SUPPLY CHAIN TAKEAWAYS FROM THE FINANCIAL CRISIS

The financial crisis took its toll on almost every business in a variety of ways but the supply chain side was hit particularly hard. Firms around the world were forced to deal with enormous demand-supply disparities caused by collapsing demand and the manufacturing sector in particular suffered severe consequences as a result of the recession: Industries such as machinery, metals, and transportation equipment observed drops in customer orders by up to 42 percent within a single year. But what did they learn and now we're emerging out of the other side how can companies evolve their supply chain practices?



Today, many firms continue to deal with individual challenges. Similarly, the economic situation in many parts of the world has become unstable and new manufacturing bases have opened up in emerging nations bringing with them vast opportunities for the savvy manufacturer, if they can gain access. For those reasons, innovative approaches for managing supply chains in a downturn could become as important now as they were just five years ago. Here we identify four supply chain action areas that supply chain executives should be familiar with.

Understanding True Demand

Before we get to those however it's important to understand that the primary lesson from the financial crisis was that numerous firms underestimated the severity of the declines in demand (up to 90 percent in some firms). Because forecasting demand is the starting point of all planning (i.e., capacity planning,

supply planning, and production planning), it is crucial to understand true demand. Indeed, any significant over- or under-reaction could trigger a disaster. This will always remain paramount.

Identify Reliable Demand Information

For most firms, the visibility of true customer demand was close to zero at the beginning of the crisis. Many found it challenging to identify reliable demand information. In addition to high levels of economic uncertainty, opportunistic competitor actions to fill capacities induced additional uncertainty. Even long-standing orders were subject to cancellation as a result of collapsing customer demand. For example, a Scandinavian heavy equipment manufacturer lost nearly all previously booked orders from Russia because of limited credit availability of these customers.

For this reason, successful firms establish a process to monitor the probability of order cancellations that is similar to the processes for monitoring the probability for winning orders. Frequently, companies began to realize that leveraging information from the over-opportunistic sales force did not provide any transparency, as sales personnel were still handcuffed to their budget thinking. When challenged to explain their sales forecasts, personnel often expressed concerns that capacity could be reduced too sharply and that longer lead times would alienate customers. Successful firms rapidly moved away from initial budgets and targets by implementing a new zero-based budgeting process.



Communicate Frequently With Customers

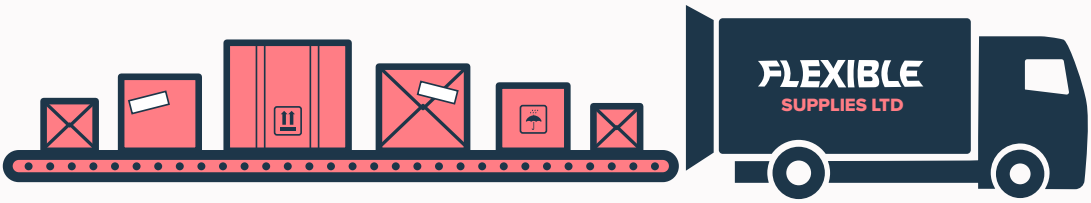
It is also prudent to establish more frequent communication with customers and place more emphasis on short-term forecasts. However, communication through established channels between sales and procurement departments can often not provide sufficient visibility, as the information flow can be slow within the customer organization. Procurement departments themselves frequently have no visibility regarding procurement

volumes in the upcoming weeks and months. Accordingly, increased direct communication should occur among planning departments while contract details are coordinated between sales and procurement departments. It's also a good idea to further integrate planning systems and establish EDI to obtain real-time updates on planned volumes.

An example of effective communication would be a vertically integrated chemical company that produces goods for all stages of the chemical value chain. By sharing demand information on all types of fine and base chemicals internally, managers could establish a reasonable picture of the market demand for different products several months in advance.

Create Flexible, Breathing Supply Chains

When demand plunged in the Financial Crisis, numerous firms grappled with overcapacity and struggled to right-size their operations in the short term. These challenges were often inevitable because network design and footprint decisions had been carefully planned and implemented over the course of several years for a very specific demand scenario.



