

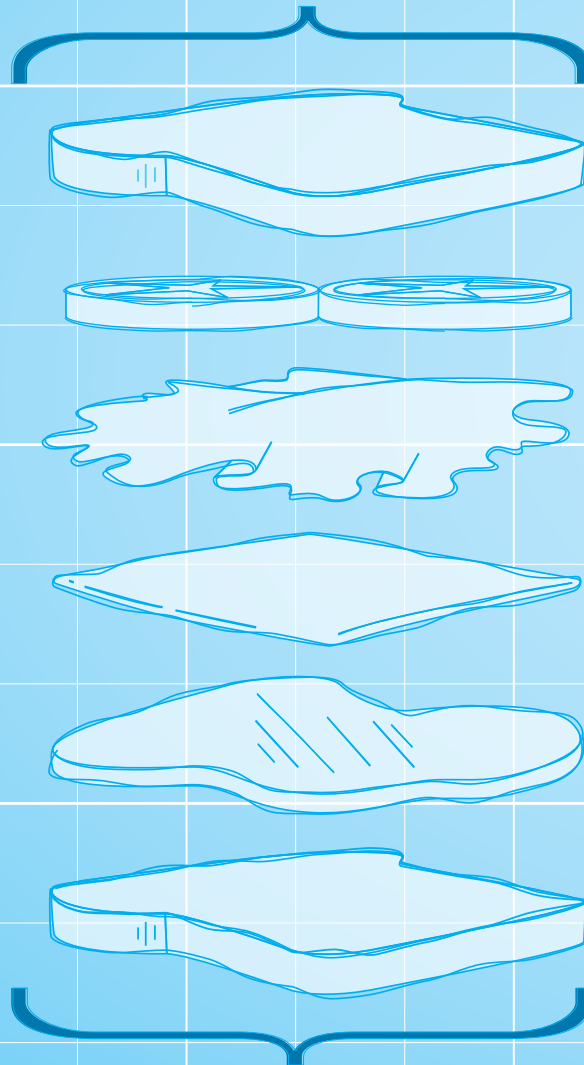


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# REASON

property risk and insurance solutions for a complex world

## FOOD FOR



## THOUGHT

# FOOD FOR THOUGHT

Your supply chain is your meal ticket. Is your risk management robust enough to protect the production process, mature enough to assess all unforeseen risks, and meaty enough to keep food on the table?

FM Global's new Supply Chain Solution features tools and resources to help clients increase their supply chain resiliency and implement strategies that mitigate risk in efficient, cost-effective ways.

**SUPPLY CHAIN/OUTSOURCING SPECIAL!**  
Part II of Reason's three-part series  
on the Global Economy  
Next issue: *Emerging Market Leaders*

