Protectors of the BRAND

In a world where Tweets go viral, supply chain professionals are charged with more than having two sources of supply. They must also have strategies and processes in place to deal with a new world of risks that can leave their organizations reeling.

BY HANNAH KAIN

IN AUGUST OF 2015, Chipotle was riding high. Perceived as a healthy food choice for its use of local, farm fresh ingredients, the Mexican food chain was one of the three most respected limited service restaurants in the world. Neither diners, who flocked to its locations, nor investors, who drove the price of a single share of stock to more than $750, could seem to get enough. Of course, that was before an outbreak of Norovirus in Simi Valley, Calif. that affected nearly 100 customers.

As if that was not enough, the California outbreak was followed by more outbreaks of food borne illnesses linked to Chipotle locations in at least 12 states. The low point may have been reached in February 2016, when the chain temporarily closed all of its locations to address the issue.

Soon, Chipotle's stock had dropped 47%. The company had lost $10 billion in market capitalization along with its reputation as the healthy restaurant choice. Now dubbed "the most dangerous restaurant stock in the industry," it was among the least respected restaurant brands among investors. While the Centers For Disease Control and Prevention looked for the culprit, a sign posted in the window of one Chipotle identified the cause: "FYI: We are sorry, but we are temporarily closed due to a supply chain issue."

The sign, and the damage to Chipotle's image, are stark reminders to supply chain managers that risk is everywhere, regardless of the industry. Whether it's faulty air bags forcing Takata to the brink of bankruptcy or Samsung's stock price taking a nose dive due to exploding smart phone batteries, negative news stories can lead to lasting damage to a company's reputation as well as its stock value.

Supply chain managers, especially those involved in risk mitigation and risk management initiatives, are no longer just tasked with making sure to have two sources of supply; they are now protectors of their organization's brand and value. In this article, we will examine this broader definition of risk management.

3 rules of risk management

Supply chain history teaches us that there are three risk-related rules:

Rule No. 1: The overlooked risk often presents the most immediate danger.

Rule No. 2: The risks keep coming and require constant vigilance.

Rule No. 3: Risk and complexity go hand-in-hand.

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Lessons learned

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- **Rule No. 2:** The risks keep coming and require constant vigilance.
- **Rule No. 3:** Risk and complexity go hand-in-hand.

In fact, complexity drives risk. While risk can exist without complexity, risk factors increase disproportionately with increased complexity.

This is important because complexity in supply chains has increased tremendously in the last decade—a trend that is likely to continue. More than anything else, it has given birth to risk management as a supply chain discipline. Regrettably, practitioners of that discipline have largely focused their efforts on avoiding supply chain disruptions following earthquakes, weather-related events or the loss of a key supplier. But risk avoidance can also result in the kind of micro-management that can stifle the supply chain. Simply put, a sustainable supply chain cannot be built primarily on risk avoidance.

A quick look back at the last 20 years may provide some perspective. For many companies, complexity arose with the advent of outsourced manufacturing to low-cost and low-wage regions of the world. The perceived risk then was the inability of a company to compete if it continued to produce in high-cost labor markets. The overlooked risk—Rule No. 1—was a string of quality problems. In those early years of outsourcing, companies spent significant resources to mitigate quality issues. But while outsourcing avoided the risk of high labor costs, the significant physical distance between manufacturing and markets prevented nimbleness; it was increasingly difficult to react to swings in demand and inaccurate forecasts—it's important to remember that risk avoidance can stifle the supply chain. It also became clear that the supply chain had become vulnerable to disruption because each of the many layers in the supply chain had created its own global supply chain for its suppliers and its operations. A disruption in a Tier 2 supply chain could bring a Tier 1 supplier to a halt.

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The impact of supply chain disruptions became more apparent as companies started practicing Lean principles. Buffer stock and WIP were no longer maintained in large enough quantities to save the day. Instead, supply chain managers who forgot Rule No. 2 were buffeted by stock outages in one location and excess inventory in another. At the same time, SKU proliferation, customization and new fulfillment strategies like vendor managed inventory and smaller and more frequent deliveries added to complexity—Rule No. 3.

