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Supply chain managers report huge upheaval and rising risk as European and UK businesses prepare for Brexit

◇ BREXIT

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Brexit is already having a significant effect on supply chains in the UK and across Europe, as companies seek to manage the risk of disruption as the UK prepares to leave the European Union.

Shortly before *Commercial Risk Europe*'s supply chain risk management event in London, the Chartered Institute of Procurement and Supply (CIPS), revealed that nearly two thirds (63%) of EU businesses expect to move their supply chain out of the UK and two fifths (40%) of UK businesses are looking to replace their EU suppliers.

Based on a survey of more than 1,000 supply chain managers, CIPS found that some 25% of large UK businesses have spent in excess of £100,000 preparing their supply chains for Brexit.

The institute pointed out that the 63% of EU companies seeking to move their supply chain out of the UK represented a dramatic shift from May, when just 44% of EU businesses that were polled said they were expecting to move out of the UK.

The 40% of UK businesses with EU suppliers that have begun the search for domestic suppliers to replace their EU partners also represents an increase from the May survey.

More positively, just over a quarter (26%) said they are taking the opposite approach and investing more time to strengthen their relationship with valuable suppliers on the continent.

'UNABLE TO PREPARE'

The survey found that half of UK businesses said they were less confident that the UK and EU will secure a deal that continues to offer 'free and frictionless trade'. Some 35% of UK businesses that took part in the survey said they feel unable to prepare due to the lack of progress on a future trade relationship.

CIPS said this uncertainty has meant that one in five (20%) UK businesses with EU suppliers have found it difficult to secure contracts that run after March 2019. The UK's formal exit from the EU is still some time away. But nearly one in ten (8%) of UK businesses said their organisation has already lost contracts as a result of Brexit, with 14% believing part or all of their organisation's operations will no longer be viable.

Most supply chain managers who took part in the survey (73%) said the UK Government should focus on keeping tariffs and quotas between the UK and Europe to a minimum, as negotiations continue.

The direct supply chain costs of Brexit are clearly a worry for supply chain managers, based on the CIPS survey.

As noted above, some 25% of UK businesses with more than 250 employees have already spent at least £100,000 preparing their supply chain for the split. These costs come in addition to the daily impact of currency fluctuation. Some 64% of UK businesses told CIPS this has made their supply chains more expensive to manage.

Businesses are still not doing enough to adequately prepare, however. Only 14% of UK businesses with EU suppliers feel like they are sufficiently prepared for Brexit, said the institute.

As the survey was published, Gerry Walsh, group CEO of CIPS, said UK businesses need more clarity about the negotiations: "The Brexit negotiating teams promise that progress will be made soon but it is already too late for scores of businesses, who look like they will be deserted by their European partners. British businesses simply cannot put their suppliers and customers on hold while the negotiators get their act together.

"While the TV cameras are fixed on Brussels, the deals which will determine the future prosperity of Britain and Europe are being struck behind closed doors in businesses large and small. The lack of clarity coming from both sides is already shaping the British economy of the future – and it does not fill businesses with confidence. The success of the negotiations should not be measured on the final deal only but on how quickly both sides can provide certainty. The clock is ticking."

In March of this year, CIPS published its next survey which found that consumers are already paying the price of Brexit 12 months ahead of official separation.

The institute said its latest survey revealed that Brexit uncertainty is causing businesses to pass the increase in costs incurred as a result of supply chain challenges on to consumers.

This latest survey was based on feedback provided by just over 2,000 supply chain managers.

CIPS said that nearly a third (32%) of UK businesses with EU suppliers have already increased their prices as a result of the vote to leave the EU, while two fifths (41%) plan to increase their prices in future to help offset the potential costs of Brexit.

To make matters worse, CIPS said that almost a quarter (23%) of UK businesses said they plan to reduce the size of their workforce to offset Brexit-related costs. This will potentially lead to an increase in UK unemployment, which rose for the first time since the Brexit vote in February 2018, to 4.4%.

More than one in ten (11%) of EU companies have already moved some of their workforce out of the UK since the Brexit vote, pointed out CIPS.

The institute said currency instability has had a negative impact on costs since the Brexit vote took place. These increased costs are now being passed from businesses to consumers. CIPS said that based on its research, some three in five (60%) UK businesses with EU suppliers say that currency fluctuations after the vote have made their supply chains more expensive to manage. As a result, consumers are already paying the price of EU withdrawal some 12 months ahead of official departure from the union, said CIPS.

"The confluence of price increases in the supply chain and a lack of new contracts coming from the EU, is causing UK businesses to look elsewhere in order to stay afloat," said CIPS.