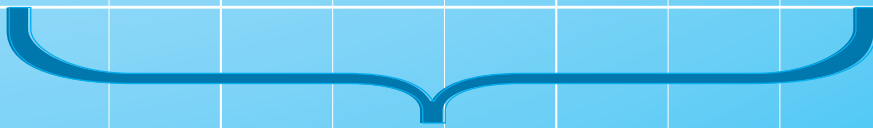
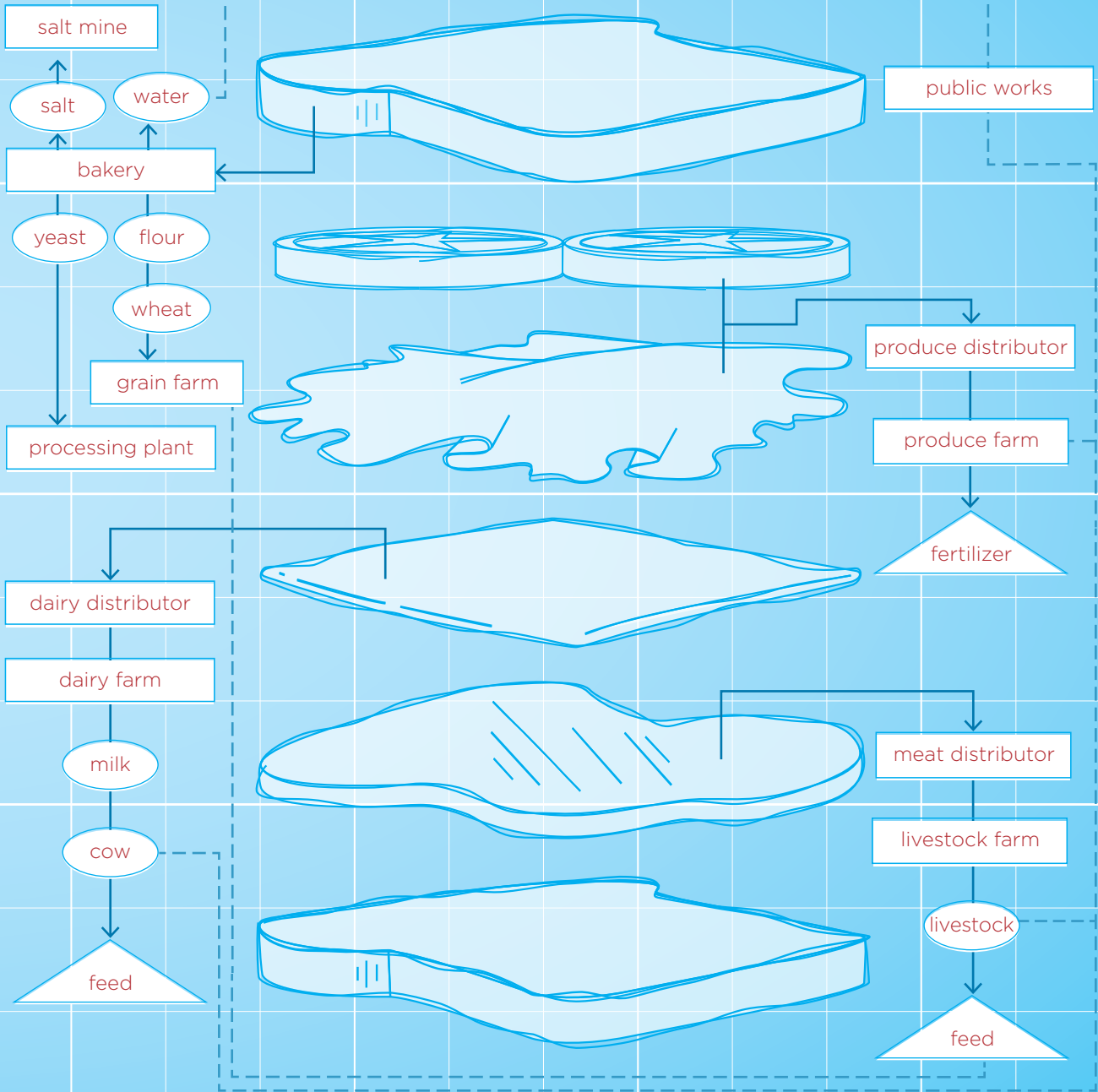
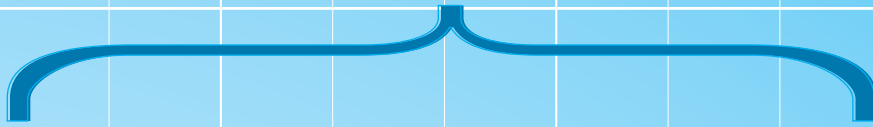
**YOU**



market



grocery distributors





# Globalization

has meant greater revenue and cost reduction opportunities in order to gain a competitive advantage. Over the past couple of decades, companies have realized it was no longer necessary to set up overseas subsidiaries. Local talent and expertise were developing to a point where they began to form their own companies to produce product components for their multinational clients. As their expertise and knowledge continued to develop, modules of products, and finally the entire design of sophisticated, high-tech products, were increasingly off-shored. Today, knowledge-based functions, such as client servicing and research and development are beginning to be outsourced to other companies. Flexibility, the need to leverage a broader knowledge and human resource base, and continued cost pressures have made the supply chain a common means of gaining of competitive advantage.

“In our research, we have found many companies that outsource the manufacture of almost their entire product to suppliers,” said Steve Douvas, assistant vice president and market research manager at FM Global. “This is clearly the direction many companies are moving in.”

A February 2010 article (“Supply Chain Risk: It’s Time to Measure It”) posted to the Harvard Business Review Blog stated that as a result of this trend, “The supply chain is

the lifeblood of the corporation. Sales revenue depends on the supply chain delivering product availability. Nearly 60-70 percent of a firm’s cost is typically controlled by the extended supply chain.”

Supply chains have become leaner over time as companies have begun to analyze them and have streamlined them to gain greater leverage over price, cost and service. Those who manage the supply chain have been given direction from their senior management to focus on minimizing production and delivery costs, especially in these challenging economic times where growing the top line is extremely difficult. Six Sigma techniques are being used throughout the supply chains to minimize defects and the additional operating costs associated with them.