That describes the world that was. In today's world, with the growth of customer expectations and social media putting company practices under a potentially viral microscope, risks that may have been overlooked in the outsourced supply chains of the past are now potentially front and center. There is now an expectation that OEMs will manage multiple layers of their supply chains, including end-user facing. Omni-channel strategies, with their emphasis on delivery speed, customization and localization, add even more complexity. If manufacturers play to win, they must have a strategically-positioned delivery system. The perfect order is the order that is delivered to today's standards, in all that that entails.

Local laws and regulations, trade agreements, cross border regulations, associated tax laws and supplier compliance also exert a heavy impact on supply chain organizations. With the complexity and integration of other business areas, the responsibilities of supply chain organizations continue to expand. Gradually, supply chain scope includes new areas such as the responsibility for being a good corporate citizen or the responsibility for converting currency on the fly while processing orders around the globe. This scope creep within the supply chain organization has created new sub-disciplines; however, with few (if any) senior professionals trained in these areas, the profession is missing senior leaders who can develop talent.

Supply chain gets attention

Something else has changed. For years, supply chain managers felt ignored and underappreciated by senior management. Now, with CEOs getting called on the carpet when their stock value drops following a supply chain disruption, supply chain is getting the attention it has long sought, but for all of the wrong reasons. The message, delivered loud and clear from the C-Suite isn't "great job." It's "don't mess up."

The much craved attention has become a double-edged sword for many supply chain pros. Yes, the board is now interested in supply chain, but that also means that risk avoidance has become a significant element of the job. The pendulum has turned: It is increasingly difficult to find supply chain pros who are willing to stick their necks out. The stakes have gone up for everyone. Yet, in the midst of the decision paralysis, nimbleness and fast reaction times are crucial.

Reacting to new risks

To understand the new risks that supply chain pros face, we must face that we live in a world of transparency and instant communications. Simply put, our new vortex is the juxtaposition of the social media and instant communication combined with a highly complex supply chain.

The associated risk affecting brand value and customer loyalty has a significant and measurable impact on financial results and shareholder value. The supply chain has become a primary factor in reputational management. Reputational risk, in turn, has become a major element in a company's success as measured in brand loyalty and in stock value. The more valuable and important the brand, the higher the reputational risk. When consumers feel that management has broken the unspoken but perceived brand promise, the punishment can become severe. These new risks include:

Labor in the supply chain. Labor conditions have been a major issue for manufacturers. One corporation took a major reputational hit online when one of its second tier suppliers employed garment workers in an unsafe building that collapsed. Another corporation struggled with worker suicides at a contract manufacturer. Customers do not want to align themselves with companies that abuse workers. The connection is made instantaneously between the viral videos and their large corporate customers.

We are seeing regulations regarding labor conditions in the supply chain, including in California where corporations with more than $100 million in sales in California must publish how they keep the supply chain free of indentured and child labor. It is a daunting task; yet with between 20 and 30 million indentured workers and an unknown number of child workers worldwide, it is one that the public expects to be met. A major corporation was caught having indentured fishermen tricked into slavery. Reacting quickly and resolutely, the company was able to avoid the impact of a PR disaster.

Consumer safety issues. Consumers and business customers are not just concerned with worker safety; they also expect that the products they purchase are safe to use and, in the case of Chipotle, to consume. One need look no further than the hit to Toyota's sterling reputation following a handful of accidents initially attributed to the Prius braking system or the fallout to the auto industry over the ongoing airbag disaster. Recalls of unsafe children's products especially enrage consumers.

Cybersecurity. In one cyber-disaster after another, millions of credit cards have ended up in the hands of criminals because a supply chain partner had a security breach. The attack on Target's point of sale system sent the retailer into a tailspin for months. It's no surprise, then, that many supply chain executives have cited cybersecurity as their biggest concern—especially because lack of connectivity is not an option.

However, the cybersecurity threat is about to get much worse. As the Internet of Things grows, medical, personal, environmental and other sensors will be embedded into our everyday products. Remember when a Jeep driven by a reporter for Wired magazine was taken over by hackers while he was behind the wheel? The hackers found a vulnerability in the Jeep's entertainment system that allowed them to play with the radio, the windshield wipers and ultimately the transmission. Technologists fear that these "new technology" companies simply do not have the expertise to prevent intrusion. Once cybercriminals have gained a foothold in the consumer's world—perhaps through sensors embedded in an athletic shoe—they can then move on to create severe havoc.

