

Chapter 1

Preparing for the Worst: Sustaining Suppliers Though the Economic Crisis

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ABSTRACT

The economic crisis has taken a major toll on almost every industry, as well as key customers and suppliers in all sectors of the economy. Supply chain managers are increasingly concerned about the financial impact on key customers and suppliers, deferred commitments and outstanding accounts. In an effort to probe into the underlying assumptions that their actions are based upon, the author surveyed supply chain executives, identifying key patterns that are beginning to emerge across industries and counter-measures that are being taken in response. Three key themes emerged. First, buyers and suppliers are co-dependent, and they should think within this context when faced with financial stress. Second, there is a need to better understand the warning signs and establish channels of communication, to address the key risks related to financial stress. Finally, managers should emphasize the need to better manage supplier relationships through modeling and event analysis, allowing them to take preventive actions before problems occur. These themes are discussed and developed into a set of propositions, as a foundation for future research.

INTRODUCTION

The economic crisis continues to linger, and its effects could very well into the next decade. Initiated by the portentous drop in mortgage-backed securities, the failure of Bear Stearns and Lehman Brothers, and the spreading economic global rise

of unemployment and drop in GDP, economists are now predicting that full recovery may extend well into 2015. Despite the impact, there is a surprising lack of action being taken by many in industry.

The economic crisis has proven to have taken a major toll on almost every industry, as well as key customers and suppliers in all sectors of the economy. However, it has also been said that the perception of a crisis is often more power-

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ful than the crisis itself, and it is the former that often creates the latter. During tough times, the knee-jerk reaction in many companies is to shore up costs, delay capital investments, cut budgets, lower inventories, and adopt a myopic attitude to conserve cash. Buyers are often likely to become complacent and stand by as suppliers fail. Suppliers become less flexible and chase unprofitable business. The rationale behind much of this activity is to “just do what we have to do to make it through the trough.”

We posit that this approach may not be the right one, and it is more important than ever to act in an entrepreneurial fashion. Supply chain managers are increasingly concerned about the financial impact on key customers and suppliers and the deferred commitments and outstanding accounts that exist. In an effort to explore the assumptions that immediate actions are based on, we completed a survey of supply chain executives, and we identified some of the key patterns that are beginning to merge across industry and the countermeasures being taken in response.

Three key themes emerged from this research. First, buyers and suppliers are co-dependent, and need to begin thinking within this context, when faced with financial stress. Buying companies, in particular, need to be cognizant of the major challenges being faced by their key suppliers, and need to explore the extent to which financial peril will impact the business continuity of these suppliers. Second, there is a need to better understand the warning signs and establish channels of communication to address key risks due to financial stress. Managers need to establish processes for assessing the current situation, think creatively about how to create truly lasting relationships with suppliers that will sustain all parties through the crisis and identify ways to emerge on the other side with stronger bonds and a true view of a joint future. Finally, managers need to emphasize the need to better manage supplier relationships through modeling and event analysis, allowing them to

take action to prevent problems before they occur. These themes are explored in this research study.

Theoretical Contexts of Supplier Financial Risk

Supply chain disruptions associated with financial health and other factors have been the subject of significant research in the last five years. Disruptions to the supply chain are now recognized as an inevitability and have been found to have significant impacts on financial performance (Hendricks and Singal, 2003; 2005). The recovery from these disruptions is critical, to ensure a smooth flow of products through the supply chain--yet this area has received little attention in the supply chain research, from both a theoretical and practical standpoint. Jüttner, Peck and Christopher (2003) state that “despite increasing awareness among practitioners, the concept of supply chain vulnerability and its managerial counterpart supply chain risk management are still in their infancy.” The need to provide insights into this area is further enhanced by the movement towards global sourcing—an arena that potentially increases the likelihood of disruptions in a supply chain. Peck and Christopher (2004) state that the increased vulnerability of supply chains to disruptive events requires “a new focus on managing and mitigating risk which extends beyond the four walls of a plant”.

Rice and Caniato (2003) produced estimates that the impact of a \$50 million to \$100 million cost impact for each day its supply network was disrupted. There are many anecdotes that display such impacts. For example, Boeing experienced supplier delivery failure of two critical parts, which resulted in an estimated loss to the company of \$2.6 billion (Radjou, 2002). In 2002, less than 100 workers in the longshoreman union strike disrupted West Coast port operations. However, it took six month for some containers to be delivered and schedules to return to normal (Cavinato, 2004).

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