However, greater rewards can result in greater risk. While cost advantages are gained, so is the complexity of supply chains. Lean supply chains create a greater dependence on a few suppliers. Because companies have outsourced critical manufacturing and service processes, it does not mean they have outsourced the risk. On the contrary, companies are now dependent upon productive assets owned by suppliers that are no longer in their direct control. Property risks at supplier facilities are no different than those at owned facilities, according to Whit-

ney Grogan, a field engineering group manager with FM Global’s Dallas operations.

“In most cases, our clients have seen an increase in the property and potential business interruption risks given that most outsourcing is to emerging markets, which can lack established risk management practices and loss prevention standards to help protect their business, and even more important, the businesses which they’re supplying,” said Grogan.

“It only makes good business sense for companies to manage risks that are external to their organization in a manner consistent with how they manage their internal risks,” added Eric Jones, assistant vice president and manager of FM Global’s Business Risk Consulting Group (BRCG) in the United States. “Where loss prevention and physical protection are viewed as important for their owned facilities, that same philosophy needs to be applied, to the extent possible, to facilities they do not own but may be equally dependent upon, if not more, from a profitability standpoint.”

In many cases, supplier facilities are located in emerging markets, wrought with natural disaster risks that are as severe as anywhere else on the planet. The risk management mind-set is underdeveloped, and the lack of adequate protection is more likely. According to an AXCO Insurance Market

**“Suppliers should be prioritized on the basis of their support of profitability to the enterprise and whether they represent a sole source, i.e., they produce a unique component to the end product that no one else can manufacture.”**

*Eric Jones, assistant vice president and manager of FM Global's Business Risk Consulting Group*

Report on China, “There is enormous variation in the quality of industrial plants, ranging from the semi-derelict remnants of communist industrialization to state-of-the-art facilities imported from abroad.”

FM Global loss experience shows that losses are several times more frequent and severe if facilities are not properly constructed or protected. And yet, “Clearly, it is extremely important that a supply chain outsourcing strategy identify risk. But in our research, we find a lack of any process to identify, prioritize, manage and mitigate risk. Nearly 90 percent of firms do not conduct a risk assessment when outsourcing production,” according to the article, “Supply Chain Risk: It’s Time to Measure It,” Harvard Business Review Blog, Feb. 5, 2010.

“With more than 1,800 field engineers worldwide, FM Global has both the resources and technical expertise to conduct on-site supply chain risk assessments,” said Grogan. “Our specialized engineers work in partnership with our clients to assess their supply chain locations, offering recommendations to help mitigate potential exposures, and support risk remediation through project coordination. As a strategic partner in this process, FM Global engineering resources enable our clients to fully understand property related to supply chain risk.”

The concern for supply chain risk is increasing as the complexity of supply chains have increased. Many recent surveys of the risk management and financial executive communities have indicated that not only has the risk increased, but also most companies are significantly challenged in managing it.

### The Challenge

To respond to this growing corporate concern, FM Global conducted client research on the status of supply chain risk management and what we can do to help clients more effectively implement a strategy. What it found is that clients are in different phases along the journey of mature supply chain risk management. “We found in our research that most companies were struggling to get the concept of supply chain risk management sold to their organization, and even if they did, the task of assessing the risk was overwhelming,” said Douvas.

In the beginning phase, a company is aware of supply chain risk but there is no formal engagement process/strategy within the organization to address it. In the establishing phase, senior management is engaged, but the organization has not yet established a robust risk identification and assessment process. And, in the mature phase, a company has established a robust risk assessment and mitigation process with senior management.

A recent survey conducted by Advisen of nearly 400 risk managers representing large companies (greater than US\$500 million) in the United States further confirmed FM Global’s client research findings. The level of maturity in supply chain risk management (SCRM) is fairly evenly distributed between the three phases. (A fourth category is labeled “not viewed as a concern.” This applies to companies that do not have an extensive supply chain, have completed an assessment resulting in no further action, or make assumptions about the supply chain risks without the assessment.)

“In our experience, even companies considered as having mature SCRM processes recognize they have gaps that they continue to address,” Jones said. “There’s almost always room for improvement because of the dynamic, ever-changing nature of this risk.”

### The Supply Chain Solution

The agenda and consequent needs for clients obviously varies. From the client research conducted, FM Global created the Supply Chain Solution consisting of various tools and resources to help support clients in different phases of their development of supply chain risk management. The overall goal is to help clients increase their supply chain resiliency by establishing a robust supply chain risk management process that assesses and identifies those critical suppliers and their facilities and applies the appropriate risk mitigation solutions that involve a combination of risk-control and risk-transfer strategies.

