



Supply-Chain Consolidation: Gaining efficiencies, minimizing risk

Many companies have pursued administrative efficiencies and cost savings through supply-chain “reengineering” initiatives—efforts to simplify and streamline the supply chain that involve systematic review, consolidation, and renegotiation of key supplier relationships.

As the global economy continues to slow in the wake of a major financial crisis, companies are moving briskly to adapt to challenging circumstances. When demand for goods and services retreats, companies tend to pursue operating efficiencies, streamline business processes, and cut costs in an effort to maintain profitability. These efforts are undoubtedly valuable, and when done well, they can create leaner, more competitive organizations that are poised to take advantage of the next economic growth cycle.

But near-term pressure to show results from efficiency efforts can make it difficult for companies to consider the long-term effects of some decisions. In a recent CFO Research Services study on supply-chain risk, we found that many companies have pursued administrative efficiencies and cost savings through supply-chain “reengineering” initiatives—efforts to simplify and streamline the supply chain that involve systematic review, consolidation, and renegotiation of key supplier relationships. These efforts—made possible by technological and logistical advances over the past several decades—can dramatically reduce a company’s total number of transactions and create administrative efficiencies; they can also help companies gain greater negotiating leverage for discounts and preferred service arrangements based on total volume of spending. But these benefits can also carry a hidden cost, according to the senior finance executives we interviewed for this study: increased exposure to the risk of supply-chain disruption.

ABOUT THIS REPORT

In the fall of 2008, CFO Research Services launched a study to examine finance executives’ views on risks to the supply chain, with a particular focus on the physical hazards (including natural and man-made disasters) that can affect companies’ supply chains and disrupt their businesses.

We conducted a series of eight in-depth interviews with senior finance executives at leading U.S. companies for this research program; this piece is one in a series of three essays that report the results of these conversations. We also conducted a survey for this study, gathering 169 responses from senior finance executives at large U.S. companies. Complete survey results are available in *Physical Risks to the Supply Chain: The View from Finance*, available at www.cforesearch.com.

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Consolidating suppliers yields benefits, but may carry hidden costs

Companies undertake supply-chain consolidation initiatives because they often make good business sense. “If you’re a big customer, you have a little more price leverage,” says the controller of a large paper and packaging company. “There’s also the issue of transaction costs. With just a few suppliers, it’s easier to automate transactions.”

While finance executives are eager to realize the benefits of consolidation, many of the finance executives we surveyed for this research program also saw room for improvement in the diversity of their company’s sourcing partners. When we asked respondents to evaluate their companies’ performance on a range of supply-chain risk management activities, more than one-third of all respondents (34%) said there was “room for improvement” (only 14% said their companies’ performance was “excellent”).

These numbers, while not entirely encouraging, certainly don’t seem devastating—not when you look at them company by company. The problem, as one of the finance executives we interviewed pointed out, is that risk concentrations are amplified as companies up and down the supply chain seek efficiencies through similar means. “You start getting more and more dependent on fewer and fewer suppliers, and they get dependent on fewer and fewer suppliers. You wake up one day and realize you’ve got more dependence and more risk than you really anticipated,” says the divisional CFO of a global electronics manufacturer.

Rather than seeking to streamline and consolidate supplier relationships across the board, finance executives suggest a targeted approach that balances risks and rewards, across several dimensions.

Companies strive to balance efficiency and risk

So what should companies do to reduce these types of risks as they search for savings? One finance executive offered the following advice in an open-ended survey question: “Find an appropriate balance for your company between sole-sourcing

(which reduces costs and creates economies of scale) and multi-sourcing (which reduces risk).” Rather than seeking across-the-board streamlining and consolidation among supplier relationships, finance executives suggest a targeted approach that balances costs and benefits, risks and rewards, across a number of dimensions: by purchasing category, supplier, and geography, among others.

Striking the right balance is especially important, for example, when companies consider consolidating suppliers for critical components. Rob BonGiovanni, former CFO of Curtiss-Wright Flow Control Co., acknowledges that companies might realize some savings from single sourcing for key components, but he notes that companies can find opportunities to negotiate discounts while retaining diversity among important suppliers: “One would think that you would ‘put all your eggs in one basket’ [when sourcing a critical component],” he says, “but because the component is so critical, you’d never source from a single supplier. You want to have multiple suppliers.” Diversifying supply for important components not only reduces risk exposure, Mr. BonGiovanni explains, but also helps create a sense of competition among vendors eager to capture business. “If you have multiple suppliers, and they each know that there’s another competitor waiting in the wings, you’d be surprised. They call up with new-found ways of reducing costs,” he says. “Getting multiple suppliers helps in a couple of ways,” Mr. BonGiovanni continues. “It helps pricing tremendously just to let one supplier know that you’re dealing with another supplier. And in the event that something does happen to one of those suppliers, then the risk is divided among the remaining suppliers, at least.”

As demand slows, finance teams and supply-chain managers who were once urgently occupied with meeting orders may find themselves with the time, resources—and the motivation—to pursue efficiencies through supply-chain consolidation efforts. While such efforts undoubtedly yield value, the finance executives who participated in this study urge their peers to proceed carefully and to adopt a long-term perspective that takes risk into account. By doing so, finance teams can help their companies avoid surprises and ensure that they realize the full value of these efforts.

—CELINA ROGERS AND JANE COULTER, CFO RESEARCH SERVICES

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