The latest survey of supply chain experts found that almost a quarter (22%) of UK businesses with EU suppliers are now having difficulty securing contracts that run after March 2019. "These numbers raise fears of an imminent collapse in the UK's supply chain following Brexit, unless negotiators can give businesses on both side of the channel greater clarity around what the future trading relationship between the UK and EU will look like," said CIPS.

The institute also said its research suggests that, since the Brexit vote, the EU is beginning to reassess the value of UK products.

Two in five (42%) EU supply chain managers said they do not think British products 'stand out from the crowd'. A third (37%) of EU businesses said it would be less expensive to work with a local supplier, compared to a UK supplier. "Negative perceptions of UK products suggest that British businesses face an uphill battle to maintain their contracts with clients in Europe," concluded CIPS.

TARGETTED RECOVERY

The positive news for British companies is that, based on this survey, fewer than one in ten (8%) supply chain managers from outside the EU said British products don't 'stand out from the crowd'. CIPS said this implies that UK businesses could benefit by targeting markets outside the EU.

"To mitigate these challenges, an increasing number of UK supply chain managers are looking to reshore their supply chains back to the UK. A third (36%) of UK supply chain managers with EU suppliers said they are already looking for alternative suppliers inside the UK," noted CIPS.

"Businesses have little choice but to pass on some of their rising costs to consumers in order to protect their profit margins and stay in business, as a result of the crippling cost of Brexit. However, businesses are still taking the brunt of the impact, as there is a limit to what they can pass on to consumers at a time of stagnant wage growth and rising inflation," commented John Glen, economist at CIPS.

"Businesses are now looking elsewhere to try and recuperate the money they are losing as a result of Brexit. To achieve this, many are also looking to switch suppliers, but they're likely to have difficulty finding suitable alternatives in the UK. It is therefore crucial they don't burn their bridges with their EU contacts but instead work to build stronger relationships with European partners. Businesses should also consider other ways through which they can improve the efficiency of their supply chain, such as by embracing new technologies and automating processes," he added.

"In the end, businesses that fail to plan ahead and use this opportunity to reduce costs in their supply chain may not survive post-Brexit," concluded Mr Glen.

Risk managers need to focus on supply chains as anti-slavery rules kick in

◇ MODERN SLAVERY

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THE UK IS ONE OF THE WORLD'S leading nations in the global effort to stamp out modern slavery. Its groundbreaking Modern Slavery Act 2015 specifically demands that UK-based companies dig deep into their supply chains to ensure that they are not wittingly or unwittingly supporting the practice, and publicly report their findings annually.

Firms with annual turnover greater than £35m that fail to comply face unlimited fines, and this needs to be taken seriously.

But an analysis carried out by international sustainability consultancy Sancroft (chaired by former UK government minister John Gummer, now Lord Deben) and Trussell Trust, the online database of public tenders and government contracts in the UK, found that of 100 leading suppliers to the UK government, more than 40% failed to meet the basic legal requirements of the Modern Slavery Act.

The report, published in March, showed a lack of understanding about the law and management practices needed. It also revealed an absence of risk assessment and/or identification among companies that clearly have not quite got the point of the Act yet, and need some help.

INTO THE LEAD

This clearly represents an opportunity for the risk management profession to take a lead role here and work with colleagues in supply chain management, procurement, legal and compliance to make sure that this risk is properly identified, managed and reported.

Sancroft pointed out that in 2017, the UK central government awarded more than £52bn in new contracts for the delivery of vital public services and infrastructure projects. It stated that these contractors, many of which are private corporations, build or run projects of national importance, with taxpayers' money, such as railways, prisons, warships, utilities and homes.

"The majority of these companies, both domestic and international, have large and highly complex supply chains which stretch around the globe. Amid growing awareness that modern slavery currently exists on an unprecedented scale, there is an increasing recognition that these businesses face considerable exposure to human rights violations. Given this context, how confident are we that the UK's vital public services and infrastructure projects are not contributing to modern slavery?" stated Sancroft.

The joint Sancroft-Tussell examination into the modern slavery reporting of central government's top 100 suppliers (accounting for £27.5bn of government contracts) revealed a stark reality, said Sancroft.

"Of these 100 companies, 90 have published a modern slavery statement. On the one hand, this could be interpreted positively, demonstrating at minimum an awareness of the law. This statistic, however, blurs a more important concern about credible reporting and action. Firstly, only 58% of statements produced were legally compliant. And secondly, a statement alone is not commensurate with a company taking effective steps to eliminate modern slavery in its operations and supply chains," it said.

The report analysed the modern slavery reporting performance of the top 100 suppliers to central government, ranked by the value of contracts won by them in the calendar year 2017.