The first and most important resource in the Supply Chain Solution is the Supply Chain Risk Management Road Map. The framework in the Road Map starts with a company self-diagnosis to assess where it is in its development. The assessment can be conducted on a corporate-wide basis or on an individual division or product line. Nonetheless, it is strongly recommended that the self-diagnosis is done on a division or product-line basis.

“Although the process may look daunting to some at first, there are a number of ways to approach it effectively without excessive complexity,” said Jones. “At the

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*Bret Ahnell, senior vice president and Western Division manager of FM Global*

end of the day, the goal is straightforward: identify a manageable number of suppliers that represent significant threats to the business, quantify the threat, and evaluate and implement strategies that mitigate the risk in an efficient, cost-effective way.”

### Beginning-Phase Companies

For those in the beginning phases, the issue is building corporate awareness resulting in a corporate champion, as supply chain risk management is a cross-functional initiative, including procurement/supply chain management and finance. “Cutting across organizational silos is critical to the process,” Jones said. “In most organizations, no single person or department has the answers; the reality is that a number of people carry a piece of the puzzle, and information has to be shared and merged together for the puzzle to be solved.”

Senior management typically provides performance incentives for supply chain management based upon obtaining the best price and quality of a supplier, and the property-related risk associated with that supplier is often not a consideration. “This can create a blind spot for an organization that can have catastrophic consequences if not adequately anticipated and managed,” said Bret Ahnell, senior vice president and Western division manager at FM Global. “Risk managers are the best equipped to help their organizations manage these potential risks, but for organizations in the beginning phases, they are too often not involved in supply chain management. Getting all key stakeholders, including risk management, involved with the supply chain is a critical first step toward effective supply chain management.”

This can take some time, and the critical step here is in the messaging. Having a concise and impactful presentation for the c-suite is critical. Risk managers have only one chance to get the message right and even if they do so, in many instances, they may have to reiterate the message a few times with both c-suite and other audiences for the message to resonate. The expectation should not be that corporate sponsorship will happen in one meeting. To that end, FM Global has created and provided a list of resources to help companies raise corporate awareness, such as white papers on supply chain risk issues and generic presentation templates to develop the impactful message for c-suite audiences.

### Establishing-Phase Companies

For those in the establishing phase, the need to start to assess risk can be viewed as a very daunting challenge. “Given the number of product lines, scope and complexity of supply chains at most multinational organizations, it becomes a matter of how to start and build the capability over time,” explained Stuart Selden, assistant vice president and manager of FM Global’s Business Risk Consulting Group in the U.K. “The first thing to do is define the most critical product lines with regard to revenue, profit and strategic importance. This can materially reduce the number of products under review.”

Once those product lines are identified, it is usually prudent to start with one product line, map the production and service process, and identify the key suppliers and their roles in the process. “In this way, revenue streams, or variable margins, can be assigned to those key suppliers, providing a

basis to quantify the true exposure that exists with each,” added Jones.

Prioritization of critical suppliers should not be based on levels of corporate spending, which is a mistake many organizations make. Rather, suppliers should be prioritized on the basis of their support of profitability to the enterprise and whether they represent a sole source, i.e., they produce a unique component to the end product that no one else can manufacture. Multi-sourced suppliers can also be critical; it depends on whether alternative sources have the additional capacity in the event of a supplier disruption.

For those critical suppliers, a further analysis of their facilities’ risk is needed. Companies mandate extensive supplier surveys to get a better handle on their operations and financial viability on a periodic basis. What is essential here is to integrate critical questions about those facilities’ construction quality, occupancy, protection and exposures (otherwise known as COPE information). One of the FM Global Supply Chain Solution resources is the Supplier Risk Survey that can be integrated into supplier surveys or can be administered on its own. If the Supplier Risk Survey does not provide consistent or intuitive responses, FM Global offers supply chain engineering inspections and business continuity planning evaluation surveys as key Supply Chain Solution resources, and supply chain mapping where appropriate.

