TAKING STOCK

A PERIODIC EXAMINATION OF KEY ISSUES AND TRENDS FROM MARSH'S RETAIL/WHOLESALE PRACTICE

HOW RETAILERS CAN NAVIGATE FOREIGN SUPPLIER RISKS

In 2016, one of the world's largest suppliers of raw chemical materials suffered a deadly and crippling explosion. The disaster's impact quickly spread across numerous industries as their clients scrambled to identify alternative suppliers of these raw materials.

Supply chain failures can happen for a number of reasons. According to a study by Zurich and others, the top three causes of supply chain disruptions are unplanned IT and telecommunications outages, cyber-attacks, and adverse weather. Other potential causes of disruption include product quality incidents and lack of credit. And global supply chains can be complicated by diverging environmental and safety standards, limited resources for smaller suppliers, and broader geopolitical issues.

During periods such as the US holiday season, supply chains can be stressed due to increased demand. This strain combined with the potential for unexpected disruptions reinforces the need for retailers with foreign suppliers to ensure their supply chains have sound continuity plans and risk transfer options to help mitigate disruptions to operations.

KNOW YOUR SUPPLIERS' PLANS

The first step in developing a supply chain continuity plan is to understand your supply chain. This includes reviewing your suppliers' plans and their response and recovery capabilities, both during and after a disruption. Suppliers should have processes and procedures in place to swiftly communicate with your organization about any incident that may impact your supply. This allows you to react quickly, for example to secure limited supplies that may be available.

IDENTIFY POTENTIAL POINTS OF FAILURE

Mapping your own supply chain is also important. Determine where you have sole-source and single-source suppliers as well as key transportation dependencies and facilities. (Products that can only be sourced from one supplier are "sole-source" whereas products that can be supplied from multiple suppliers but are currently only sourced from one are "single source.") You can then identify specific points of potential failure by asking questions, including:

- What could give rise to a supply disruption, for example, supplier insolvency, a strike at a supplier, utility failure, or the political environment?
- How long could a disruption last?
- What would be the total gross profit impact?

Also, consider the following about your suppliers:

- Where does their supply originate?
- How long have they been supplying you?
- What location(s) is the supply delivered to?
- What is the main mode of transportation?

It is also important to perform financial assessments of named suppliers.

MONITOR YOUR INVENTORY

Once these baseline evaluations are completed, your organization should consider strategies to respond to a disruption. This includes identifying current inventory levels and locations within the supply chain. By doing this, your organization will be positioned to efficiently evaluate and reposition the inventory in the event of a disruption such as severe weather, or shipping delays due to high holiday traffic.

Additionally, your organization should consider using monitoring tools to obtain alerts about events that may impact specific locations in your supply chain. This is particularly important for smaller suppliers in countries where geopolitical issues are a concern.

Based on the information gathered during these exercises, your organization should develop written plans, playbooks, and potential responses, including internal business continuity and crisis management plans. Once plans are established, key team members should perform exercises to walk through potential disruption scenarios to ensure that all participants understand their roles and responsibilities in the event of a crisis. It is also prudent to pre-identify alternative vendors and have a contract in place should the need arise to use other suppliers.

TRANSFER THE RISK

While the above steps can help prevent and mitigate supply chain issues, it isn't always possible to prevent disruptions. Therefore, retailers should consider ways to transfer these risks, potentially decreasing their financial losses in the event of a failure along the supply chain.

Supply chain insurance policies can provide retailers with coverage for business interruption or loss of profits in the event of a supply chain disruption. These policies can be triggered by physical events, such as adverse weather, along with non-physical events, including labor interruptions, political risk, port or border closures, and supplier insolvency. Supply chain insurance policies typically include a maximum limit of $100 million during a 12-month policy term.

Before extending coverage, a supply chain insurer will typically conduct a detailed assessment of a retailer's supply chain. As part of the review, the insurer will identify the company's major suppliers, detect potential sources of disruption, and review its financials. This enables the insurer to design a policy that meets the company's specific needs and more effectively addresses its supply chain risk.

In addition to supply chain insurance, retail companies should talk to their insurance advisors about other forms of coverage that could protect against disruptions. Among others, these could include contingent business interruption, marine business interruption, trade credit, political risk, and product liability insurance policies.

Challenges along the supply chain can be unpredictable, but the financial impact on a company's operations is real. By taking the above actions, retailers can help mitigate the impact of foreign supplier risks on their inventory and bottom line.

This briefing was prepared by Marsh's Retail/Wholesale Practice, in conjunction with Marsh Risk Consulting, with contributions from Zurich Insurance Group.

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