It then set out the business case for companies to do more to eliminate modern slavery in their operations and supply chains, and provided guidance to business on where, how and why they should be taking effective action to manage modern slavery risk. It also discussed how central government could incentivise better performance by businesses.


John Gummer, the Lord Deben

Analysis of performance was guided by the legal compliance of each modern slavery statement, and the degree to which the statement responded to the six suggested reporting areas as outlined in the Modern Slavery Act itself. "An overarching trend was the wide variance in both legal compliance and quality of published statements," said Sancroft.

Sancroft reported that the key findings were:

- POOR LEGAL COMPLIANCE: More than 40% of the top 100 suppliers failed to meet the basic legal requirements of the Modern Slavery Act
- LACK OF UNDERSTANDING REGARDING LAW AND MANAGEMENT PRACTICES: In some cases, companies had failed to understand the Modern Slavery Act itself, as well as what was meant by policy, due diligence and other important terms
- STRONGER REPORTING ON ORGANISATIONAL STRUCTURE AND POLICY ARCHITECTURE: Of the six recommended reporting areas, organisational structure and policies were where companies performed best
- ABSENCE OF RISK ASSESSMENT AND/OR IDENTIFICATION: There was a lack of understanding about the nature of modern slavery as a complex and, for the most part, hidden crime, evidenced by some companies neglecting the existence of any modern slavery risk in their business
- FAILURE TO MEASURE PERFORMANCE: Companies put greater emphasis on future, and as yet undetermined, progress, than seeking to understand the effectiveness of current policies and processes in place. Only 12 companies referenced key performance indicators (KPIs) in place to quantitatively measure performance.

GOOD BUSINESS SENSE

"Addressing modern slavery should be a top priority for all businesses, particularly for those receiving taxpayers' money. Partly because it is ethically the right thing to do, especially when using public funds and delivering public goods. And partly because addressing modern slavery is increasingly shown to make good business sense. Despite the latter, our analysis overwhelmingly found that government suppliers can, and should, be doing much more," concluded Sancroft.

According to the consulting firm, effective modern slavery reporting helps a business to:

- Ensure compliance with UK law as well as navigate and manage an emerging body of global legislation
- Increase competitive advantage: having a strong modern slavery statement, with robust policies, action plans and KPIs, serves to enhance an organisation's reputation as a responsible business
- Improve security and resilience of supply through understanding and mitigating risks and building stronger, more transparent relationships with suppliers
- Break down organisational silos through the establishment of a cross-functional team to work on modern slavery, and the wider responsible sourcing agenda
- Manage risk by raising organisational awareness and knowledge about modern slavery and how to tackle associated risks.

"Looking to the future, government suppliers, and businesses in general, must continue to evolve their approaches to modern slavery. At a time when large government suppliers are under increasing scrutiny, companies have a responsibility to ensure that they are compliant with the Modern Slavery Act, and that they are reporting transparently and comprehensively on progress," concluded Sancroft.

Blockchain offers huge potential for risk management in logistics

◇ BLOCKCHAIN

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Matthias Heutger, senior vice-president, DHL Customer Solutions and Innovation

BLOCKCHAIN TECHNOLOGY could revolutionise the logistics industry and have a profound effect on the way global supply chains are managed, according to international logistics firm DHL.

The finance sector and insurance industry in particular are fast waking up to the potential offered by the blockchain distributed ledger system and smart contracts that facilitate and verify the performance of contracts without third parties.

Some believe it will radically improve the efficiency of the insurance market, not least in the complex area of global programmes.

DHL recently produced a trend report that it carried out with technology consulting firm Accenture, which found that blockchain could also be used for asset management to improve transparency and traceability, and to automate commercial processes in the supply chain with "smart contracts".

BIG POTENTIAL

The trend report focused on blockchain technology's potential to transform the logistics industry.

"Global supply chains are notoriously complex, with a diverse set of stakeholders, varying interests, and many third-party intermediaries – challenges that blockchain is well suited to address," stated DHL.

The report includes initial findings on a working prototype developed by DHL and Accenture that tracks pharmaceuticals from the point of origin to the consumer, preventing tampering and errors.

"The experiments with blockchain in finance are well known, but we believe logistics is an area where the new technology will have a truly profound impact," said Matthias Heutger, senior vice-president, DHL Customer Solutions and Innovation. "Implementing productive solutions, however, will require further technological development and, critically, collaboration between all stakeholders," he added.

Blockchain is a form of database system that maintains, records and authenticates data and transactions. DHL explained that, in supply chains, products are assigned unique identifiers that allow their entire history to be captured as they move to the end customer. Stakeholders validate this information in real time and if anyone tries to tamper with, alter or erase a record, everyone will know, explained the Germany-based logistics firm.

