, including the plan for tracking those benefits.

The chart below shows how the different elements combine into the overall business case that then drives the program to be implemented.



STEP 1: Explain the Supply Chain Risk Facing Your Organization

The first job of the business case is this: Convince your stakeholders that they have a problem.

The business case should start by laying out how supply chain risk is currently managed within the organization, highlighting strengths and—perhaps more importantly—weaknesses and areas for improvement. The aim should be to describe the situation honestly while being clear about the gaps and weaknesses. Here are some key questions that can help to structure that description:

- On a scale of 1-10 (10 being the best), how good is your visibility of suppliers?
- How many direct spend suppliers are monitored?
- Can you identify your suppliers and supply chains that generate the most significant risk?
- What supplier information is available?
- How is supplier information and data obtained and kept up to date?
- Do you know where your key goods (raw materials or components) are manufactured?
- Do you have any processes to identify multi-tier supply chain risk; e.g., suppliers who are not first-tier but who could suffer risk events that would impact your organization?
- Do you analyze and segment suppliers based on their risk profiles?
- What is your process for being alerted to new and emerging risk, from supplier financial issues to natural disasters affecting supplier premises?
- What contingency plans are in place to respond if a potential risk becomes an actual risk event?
- Can your organization give assurances—relating to regulatory or reputational drivers—about issues such as modern slavery, GDPR (general data protection regulations) or child labor in the supply chain?
- Where and how has the organization experienced supply chain risk events in the past?

Answering these questions should give you a good understanding of what you're doing now, and where there are gaps in the processes that could be improved. In addition to asking these questions, it may also be helpful to highlight them with examples of past risk issues that had an impact on the business.

STEP 2: Explain the Implications and the Cost of the Supply Chain Risk Facing Your Organization

Your business case must make a persuasive argument for investment to those who control the money. One problem is that individuals and organizations understand conceptually that supply chain risk is important, yet still do not consider it important enough to invest.

Executives can learn here from successful sales techniques. The classic Huthwaite SPIN selling methodology (situation, problem, implications, need-payoff) suggests that to make the sale, it is not enough to highlight the problem to the buyer (or, in this case, stakeholder). Even if they understand that they have a real issue or problem, it is vital that they understand the implications of the problem.

And so it is with a supply chain risk management business case. In addition to communicating the problem, you must also communicate what the implications of the problem are—the "so what?" part of the story. And that needs to be expressed in terms of clear business outcomes, not just theoretical supply chain nice-to-haves.

For example: "If we don't know when an earthquake has hit our factory, we may face a supply shortfall or even not be able to supply our product at all, which translates to lost sales, unhappy customers, declining market share and maybe even penalties."

Or: "If we don't get advance notice about a supplier in our supply chain violating social corporate responsibility policies, we won't be able to prepare an appropriate and coordinated response, which may lead to a consumer boycott with a major dilution of brand value as well as a short-term sales hit."

There are also regulatory and compliance issues in certain industries that increasingly require organizations to show they understand their supply chain, know who key suppliers are and manage risk proactively. From modern slavery to GDPR to carbon reduction and environmental issues in the supply chain, both regulators and shareholders are taking an increasing interest in supply chain risk. Any current gaps here can be highlighted as part of the justification for investment.

Again, posing questions to the organization can be a useful way of highlighting the implications of risk problems. For example:

- What would happen if a major raw material or component could not be delivered for days or weeks?
- What would you do if a major supplier went out of business?
- How would you respond if one of your key partners or suppliers experienced a major cyber risk event or were found to be breaching human rights or environmental regulations?

Risk Event	Implications
Supply interruption leading to lost production/supply to customers	Loss of short-term sales; reputational damage to brand; increased/unplanned cost for firefighting
Supplier bankruptcy or closure	Price increases for goods or services; loss of good supplier leading to changes in market dynamics
Reputational risk event in supply chain	Lost sales and brand value; damaging publicity; personal exposure for senior management
Price volatility in the market (driven by geo-political events, natural disasters, etc.)	Increase in costs/loss of savings; reduced profit margin; potential for loss of competitive advantage

Organizations and procurement functions that focus on cost minimization and ignore supply chain risk can find that all their good work managing costs is undone with one major unmanaged risk incident.

Your explanation of the costs and implications of a risk event might contain some numbers, but stories can also be effective. These might include examples of when supply chain risk has caused major problems for other companies in a similar industry—or even for your own organization. (For some examples of famous supply chain risk events, check out these resources on financial risk, reputational risk, natural disaster risk, man-made risk, geopolitical risk and cyber risk.)

Identifying why the organization should invest can include reference to disaster events, but should also emphasize that this is about doing business better. Understanding supply chain risk drives organizations to better understand the supply base, which feeds back into more effective category strategies, more informed negotiation and other benefits. It can even help improve product quality via a better understanding of the supply chain, and the risk and opportunities in terms of raw materials and components.

"If with the right hand you focus on cost minimization, but then don't protect the company, it's like throwing out all the savings with the left hand."

