

## *The special risk features of the supply chain project*

### **Generic outsourcing risk issues**

There are two dimensions to outsourcing risk and, whilst they are related, they are worthy of separation for the purposes of bringing out the key issues of each. The two fundamental concerns are a) the initial risks around the business changes that come with outsourcing and then b) the risks associated with those changed organizational structures once they are in place. We will begin this chapter by looking at concerns and opportunities related to generic outsourcing risk.

Once completed, the generic risk assessments will have made more clear the understanding around the organization's crucial objectives and sensitivities. The risk picture will have identified which dependencies lie deep within the intellectual assets, the legalities, the physical resources, stakeholder support, the ability to maintain business control and the people skills that are needed to stay 'in business'. This will apply equally whether that 'business' is profit making, public service or charity.

Part of the strategic understanding that emerges will be clarity about what precise values the organization expects from its internal and outsourced supply chains. As stated, a move towards outsourcing those values may be simply to reduce costs and management time and/or to enable more competitive product pricing. The objectives may, however, be much deeper, with a strategic placing of part of the wider business model that will enable flexibility, customer product differentiation, differentiation from competitors and/or to enable entirely new product lines.

It is only from a clear understanding of these objectives and perceived deliverables that the risk manager can then begin to fully understand the

outsourced supply chain and consider what additional risks it brings, and indeed how it can itself be used as a risk management opportunity.

## **Criticality**

We have already stated that the criticality of risk and potential impacts inherent within the decision to outsource must be considered before contracts are signed. They are, essentially, to be integrated within the very strategies to be adopted.

To reinforce the point, an organization can create the cheapest supply chain by focusing all supply needs on one supplier, perhaps in a low-cost, low-currency value, developing country. That exclusivity could enable the receiving organization to use critical mass with that supplier to force the prices down even further. The organization may, however, decide that this brings unacceptable risk and will wish to diversify supply amongst suppliers and countries. The second choice comes at increased cost. The organization may decide that the additional costs of the multiple-source supply chain are an acceptable and valuable risk management 'expense'.

To understand and communicate these exposures effectively, a supply chain needs first to be mapped so that each link can be risk assessed. One important piece of risk information is whether the organization will have a supply chain that is itself dependent on a further, long supply chain or whether the link is more self-contained. Clearly, the further the end organization is from key ingredient providers way down the line, the more difficulty there is in risk managing those ingredients, not least when risk understanding and management is necessarily third hand, fourth hand or more. A single self-contained link, however, again brings its own single point of potentially catastrophic failure.

The business-critical needs may be operational, a physical ingredient or intellectual. The organization will need to consider where these needs fit into Table 3.1 of urgency and the availability of alternatives.

The three levels of urgency may be defined as a measure of time ranging from simultaneous (for some e-commerce businesses, for example) to measures in minutes, days or even weeks. This will vary organization by organization, according to the need to meet the urgent contractual and market needs and to retain stakeholder confidence.

**Table 3.1 Urgency and alternatives**

<i>Speed required</i>	<i>Alternatives</i>
Immediate dependency	Not available elsewhere in volume, quality and quickly enough
Immediate dependency	Available elsewhere in volume, quality and quickly enough
Mid-term dependency	Not available elsewhere in volume, quality and quickly enough
Mid-term dependency	Available elsewhere in volume, quality and quickly enough
Non-urgent dependency	Not available elsewhere in volume, quality and quickly enough
Non-urgent dependency	Available elsewhere in volume, quality and quickly enough

Dependency is equally about the impact of the loss of that supply chain ingredient on each of the criticalities that has been defined in the risk policy statement as being critical or potentially catastrophic. One approach therefore would be to take the previously agreed definition of potentially catastrophic risk and then measure against that definition the importance of the ‘dependency’ under review.

For example, if a particular supply chain failure could cause the loss of regulatory compliance, it would be a primary risk consideration. Compliance and legality are clearly ‘killer risks’. It is likely also to be in category 1 as there will be an immediate need to be able to illustrate compliance to the regulator. To repeat, that immediate urgency is not only to remain compliant, it is equally important still to be able to illustrate that compliance in the period leading up to the risk incident. The loss of an audit trail that is needed to give those reassurances can be just as destructive as then losing control of the business to the point that new activity fails to meet compliance requirements.

The word ‘available’ used in the table, however, is not just about the delivery of physical parts for the production line of a motor car or piece of machinery. It is equally about how fast the host organization can regain all of the things that it needs to enable it to provide the value chain items themselves, or arrange supply from another source. There may be vital business-to-business

communication software, databases that themselves need skilled staff, and software and hardware to access and use. The software may need the software source code to enable other technicians to service and upgrade it and these are no less crucial dependencies.