"We see especially exciting potential for blockchain in pharmaceuticals, which is why we focused our proof of concept with Accenture on the life sciences and healthcare industry," said Keith Turner, CIO, chief development office, DHL Supply Chain. "By utilising the inherent irrefutability within blockchain technologies, we can make great strides in highlighting tampering, reducing the risk of counterfeits and actually saving lives," he added.

Mr Turner said that as many as one million lives are lost each year because of counterfeit medications, according to Interpol. It is estimated that up to 30% of pharmaceutical products sold in emerging markets are counterfeit.

DHL and Accenture created a blockchain-based serialisation prototype with nodes in six geographies to track pharmaceuticals across the supply chain.

The ledger tracking these medicines can be shared with stakeholders, including manufacturers, warehouses, distributors, pharmacies, hospitals and doctors. Lab simulations show how blockchain could handle more than seven billion unique serial numbers and 1,500 transactions per second.

"We've worked closely with DHL to understand and document the broad impact blockchain will have on supply chains of the future," said Andreas Baier, Accenture lead for the travel and transportation industry, and DHL client team leader.

> "**Global supply chains** are notoriously complex, with a diverse set of stakeholders, varying interests, and many third-party intermediaries – challenges that blockchain is well suited to address..."

SAFER & CHEAPER

"Using a common, indelible and secure ledger, the industry can achieve much higher safety standards – from the factory to the patient – at much lower cost. This is one of several opportunities blockchain affords to restructure business processes while reducing cost and complexity," he added.

According to the International Data Corporation (IDC), global spending on blockchain solutions is forecast to reach $2.1bn in 2018, more than double the $945m spent in 2017. In 2021, annual spending is expected to reach $9.7bn, according to the IDC Worldwide semi-annual Blockchain Spending Guide, H1-2017.

This investment will be needed to realise the potential of this technology, according to DHL.

"The potential for blockchain in logistics is significant. However, moving from concepts and pilot applications to actually deploying viable solutions will require the technology to be further developed, organisational transformation and a willingness to collaborate between all stakeholders. Success depends on all parties working together to transform legacy processes and to jointly adopt new ways of creating logistics value," stated DHL.

Commercial Risk Europe
Insurance & Risk Management News

COMMENT

Time for action on supply chains

The risk of supply chain disruption has become one of the most fundamental risks that faces organisations across virtually all sectors in today's global and increasingly interdependent economy.

This is why we decided to host a dedicated event that focused on supply chain risk management and transfer at the end of last year in partnership with Airmic, the UK risk management association, and the Business Continuity Institute (BCI), the leading global body for the business continuity profession.

This lively and challenging event was funded by sponsors AIG, Ausum Systems, Belfor, Clyde & Co, Marsh and Munich Re, which all provided excellent speakers who took part in an open debate of the key issues throughout the day.

The topics under discussion where pretty fundamental. They were:

- What are the key risks to supply chains currently?
- How are these risks best managed and by whom?
- Who do risk managers need to work with to make sure these risks are effectively identified, managed and potentially insured?
- What are the latest tools and methodologies available to help more accurately identify and measure supply chain risks?
- What level of insurance coverage is available, does it meet buyers' needs and is it fairly priced?
- Where are the coverage gaps and how can they be filled?

The speakers and delegates came from a broad range of disciplines – risk managers, business continuity managers, supply chain managers, insurers, reinsurers, brokers, claims experts, lawyers and other specialist professional service providers.

The positive news from this excellent conference was that there appears to be demand for solutions.

There is a real awareness of the importance of supply chain risk and the need for it to be properly identified, managed and – when and where possible – transferred in a structured and professional manner.

There is also seemingly a growing acceptance that this is an enterprise-wide risk that cannot be managed in silos. No single individual, department or profession owns this risk and it needs to be shared and collectively managed.

The need for any decent global corporation to ensure that its supply chain does not directly or indirectly fund modern slavery is a great example of the complexity of this risk and how it does not neatly fit into the realms of traditional silos.

But, while it was encouraging to host positive debate on these critical questions with a diverse group of individuals, it was also very clear that there is still a huge amount of progress to be made in this critical area.

It remains quite astounding to this observer, for example, how many serious multinational companies do not really seem to know exactly who is supplying their key components beyond tier one, how reluctant they appear to be to share this knowledge when it exists, and what few practical contingency plans appear to be in place to deal with disaster when it inevitably strikes, as in Thailand in 2013 and Tianjin a couple of years later.

The BCI's excellent annual survey and debate during this event clearly showed that, as with cyber, there remains a big gulf between the realisation of the scale of this risk and the apparent willingness and ability of the market to truly face up to it, be able to properly manage it and thus insure critical elements of it.