(Bill DeMartino, riskmethods)

STEP 3: Explain What Supply Chain Risk Management Should Look Like

Having laid out the current situation and the implications of current weaknesses, your next step is to describe the vision for future supply chain risk management. What will the improved processes, performance and outcomes look like? How will technology support those changes and improvements? Compared to the current situation, what will the tangible differences be?

Starting from the weaknesses identified, lay out how your brave new world of supply chain risk management will work. This needs to work though the end-to-end risk management process. It is also key that proposed solutions don't focus just on having access to risk event information. It is just as important and increasingly vital that organizations have a way to sort the signal from the noise. With the huge amount of data and information available today, the key point is having a way of establishing what really matters to your specific organization. Increasingly, that means using smart technology that relies on artificial intelligence and machine learning to help sift what is really relevant from the rest.

In defining the vision for supply chain risk management, the following might be part of the post-investment picture (although, of course, the exact details here will depend to a certain extent on your individual organization):

- Relevant staff will be in place, with an appropriate level of designated resources, who are tasked with managing risk.
- Your critical risks will be identified, and plans put in place to address and mitigate the most serious ones.
- The board or other senior group will regularly review supply chain risk based on appropriate reporting.
- A process and tools will be put in place to provide risk alerts and notifications, so that you are aware of risk and know quickly when and where risk events need addressing.
- Technology will help to identify the specific and relevant information that really matters to your organization and thus will help you to manage risk better.
- You will avoid the direct consequences of risk events; e.g., product shortages, price increases, lost sales or higher insurance premiums.

One of the ways to present this information is to lay out a before-and-after comparison between the current practices and the post-investment practices. The table below gives some examples of this.

Risk Management Issue	Our Current Practice	The Vision
Supplier visibility and information	Multiple information sources, limited visibility below top 100 or so suppliers	Accessible, systemized master file covering all suppliers, including key data, regularly updated and verified
Multi-tier risk visibility	Little or no knowledge of suppliers beyond the first tier—no analysis of multi-tier or network risks	Risk management (analysis, information, updates and warnings) for all key suppliers at multi-tier levels
Proactive approach to risk identification	No process to predict risk events or gain knowledge other than ad-hoc, supplier-driven or reactive processes	Structured contingency planning plus early warning systems and a platform with notifications and updates
Risk reporting	Ad-hoc; requires considerable manual work	Automated reporting that includes changes in risk profile, risk events, actions taken, etc.
Sourcing	Based on price, quality and pre-qualification scoring	Based on price, quality, pre-qualification scoring and risk

For a look at how supply chain risk management has changed other organizations, check out some of riskmethods' customer stories.

STEP 4: Explain the Plan: How to Achieve the Supply Chain Risk Management Vision

Next, you should provide a description of exactly what is proposed in terms of the investment, and how it will be implemented. In most cases, this will involve the introduction of a tool, platform or system to support better supply chain risk management.

There are four significant issues that need to be considered here as part of the overall change and investment program: people, tools, process and governance. Obviously, this is driven by the specific nature of the business case. If it is focused purely on investment in a risk management tool, then all of these areas may not need to be covered. However, even in this case, there will usually be some implications, in terms of process at least, if as much value as possible is to be gained from the investment. In other cases, if the organization is looking to completely transform the way it approaches supply chain risk, then all four of these areas may need addressing.

People

Is there a need for additional staff, or for structured staff training and development in order to become more competent supply chain risk managers? This may require detailed training for some staff, while in other cases it may be more about increasing general awareness of the issues without trying to create deep expertise. If this is required, what will be provided to make that happen, how will it be delivered, by whom and when?

Tools

It's difficult to see any business case today for improved risk management that does not have an element of technology. The vast amount of data and information available relating to the supply chains for any organization of a reasonable size is virtually unmanageable without appropriate automation and systemization. So, assuming you propose to buy risk management tools, what will they provide in terms of better risk management, how will they be implemented and what integration issues (with existing systems) need to be addressed? Some risk platforms are relatively quick and easy to implement; other options may require considerable amounts of effort, meaning time-to-value will be longer.

Process

Are any changes in procurement processes needed to assist in risk management changes? For instance, does your supplier onboarding process need to be reviewed or tightened up? Is a process needed to identify critical suppliers, or to ensure that appropriate information (which contributes towards effective risk management) is obtained from suppliers?

Governance

Will you need to change the governance around supply chain risk? This might mean new or revised policies (to support process change) or reporting and review requirements. Some organizations produce a quarterly supply chain risk report that may be formally reviewed at senior levels, for example.

Some business cases also provide a detailed project plan for the investment being proposed. Other organizations prefer a full plan to follow approval of the business case. There is no right or wrong here; the best approach depends on how the organization prefers to handle the process for investment.

The downside of a detailed plan at this stage is that the work will be wasted if the investment is not approved. However, a business case that does not include any real detail on the plan might leave those who have to approve it wondering if the appropriate level of thought has gone into the process. It may leave open the suspicion that all the costs have not been assessed, or that the proposers do not understand the effort that might be needed to implement the recommendation.