The ‘availability’ also needs to be defined in the ability to source the ingredient to the required specification, volumes and quality, and deliverable to the site or website required. ‘Availability’ needs to be defined too in terms of the costs of the alternatives that enable the receiving organizations’ pricing and financial models to remain valid. The cost levels will again not only cover the actual monetary cost but the credit terms available. If an organization’s financial models depend on positive cash flows, then those same credit terms applied equally to the alternative supply are, again, no less a ‘dependency’.

Furthermore, dependency is no less related to ‘ownership’ of the databases, software and other intellectual assets that are also crucial to the delivery. Additional questions raised will be whether these intellectual assets are recoverable at all, and if so, how? Are there legal barriers such as contract terms, and what is the ease and speed of being able legally to transfer the ownership of the very wide range of intellectual assets? Who now owns the brand names? Are there statutory barriers such as the Data Protection Act 1998 (UK)? This Act, and others in other jurisdictions, demands that the name of the ‘Data Controller’ is registered wherever personal data is used, and specifies how that data can and cannot be used and thus limits the use of that data for the registered purpose and by the registered person. Gaining access fast enough to a personal information database almost certainly will need pre-registration of that alternative data controller.

To reaffirm, these are questions that cannot be usefully raised once the contractual relationships and dependencies between the supplier and the receiver have already been set in stone.

## **The outsourcing project**

We have once again two important inner risk dimensions:

1. the need to understand and take on board the risk implications whilst the strategic decision making is unfolding;
2. the re-engineering risks being carried whilst the outsourcing, in whatever way it is agreed, is being implemented into the existing organization.

*1. The need to understand and take on board the risk implications whilst the strategic decision making is unfolding*

Perhaps the greatest of all risks that lie within the project is the confidence amongst the project owners that their brilliant and stunning management decisions cannot possibly go wrong. This ‘can do’ philosophy and, conversely, a fear of a blame culture, vary organization by organization. It may, though, rest no more than in the individual executive’s desire to show to those who will be influencing his or her future career, just how brilliant he or she is. The result of this approach can be that crucially dependent relationships are created with no exit strategy at all.

The project deliverables are unsafe if they do not include a ‘prenuptial’ agreement that defines just how the divorce will unfold and how the widely defined assets of the relationships are to be divided and accessed. Access to those assets, whether they are people, equipment or intellectual, is not just a physical and legal consideration. ‘Access’ needs to embrace the operational ability to use and gain the required values from those assets, and the wider legality in how the assets can be used.

This is especially important in the light of research by Metrica, a UK research firm, which suggested the following were the greatest worries of risk managers involved in outsourced processes:

- losing control over the process;
- losing control over customer relationships;
- potential loss of quality;
- threats to brand and reputation;
- the operational and financial stability of the supplier.

These may be ‘soft’ or less well-defined risks to manage but they lie at the very heart of the survivability of the organization.

Clearly the project is just waiting for failure if the objectives are neither clear nor realistic, and these of course include the initial cost of the project to bed the outsourced elements into the existing and wider organization. Items such as the employee cost of redundancy and pension fund shortfalls can alone destroy the viability of a project.

Taking great care in getting this clear and right is a crucial process of risk management.

## *Managing Risk and Resilience in the Supply Chain*

We can usefully drill down further into the 'soft' but absolutely crucial risk issues surrounding the decision making that precedes a decision whether to outsource or not, and if so, how. The following checklist embraces some more generic project specific issues.

- Are the objectives clear and communicated?
- Is the sponsorship at the correct level?
- Are programme management and communication tools agreed and up to the task?
- Who is measuring and who is accepting any uncertainties and risks? Do they know that they are?
- Are communication and risk-reporting mechanisms clear between the above and the project workers at all levels?
- Whose job is it to stop 'creeping' of the original project objectives?
- Are this and similar responsibilities embedded at the right level and function within the organization?
- Are the time deadlines realistic and the project adequately resourced to deliver without unacceptable stresses?
- Have existing stakeholders been brought in?
- Have potential stakeholders been brought in?
- What is the ability to accurately plan and estimate, and are the margins of error acknowledged?
- Is there ability to control and monitor, and by whom?
- Is 'shop floor' real input and team working in place?
- Is the 'consultation' a genuine effort to listen or just a ritual designed towards getting agreement?
- Can issues that emerge be quickly escalated for business-critical understanding and decision making?
- Can a possible decision not to proceed remain an option as the detail emerges?
- How rigorous is the testing, including volume testing?
- Could the clear strategic rationale be subsumed as the project unfolds?
- Will the re-engineered processes be pushed into the organization or received by an organization that is on board, enthusiastic even, and ready to make the changes?
- Will the control procedures ensure that personal agendas and politics are removed from the decision path? Is it possible to bypass any vested interest?