At the recent annual general meeting of Anra, the Italian risk management association, we carried out a spot poll of risk managers representing the leading corporations in this important global economy. Asked whether the risk manager should be involved in the management of the supply chain, a surely encouraging 93.4% of those who took part said yes. But when next asked whether their supply chain is insured, some 53% said no.

During our coming roundtable discussions with the Italian risk management community and others around Europe for our annual Risk Frontiers survey, sponsored by HDI Global, we will take this discussion further by asking the next obvious question: Why is relatively so little of this risk insured?

One strongly suspects that the answer (as indicated by our discussion during the risk transfer part of this supply chain conference) will be that the limited cover that is available is too expensive. The insurers and brokers involved in the discussion will say that this is basically because they are not confident that the risk is adequately identified, measured and managed.

This is therefore clearly a work in progress that needs to be stepped up. We at *Commercial Risk Europe* look forward to working with leading bodies in the field such as the BCI, the insurance market and our partners in the risk management profession such as Airmic, to try and take this significant step forward and hopefully report real progress at our next supply chain event in London in December.

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From
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KFC debacle underlines need to treat supply chain risk seriously

◇ REPUTATION

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SHORTLY AFTER OUR FIRST Supply Chain Risk Management Conference ended, fast-food chain KFC and global logistics firm DHL provided a chilling example of why supply chain risk management is critically important in the modern, complex and outsourced economy, as hundreds of UK outlets were forced to close because they ran out of chickens. This calamitous chain of events delivers a range of serious messages that need to be heeded by any company that cares about its brand.

The decision by fast-food chain KFC to radically overhaul its UK supply chain system, which ultimately forced it to temporarily shut down some 750 of its 900 UK outlets because chicken deliveries failed to turn up in February this year, underlines how important supply chain risk management and business continuity planning have become for all sectors.

CAREFUL MANAGEMENT

Supply chain experts were quick to point out how this high-profile case, which seriously damaged the reputation of both KFC and its new logistics provider DHL, once again proves that the complexity of modern-day supply chains, usually involving multiple third parties, needs to be managed very carefully. To base your supply chain strategy on cost-cutting considerations alone is really not a good idea, they warned.

KFC replaced its existing logistics provider – Bidvest Logistics – with DHL and specialist foodservice logistics provider QSL towards the end of last year. DHL announced the major contract win with a jubilant press release accompanied by a somewhat cheesy photograph [*see above*] that, in hindsight, probably seems a little hasty and over the top to the executive team involved in the decision.

The press release, published on 11 October, carried the bold headline: "KFC revolutionises UK foodservice supply chain with DHL and QSL appointment."

DHL explained that KFC had appointed DHL and QSL to manage the supply and distribution of food products, packaging and consumables for more than 850 restaurants throughout the UK, as part of its ambition to "revolutionise" the UK foodservice distribution market.

[FROM LEFT] Mel Brockhouse, vice-president, grocery and convenience, DHL Supply Chain UK and Ireland; Jens Hentschel, director, supply chain, KFC UK and Ireland; Oliver Jäger, country manager, QSL

The logistics company said the new three-way partnership would focus on innovation, quality and reliability in the UK foodservice distribution market. "DHL will 'rewrite the rulebook' and set a new benchmark for delivering fresh products to KFC in a sustainable way," stated the company.

DHL said the key areas of focus would be the reduction of logistics-related emissions to net zero over the life of the contract, optimised delivery scheduling to provide a faster turnaround of orders, and "greater integrity" of food during transportation, allowing for "even fresher" products upon arrival in KFC restaurants.

Germany-based food logistics specialist QSL would bring its expertise in the quick-service restaurant sector to the UK, in the form of crucial demand planning and stock management, with dedicated IT solutions, said DHL.

"To date, there has been little variation in foodservice logistics but we have specifically chosen DHL and QSL for their reputation for innovation in logistics across other industries," explained Jens Hentschel, supply chain director for KFC. "Our mission is to deliver outstanding products to our consumers in all we do, and the supply chain plays a fundamental part in this.

"We are rethinking all of our internal and external processes, and placing distribution and logistics at the heart of our new supply chain strategy. We want to deliver a new level of service to our restaurants and franchise partners, improve the quality of service to our customers, and reduce our environmental impact – all to a level that has never been done before. It's an ambitious plan, but by working closely with our partners DHL and QSL we're confident that we'll be able to deliver against our strategic ambitions," added Mr Hentschel.

NO RULEBOOK

John Boulter, managing director of retail, DHL Supply Chain UK and Ireland, added: "We're delighted to be delivering a truly unique proposition for KFC, geared to the specific needs of the business. We intend to rewrite the rulebook and create a stock management, distribution and reverse logistics model based on best practice from a range of sectors including foodservice logistics. This model will support KFC in its ambition to be market-leading in all that it does, while improving service levels to its restaurants and customers."