Often, the best solution will be a middle-of-the-road approach. The business case should have enough detail to demonstrate that it has been well-considered and is very likely to work, and that there will be no unpleasant cost surprises. This means including a clear outline of what is going to be done, the timelines, the resource implications and who will execute the work. An outline of the key risks to the business case (i.e., what could stop the investment return being achieved) can also be included. It does not mean that a full project plan, with resource allocation and identification, day-by-day activity and even risk issues should be necessary. But the exact balance will depend on your organization's own expectations and ways of working in terms of business case development and presentation.

STEP 5: Explain the Costs and the Benefits

No business case is complete without an analysis of the costs and benefits. This is your last step in making the case for supply chain risk management. Make sure you use the organization's internal policies for financial business cases—such as how issues like net present value should be handled.

DESCRIBE THE COSTS

Although there may be soft costs associated with a supply chain risk management program, it's usually the case that the biggest hurdle for approval is getting new technology approved. Assuming there is a technology component to the investment, categories of cost that should be included are:

- Core technology cost, upfront license fees or annual/monthly subscriptions (particularly with cloud-based platforms)
- Other technology-related costs, if relevant (e.g., maintenance, upgrades)
- Training costs: formal or informal; may be linked to a system implementation or could be a core part of the program
- Integration: costs of developing links and feeds between the new system and any existing systems
- Communication: any costs associated with the launch of a new system
- Recruitment costs: if any additional staff required

"Net present value is the present value of the cash flows at the required rate of return of your project compared to your initial investment."

(Joe Knight, financial expert).

Organizations have their own guidelines on how to calculate and present the financial elements of the business case. Future costs and benefits will usually be discounted to a present value—that reflects the view that money spent or gained in the short term matters more than that saved or spent in the distant future. Organizational policies on aspects such as the discount rate to be used need to be understood and followed.

FOCUS ON THE BENEFITS

Historically, many capital investment programs considered a lengthy timeframe, mainly in order to show many years of benefits to compensate for a major up-front year-one investment cost. That was true for capital equipment but also many more software-based products that came with a major up-front license purchase cost (followed often by ongoing maintenance fees every year).

The growth of cloud-based options, which generally don't have that year-one hit, has made many business cases more attractive. There will still be some year-one costs such as training and perhaps some integration costs, but generally the business case can be made over a shorter time period.

Laying out the benefits clearly and convincingly is perhaps the most critical element of the business case. What are the key areas where you will expect to see benefits in terms of supply chain risk management? Benefits can be divided into three main types.

1. Quantified cost benefits

- Improved working capital and return on capital: Reduced stock holding arising from better risk management can lead to less money tied up in stock and a consequent reduction in working capital.
- Reduced insurance costs: By demonstrating risk management is in place, insurance firms often offer reduced premiums to clients.
- Less manual work for buyers: Reduction in workload from information gathering, supplier liaison, data handling—even an hour or two a week—can add up to substantial savings across a large organization and multiple people.
- Reduced or avoided costs for existing data providers where new technology is introduced.

2. Cost avoidance

- Operating efficiencies: Better risk management means more factory up-time and productivity and lower chances of stoppages or slowdown.
- Staff time and effort: A coordinated response to a risk event mean costs are avoided in terms of staff and management effort.
- Avoidance of price increases: Early knowledge of a risk event enables faster action, which reduces the chance of the buyer being subject to higher prices in the market.

3. Revenue and reputation

- Reduced risk of reputational damage through product issues, shortages, etc. This can also have a direct cost effect; e.g., the operational cost of product recalls or advertising aimed at reassuring customers.
- Reduced risk of lost revenue; e.g., major risk events leading to outages or even product withdrawals or recalls.

For a little assistance in measuring the benefits of an SCRM program, check out this SCRM ROI calculator.

The case for benefits is only half-made if you don't explain how to track them. Put simply, make sure to explain how you will know if the investment has been successful. Your business case should identify the KPIs (key performance indicators) or metrics that will help to identify the outcome from the investment and track whether it has met its goals.

As much as possible, hard numbers should be used, although it is important to recognize that in some areas (such as avoidance of catastrophic risk events or consequences), we are inevitably measuring something that did not happen. But in other cases, there will be numbers available to support both specific and ongoing investment in risk management capability and tools.

Conclusion

The nature of risk management is such that we are often looking to stop things from happening, which means the business case may need more thought than one that is looking at increasing sales or generating new products. But by highlighting any weaknesses in the current situation, identifying the potential implications of supply chain risk events, laying out the vision for an improved situation, proposing a plan and analyzing the costs and benefits, a persuasive business case can be constructed.

When the benefits of a high-performance supply chain risk management program are laid out, it is clear that they are wide-ranging, varied and substantial. A business case that combines as much rigor and as many hard numbers as possible, with some narrative to support that (such as stories of past problems or failures), can prove effective in gaining approval for the investment needed.

Ready to get started with your own business case? Check out our business case brainstorming template to get the juices flowing. And don't hesitate to contact us or request a demo to learn more about SCRM or riskmethods!