### Mature-Phase Companies

Companies in the mature phase have established and had robust processes for a number of years. Their need is to refine and enhance their processes with better risk information

## Supply Chain Mapping

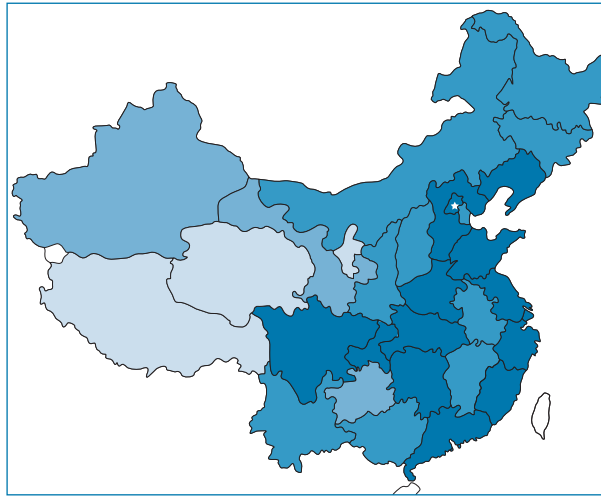
Layering maps of a country—in this example GDP, wind and earthquake—allows companies to better discern a site's geographic risk qualities.

and better risk mitigation solutions, both in the form of risk transfer and risk control. Risk-transfer solutions should be and are viewed as last resort solutions—loss or reputation, market share and shareholder value go beyond coverage. As evident with recent supply chain disruptions in the automotive and aerospace industries, these intangibles can be adversely effected. FM Global research has indicated that clients have adopted various innovative ways of managing supply chain risk, from integrating it in the product and manufacturing process design to in-sourcing various critical processes. FM Global's engineering expertise can be leveraged to provide those creative solutions.

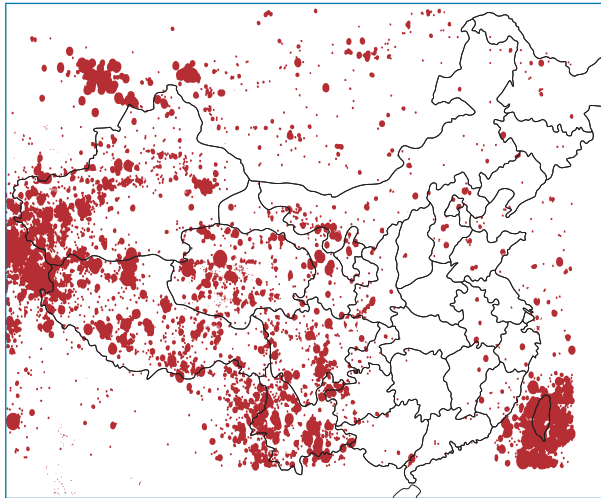
### The Bottom Line

Supply chain risk management is becoming more critical and complex as companies continue to outsource more functions. Lean manufacturing and supply chains are the name of the game in this era of economic challenges where the focus is on the financial bottom line. As with any decision to gain a competitive advantage either on the top or bottom line, there is always a risk of placing too many eggs in one basket. The need for greater supplier collaboration to better understand how they operate becomes more integral to companies' overall success. "Regardless of whether a facility is owned or outsourced, it is always subject to the same fire and natural hazard risks," emphasized Douvas.

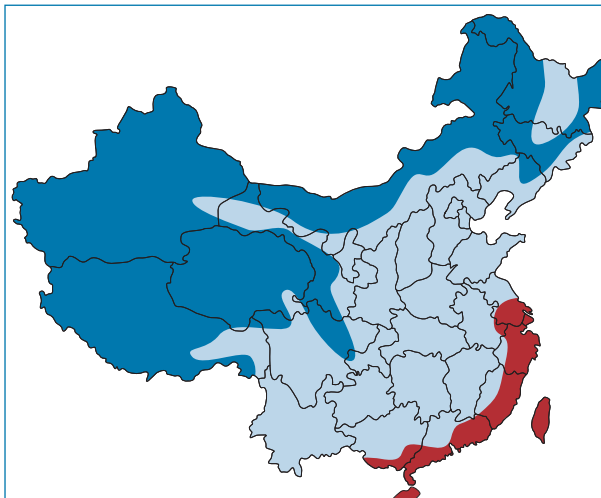
The Supply Chain Solution enables FM Global to become a strategic partner to that effort. The result is a more resilient enterprise and potentially greater coverage. [R]



**Economic Activity in China**  
The darker the region the higher the gross domestic product.



**Earthquake Activity in China**  
Overlaying an EQ map on the GDP map will help determine risk based on economic activity. **RED** denotes earthquake activity.



**Wind Activity in China**  
Overlaying this wind risk map on the GDP map would show significant hazards in the area with the highest GDP. Here, **RED** represents high wind risk and **BLUE** represents moderate wind risk.