Florian Entrich, managing director of QSL, added: "For our customers, we are genuine partners because we take their needs to heart and make them our own. We are very proud that KFC has decided to use our tailored QSR solutions for its biggest market in Europe. With DHL, we are confident of establishing a new benchmark for quick-service restaurants in the UK."

It appears, however, that the bold new plan was rather too ambitious. In March, only a few weeks after hundreds of KFC outlets were forced to turn customers away, KFC revealed that it had reappointed Bidvest for some 350 of its northern UK outlets.

KFC conceded that "operational issues" at DHL had left a serious backlog of chicken at the delivery group's only UK warehouse in Rugby.

The shortage of the KFC chain's key ingredient – chickens – along with other menu items, including fries, coleslaw and gravy, understandably sparked questions about why the group had chosen a new supplier with a single, new and untested distribution centre, apparently with no contingency plans in place.

A KFC spokesperson said that after "working hard to resolve the present situation", a decision had been made in conjunction with QSL and DHL to revert the distribution contract for up to 350 of its restaurants in the north of the UK back to Bidvest.

The spokesperson added that the company would continue to operate with QSL and DHL for the remainder of its restaurants in the country.

Paul Whyte, Bidvest Logistics business unit director, did well not to sound too smug as he said: "We are delighted to welcome KFC back to Bidvest Logistics. As the UK's leading food service logistics specialist, we understand the complexities of delivering fresh chicken…we will provide them with a seamless return to our network."

'BIRD-BRAINED'

A DHL spokesperson said that it remained "fully committed to delivering excellent service to KFC's remaining 550 restaurants across the UK".

The GMB Union had warned of the folly of KFC's 'bird-brained' decision to switch from Bidvest to DHL back in October and had a field day as it issued a series of comments

"The decision by fast-food chain KFC to radically overhaul its UK supply chain system, which ultimately forced it to temporarily shut down some 750 of its 900 UK outlets because chicken deliveries failed to turn up in February this year, underlines [the] importance [of] supply chain risk management..."

basically saying 'we told you so'.

The union claimed that in its bid to increase profits, KFC had awarded the contract to DHL causing 255 redundancies and the closure of a Bidvest depot.

"GMB tried to warn KFC of the folly of this decision, but money talked for the fast food chain. Bidvest had a network of distribution centres across the UK – now DHL are trying to do the job with just one. KFC's penny-pinching decision has not only cost 255 jobs, but leaves hundreds of workers at closed KFC restaurants not getting paid," stated the union.

Mick Rix, GMB national officer said: "We tried to warn KFC this decision would have consequences – well now the chickens are coming home to roost. Bidvest are specialists – a food distribution firm with years of experience. DHL are scratching around for any work they can get, and undercut them. It's an absolute cock-up. KFC are left with hundreds of restaurants closed while DHL try and run the whole operation out of one distribution centre – where conditions are an utter shambles."

TERRIBLE MISTAKE

He added: "Three weeks ago KFC knew they had made a terrible mistake, but by then it was too late. KFC's bird-brained decision has caused untold misery to customers, to Bidvest workers and restaurant staff who are not being paid. Now they've been left with egg on their face."

To make matters worse, the union subsequently revealed that Rugby Borough Council confirmed that DHL's cold storage hub had not even been granted the registration required to operate.

Mr Rix continued his play on words as he commented: "It's taken days to uncover the real truth about the shambles at this DHL hub that has plunged KFC's supply chain into total chaos. They've been winging it. It's clear that the left hand doesn't know what the right hand's doing in this operation. It's the company's colonels who need to be held to account for this mess, not the workers who have lost time and money through no fault of their own."

Supply chain experts were quick to point to the various and important lessons to be learned from this unfortunate experience for KFC and its customers.

John Perry, managing director of specialist supply chain and logistics consultancy Scala, reportedly told *Supply Chain Digital* magazine: "It puts DHL in a difficult position, as it is effectively being bailed out by a competitor, but it is also potentially harmful to its reputation and the success of winning other business. Splitting the operation between suppliers at this stage, after implementation, raises the question again as to why the transition from Bidvest to DHL wasn't phased in and whether the proposed solution can be made to work.

"Making changes to a contract, where often it is only the current supplier and the individual workforce who truly understand what the logistics operations involve, is a huge risk that has to be managed," Mr Perry added.

Dr Virginia Spiegler, senior lecturer in operations and supply chain management at the Kent Business School at the University of Kent, commented on the university's website that, regardless of what happened to KFC, the interest in supply chain risk management and in building supply chain resilience (the ability of a supply chain to prepare for unexpected events, respond quickly to disruptions and recover from them) had already sharply risen following high-impact events, such as manmade and natural disasters, in the early 2000s.

