

A photograph of a man balancing on a tightrope against a blue sky with light clouds. The man is shirtless and wearing dark trousers. To his right, there are several wooden posts or stumps, some with chains attached, suggesting a construction or industrial setting.

Risk: it's a balancing act

Risk is fundamental issue in achieving effective supply chains, but it's a far from static quantity. Mark Hubbard explains how awareness of external threats must be balanced against other factors for best results

Continuing disruption in the Middle East has flagged up just how volatile the world economy has become. In just a few weeks the price of oil has rocketed and the longer-term is totally unpredictable across a range of commodities.

Once again the question of supply chain risk has arisen: how reliant is your business on products from the region – either directly or indirectly?

A knee-jerk response is to assume that any vulnerability in the supply chain is a Bad Thing and must therefore be reduced to the minimum.

A slightly more sophisticated strategy, however, is to recognise that risk is always present in every supply chain and the challenge is to balance it against other factors to achieve the most effective formula.

Risk in a supply chain expresses itself in a several ways and there are approaches we can adopt to help mitigate it. The complicating fact, though, is that these approaches often contradict one another.

Take the risk of the price of suppliers' goods and services changing, for example. We may want to stabilise a price so that it can be locked in to our end product price position. But to do that we would generally be asked to enter a longer term contract or adopt variable pricing approaches to reach an average, based on the manipulation of shorter term contracts.

It may not, however, make business sense to adopt either of these approaches where they are contradicted by the size of the contract, for example, or where there is a wariness about locking in prices over larger volumes.

Then there is the risk of supply. We often see sourcing from a single supplier as a benefit: we can learn and grow together. The problems arise, though, when our supplier faces disruption. We have become locked into a single supplier and suddenly face huge threats to our business.

Clearly, the risk of disruption to supply chains is serious and an escape route – an alternative supplier base – may be a sensible approach. But the potential cost of this strategy must be balanced against the real risk posed. The risk of disruption must be balanced against the benefits of an excellent long-term relationship with a single supplier.

Thirdly, there is the question of innovation. Developing a strong, stable supply base is generally a positive strategy and may in itself maximise opportunities for benefiting from our suppliers' creative thinking. But the rest of the supplier base may be locked out.

A balanced approach in which newer, smaller and less traditional suppliers are given some space may be a very effective counterbalance against the risk of long-established suppliers becoming complacent.

Finally, there is the risk of market changes, especially relevant currently in terms of oil and oil-based products. Markets are always subject to changes in supply and demand which can affect prices and/or supply.

But there are positions you can take to mitigate the potential pressure: long-term price agreements or hedging, for example.

These, however, come at a price and create a typical cost/effectiveness challenge: is it worth paying a potentially higher price for stability over a period of a year or more into the future, or does it make more sense to accept the risk?

To be able to manage these and other forms of risk in an unstable world, we need a really clear understanding of the business's appetite for risk. To what extent are we prepared to accept risk in order to reap potentially higher rewards? Conversely, how much do we value stability, even though it comes at a higher price?

As with many other business requirements, the risks facing an organisation may not be clearly expressed and we will need to clarify what we really want, then use that expression to guide us in the development of our strategies.

The really effective strategy is to understand all the factors involved and then make sure you have balanced them against each other to produce the best results.

Mark Hubbard is director of Positive Purchasing

www.positivepurchasing.com

t: +44 (0) 845 331 3312

e: team@positivepurchasing.com