Traditional technology companies haven't fared much better than consumer companies. Over the years, millions of home routers from leading technology companies were sold with software that was vulnerable to hackers. When breaches like that can happen due to an oversight by established technology companies, imagine what can happen when your mattress has technology to track your sleep patterns, your car is self-driving and your refrigerator is tracking the food on its shelves.

Corporate citizen. Sustainability and environmental issues are other areas where brand names are vulnerable. Originally, everyone could wash his or her hands once a product was outsourced. Now environmental concerns and corporate culpability are discussed on social media.

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Just think about the impact of the 2014 Elk River chemical spill in West Virginia on Freedom Industries. Within a week of the spill the company filed for Chapter 11 bankruptcy and faced mounting lawsuits.

Consumers expect their favorite brands to be good corporate citizens. They expect diversity among suppliers, staff and executives; community involvement; and a reasonably equitable market strategy. Pharmaceutical companies such as Mylan and Turing have endured hits to their reputations after significant increases to the cost of life-saving drugs. Supply chain professionals must be conscious about whether their suppliers and their employees are being treated fairly, and whether their suppliers act as good corporate citizens. Volkswagen's disclosure of its software rigging emission test results is an example of a broken brand promise at a time when consumers take pride in supporting the environment. The company just settled for $15 billion but is not done with lawsuits and reputational damage; recovery will be long and expensive.

Temptations to shortcut laws. It goes without saying that corporate citizenship at a very minimum means following laws and regulations, no matter how cumbersome and difficult that might be. Throughout the supply chain, managers need to solve these issues in real-time while grappling with stressful practical, ethical and business dilemmas. If you have promised delivery to a wholesaler that launched a big promotional campaign, how do you deal with the corrupt Customs officer who is demanding an under-the-table payment? For U.S. corporations, it is clearly illegal to comply with the request for a bribe under the Foreign Corrupt Practices legislation. Yet, when the yelling starts, it may be tempting to let the local subsidiary or brokers take care of the problem. Another temptation faced by companies involves how to declare products for border crossings: If the Customs charges brings the product's price point into a non-competitive zone, is it acceptable to declare the product "slightly" wrong to avoid the Customs charge, for instance as a slightly different commodity subject to smaller Customs and duties charges? Don McCabe, a professor of management and global business at Rutgers University, found that 74 % of undergraduate business students had cheated during their studies. It is not farfetched to assume that they would cheat to achieve business and career goals later in life. Without clear direction, local managers may make the wrong decisions—even with the best of intentions—thinking that they in fact are looking out for their employer.

Supply chain professionals must ask themselves how the public will perceive each of their decisions. No doubt, there may be different levels of judgment based on whether any deviation from acceptable practice came about due to deliberate actions, negligence or an unfortunate coincidence.

In the internal or external parts of the supply chain, the temptation to circumvent safety, security, laws and ethics in order to expedite product or save money is one of the major risks that supply chain executive must face. In fact, many still speculate that the desire to be seen as a problem solver was what ultimately caused Volkswagen employees to develop deceptive software for their certification.

Supply chain professionals must ask themselves how the public will perceive each of their decisions. No doubt, there may be different levels of judgment based on whether any deviation from acceptable practice came about due to deliberate actions, negligence or an unfortunate coincidence. Assuming that supply chain professionals don't take deliberate actions to upset their constituents, it is tempting to simply focus on negligence. However, for prominent brands the presumption is that a high level of due diligence is exercised and that they avoid even the slightest coincidental exposure.

Proactive and reactive risk mitigation

Now that we have identified some of the new and complex risks that supply chain managers must contend with, what can be done to mitigate those risks? We believe that there are proactive and reactive strategies that supply chain managers and their organizations should consider.

One simple solution is to decrease complexity. While much complexity comes from outside sources, a few elements can be controlled within the supply chain organization. For instance, SKU proliferation can be reined in, the number of suppliers can be controlled, the location of warehouses can be optimized and concessions to customers can be done collaboratively with supply chain involvement. When new complexities are inserted, we must make sure that the gain in supply chain value justifies the increased risk.