Dr Spiegler said that since these events, research in this area has focused on uncertainties originating from the customer side, supplier side, external and environmental factors, and internal processes.

The KFC case highlights the importance of transportation and logistics operations, which are frequently and unfairly regarded by many scholars and companies as non-value-adding, she said.

"In the past few years, many companies have taken steps to streamline supply chain processes by reducing holding inventory, outsourcing non-core activities and cutting the number of suppliers, on the assumption that the market is relatively stable and predictable. KFC's decision to switch their 3PL (third-party logistics) provider from Bidvest to DHL was a measure to reduce logistics service cost," commented Dr Spiegler.

"However, having hundreds of restaurants closed could cost them millions in lost sales and low capacity utilisation. This problem could have been anticipated by comparing Bidvest and DHL capabilities. While Bidvest is specialised in foodservice distribution and operates a network of distribution centres across the UK, DHL is trying to run the same operation from a single distribution centre," she added.

ALIGNMENT

"Moreover, it is the first time that DHL is partnering with QSL, which has been providing IT solutions on demand planning and stock management to KFC since 2011, therefore the alignment between QSL services and DHL physical distribution is also crucial, and building such alignment can take time," concluded Dr Spiegler.

Richard Wilding, professor of supply chain strategy at Cranfield School of Management, posted his thoughts on the KFC case on the website of *Supply Management*, the magazine published by the Chartered Institute of Procurement and Supply. The respected supply chain expert said media discussion about the KFC debacle had tended to focus on failings at DHL and the reliance on a single distribution centre. The professor said that, on both counts, that is the wrong approach.

HUGELY COMPLEX

"The most important thing about the story is that it's broken the spell for consumers around how supply chains actually work. There's no 'magic' that gets just the right amount of fresh chicken from farms to outlets just when it's needed, no fleet of KFC trucks and KFC drivers receiving orders from KFC stores. Modern supply chains are hugely complex and, critically, will involve a number of different organisations to make any system work, all contributing different expertise and resources," he wrote.

Professor Wilding disagreed that the core problem was to use only one distribution centre. He explained that using a single distribution centre in the so-called 'Golden Rectangle' between Milton Keynes and Rugby on the M1/M6 is a proven means of delivering products to a network of outlets anywhere in the UK, adding that leading supermarkets have been working this way from warehouses in Daventry for many years.

According to Professor Wilding, the real reason that chicken did not reach KFC outlets in this case was because a whole new system, involving a group of new partners, was introduced all at once. "Experience has shown that plugging together new software and technologies leads to teething problems, no matter how much more advanced and sophisticated the technology might be," he said.

The automated baggage problems at Heathrow's Terminal 5 were a recent example of this problem. "It's like any complex machine, like a car or airplane. You test the engine, that works fine, test the air conditioning, the wings, the navigation system – all okay. Bring them all together and suddenly one element isn't working properly with another element and the whole machine stops working," explained the professor.

Professor Wilding said there are four key components to any supply chain strategy. These are: the processes, the infrastructure in terms of warehousing and transport, the information systems that run it, and the people involved.

"KFC could see that, for the future, it could provide fresher, better-quality product to its customers with a different approach to its supply chain – maybe by reducing inventory levels within stores (less old chicken), and relying on more regular 'just-in-time' meat. Under the new KFC approach, DHL has taken on the infrastructure side. The other party is QSL, which supplied the software for the information systems. The supply chain came together for the first time by all reports on Tuesday 13 February…and somehow it failed," he wrote a week later.

Professor Wilding said the situation with KFC had proven the reality of modern business: competition is no longer between individual businesses but rather between whole supply chains. KFC, along with so many other major brands, is now dependent on others to deliver its product at the right quality and when needed. The problem at KFC was therefore not a blip or a simple human error, but part of the risk involved with modern supply chains.

The next obvious question is: could this calamity have been avoided, and how?

Professor Wilding pointed out that there naturally would have been extensive testing since the contract was awarded to DHL and QSL in October of last year. There would have to have been a "great deal of confidence" before the 'go' button was pressed. But, the professor suggested that perhaps a more phased approach would have been advisable. "Just using the new infrastructure to deliver to one region before a rollout. It's all part of the risk management assessment, where the supply chain industry knows, from the evidence, that 10% of supply chains are severely disrupted each year," he said.

"The KFC supply breakdown has had a serious impact on many people: the franchisees, the employees, as well as the brand as a whole. Immediate lost revenues, huge amounts of management time, damaged shareholder value and hordes of regular customers who tried a different fast food outlet. So lessons need to be learned," wrote Professor Wilding.