In the future it's advisable that managers proactively address demand uncertainty and create supply chains that are flexible to a wider range of demand. This can be handled in a number of ways but the smartest and most secure option would be to utilise a supply chain trade platform that can soak up the slack during times of need and guarantee payment even in regions that lack the comprehensive financial infrastructure and stability of established manufacturing bases.

For example, a company like the UK based Stenn International has a **$300 million** financing platform that's able to assist suppliers across the globe access and service buyers of their products in developed markets. The platform acquires up to **120-day** trade receivables from small-to-medium enterprises ("SMEs"), particularly in China and Southeast Asia, who produce and export goods for sale to U.S., European and other global buyers.

Access to flexible short-term funding is now not just convenient but essential for developing market suppliers, who need working capital to finance orders bound for global markets until payment is received from their buyers. Stenn's financing solutions offer payment for goods immediately after shipment, which enables those suppliers to offer generous delayed payment terms to their western buyers. In effect this provides cash flow relief at both ends of the transaction: Buyers get long generous payment terms. Sellers get paid at shipment.



With many businesses still feeling uncertain about issues such as overcapacity, specialist international supply chain trade finance can offer increased financial security, risk management and allow them to focus on other core areas like product development and customer service.



Understand the Effects of Demand Fluctuation

One key task in defining supply chains is to match capacity with demand. Accordingly, it is crucial to obtain a fair understanding of the effects of demand fluctuations. Firms must identify which actions should be selected based on the prepared demand scenarios and must embed the breathing supply chain thinking into their supply chain strategies by asking questions such as: How do we provide the most flexibility regarding any changes in demand?

For each demand scenario, a firm must identify preferable actions that holistically consider the effects of selling, closing, or idling manufacturing assets as well as any potential insourcing or outsourcing effects. On a more operational basis, situations are frequently complicated by increased MRP complexity in low-demand situations as a result of coupled production, minimum batch sizes, and order quantities.

Convert fixed costs into variable costs. Ultimately, it is crucial to convert fixed costs into variable costs to compensate for lower production levels by diminishing marginal costs. Firms have often closed or idled assets with lower productivity while carefully considering the incremental costs of moving production to other plants. One alternative for reducing fixed costs involves increasing the utilization of “fixed” assets and labor by insourcing.



Define Smart Contracts

The definition of smart contracts with suppliers plays a crucial role in creating breathing supply chains. Many firms closed long-term contracts with suppliers to benefit from discounts. However, once locked in, volume or price reductions often depend entirely on the good will of suppliers. Successful companies have considered fluctuations in demand when defining their contracts.

As an example, example, one Dutch chemical company had an annual contract with a provider of tank capacity beginning on January 1. The firm received a volume discount based on the tank capacity signed for the year.

However, company officials realized that the firm would need to pay for unused tanks or would fail to receive volume discounts if capacity requirements deviated from the plan in mid-year. Therefore, the firm opted for a smart contract design. Rather than renting all tank capacity on January 1, the firm now begins its annual rents on a rolling basis throughout the year (e.g., certain capacity on January 1, certain capacity on February 1). Rather than receiving a volume discount on the capacity signed at the same time, the discount is now based on the capacity rented at a given time. The firm can easily discontinue the rent for the tank with the next expiring contract to adjust capacity while continuing to receive high-volume discounts for the remaining tanks rented. The example highlights the importance of considering your options before any crisis arises to ensure flexibility in tough times.

History Only Repeats For Those Who Refuse to Learn Its Lessons

Although it appears that global business has survived the recent financial crisis, in our current accelerated economic environment it is inevitable that another downturn could arrive at any time, especially when you consider the fluctuating geopolitical situation in many, often regarded as stable, regions.

Utilising a supply chain trade platform can mitigate much of the risk associated with all of the aforementioned issues and they are obviously a foregone conclusion as a solution for small to mid-size businesses that lack the financial liquidity of the world's bigger firms.

However, it is also paramount that firms should continuously improve their agility, as a means of ensuring success in any economic situation. Fewer stockpiles are accumulated when state-of-the-art inventory management policies are implemented, capacity can be adjusted quickly when contracts with suppliers are designed intelligently, and supplier bankruptcies can be handled easily when alternative sources are constantly identified.

For firms that have not yet become sufficiently adaptable in this regard, now is the time to take the proper steps to safeguard their supply chain situation before external forces apply a downward pressure once again.