Risk mitigation can and should be proactive, especially in established public companies. The first step is to identify the risk. Using tried and true FMEA and other risk assessment tools, we can certainly rate the risks and then put in place processes to mitigate them. Beware: As easy as that sounds, it is a daunting task.

The first problem is identifying the risk. Remember Rule No. 1: The danger comes from the overlooked risk. The second problem is that some situations simply spread like wildfire on social media with the potential to cause irreparable harm to the company brand. While it may not be game over, the damage can persist for years. Most analysis tools do not consider how to react to very rare but catastrophic events. The third problem is to identify up front which risks are important to mitigate. Being proactive requires corporations to employ highly qualified supply chain professionals. It also requires a long planning cycle. It may take years to qualify new suppliers, and most corporations are very conservative when it comes to adding new suppliers because of the high cost. The result is an opportunity cost in lost nimbleness.

Reactive risk mitigation must also be considered because the agility required in supply chains makes it virtually impossible to proactively and systematically identify all risks. Reactive risk mitigation requires constant vigilance internally and externally, empowerment and high-level involvement. Customer service oriented companies are now monitoring social media and taking complaints and individual concerns offline. Reactive risk mitigation involves the fast elevation of issues that can or are about to go viral, followed by expeditious and honest responses. One example of fast intervention occurred when Tesla's CEO Elon Musk contacted Tesla owners whose cars had caught fire and then sent Tweets about his conversations.

The strategy requires PR savvy and it is not enough to respond. When lululemon shipped sheer yoga pants to its stores and customers, the founder and CEO implied that the unfortunate see-through problem only happened to fat customers. The outrage knew no end and the CEO is no longer associated with the company.

Supplier management beyond questionnaire of the week

Supplier management relies heavily on technology to identify supplier related risks; most risks are identified by sending out questionnaires but with little follow-up. This is quite understandable as larger corporations deal with 10,000 or 100,000 Tier 1 suppliers. Thus suppliers are used to filling out endless questionnaires that require hours of valuable time to answer diligently.

Supply chain professionals think that they need to prove due diligence. Yet, they are faced with the questions of how to prove due diligence without micromanaging. A more strategic solution is to emphasize value alignment in the supply chain. Supply chain research has proven that the value alignment and relationship building approach generates higher profit for all parties. Instead of focusing on price points, procurement's role shifts from cost reduction to risk management and value creation. Indeed, some supply chain professionals are actually walking this walk.

However, most companies are still looking for the lowest bidder and measuring their purchasing staff by how they lower unit costs and not on mitigating risk or lowering total supply chain cost or increasing value.

Creating a sustainable supply chain: Lessons for executives

In most companies, supplier management is now on a track to create a staid, non-flexible supply chain that is simply not sustainable. The heavy-handed approach precludes the nimbleness and innovation that creates winning supply chains.

It is clear that just getting product out the door at the lowest possible cost doesn't cut it—especially if that means using suppliers that create brand disasters.

Supply chain executives simply have to review how they maintain control without stifling innovation. The supplier relationship and the oversight must change accordingly.

In the end, the shareholders, the board and the executives define what constitutes a job well done. It is clear that just getting product out the door at the lowest possible cost doesn't cut it—especially if that means using suppliers that create brand disasters. VW found itself in hot water because of executive pressure to meet U.S. requirements for diesel engines. Somewhere, somebody must have felt that the goal justified the means.

That should be a lesson for executives: As they push cost reduction as the primary goal in the supply chain, they may sacrifice a much broader risk that could affect their brands and put them out of business. Just as important, not all supply chain failures are the result of nefarious actions, like cheating to meet emissions requirements. Chipotle had the best of intentions when it used local farmers to source fresh ingredients rather than the larger corporate farms used by its competitors; what it lacked was the supply chain processes to identify and mitigate the risks presented by those suppliers, and a plan for how to respond if and when a problem arose.

Supply chain professionals at all levels must understand and monitor risk elements to fill this new role as protector of the brand. More importantly, the companies they work for must support them with the development of proactive and reactive risk strategies. Ignorance is no longer bliss as the world expects diligence and responsibility.