CASE STUDY

"KFC will be a really important case study in terms of scrutinising how the tendering process and procurement took place, how the collaboration was established and run (given that we now have ISO standards for managing collaborative relationships), how the handover was carried out with the previous partner involved. There's a need to look at the different risk profiles to see how the inevitable risks can at least be reduced – maybe there's a need to look at having more distributed networks, so that supply chains are not so reliant on one software system or facility," he added.

Professor Wilding concluded with a strong and clear message for all supply chain, procurement and risk management professionals: "What's next, pubs with no beer? It's quite possible. We have come to expect high quality, convenience and good value wherever we are, but that comes at the price of great supply chain complexity. A complexity we need to understand and manage better," he said.

The collapse of the Rana Plaza factory in Bangladesh in 2013 that caused the deaths of some 1,100 workers was a huge wakeup call for the global clothing industry, as it was revealed that leading brands such as Primark and Benetton were customers of the abused factory workers that were forced to toil in such dangerous conditions. It was suddenly clear that responsible supply chain management was not just all about outsourcing to slash costs. Global brands need to carefully manage their supply chains to avoid potentially catastrophic reputational risk. Adidas is fully aware of how reliant the continued success of its global brand is upon its approach to supply chain and sustainability and has invested a lot of time, effort and money into developing a sophisticated system designed to root out modern slavery and abuse of workers within its supply chain. This investment is paying dividends as the German sportswear company keeps winning respected industry awards for its work. **Adrian Ladbury** reports on Adidas's impressive approach to supply chain management

Adidas reaps reputational rewards for best-in-class modern slavery strategy

◇ REPUTATION

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THE CLOTHING AND FOOTWEAR industry is one of the most exposed to supply chain and slavery risk, as highly valuable global brands rely on cheap production in emerging nations with relatively high levels of forced or low-wage labour working in poor conditions, not least in the Asia-Pacific region.

Germany-based global sports goods manufacturer Adidas has huge potential supply chain and reputational risk exposure, as it has outsourced most of its production globally.

Some 68% of its products are produced in Asia and the leading countries are China, Vietnam, Indonesia and India. This means that Adidas's potential exposure to modern slavery risk is exceptionally high, because the incidence of modern slavery is far higher in Asia-Pacific than any other region of the world.

SLAVERY INDEX

The International Labour Organisation and Walk Free Foundation publish an annual Global Slavery Index. The 2017 report found that there some 40.3 million individuals who are categorised as forced labour or sexually exploited in the world today.

Some 30.4 million of these people (62%) are based in the Asia-Pacific region. This is followed by the Africa region (23%), Europe and central Asia (9%), the Americas (5%), and the Arab States (1%).

"The Asia-Pacific region has the highest share of victims across all forms of modern slavery, accounting for 73% of victims of forced sexual exploitation, 68% of those forced to work by state authorities,

Rana Plaza, Bangladesh

64% of those in forced labour exploitation, and 42% of all those in forced marriages," states the latest report.

The countries listed above that are Adidas's major producers in this region do not score well in the index. India has a real problem with modern slavery, with some 1.4% of its population enslaved – a total of 18 million people. Some 0.3% of the Indonesian population are enslaved, making a total of 736,000 people. China has a lower percentage at 0.3% but, because of its massive population, this still represents a huge number of people – 3.4 million. An estimated 0.15% of Vietnamese citizens are enslaved, meaning that country has some 139,300 slaves within its population.

The Adidas business is built upon its brand and reputation. Given that it works with about 800 independent factories in more than 55 countries, it takes this matter seriously – as explained on its website. "As our supply chain is large, multi-tiered and varied, we have a detailed and systematic approach to managing the relationships with

> "**To enforce compliance** with its standards, Adidas has a multi-level monitoring and enforcement process in place, including the use of an innovative rating system for the assessment of its suppliers [and] has fully disclosed its global supplier list..."

our suppliers," states the company.

"Besides our own employees, workers in our suppliers' factories play a central role in our sustainability programme. It was our concern for their working conditions and wellbeing that led us to establish our 'Workplace Standards', the supply chain code of conduct which also covers workers' health and safety and provisions to ensure environmentally-sound factory operations," explains Adidas.

To enforce compliance with its standards, Adidas has a multi-level monitoring and enforcement process in place, including the use of an innovative rating system for the assessment of its suppliers. The rating results are shared with its sourcing teams which then decide whether, and to what extent, it continues the business relationship with a specific supplier.

SUPPLIER LIST

Adidas is one of very few companies in the industry that has fully disclosed its global supplier list.

The company carries out internal and external audits at its suppliers' factories to ensure they comply with its standards. It has adjusted its methodologies and tools to the different sourcing relationships that it has in place with supplier factories. There are two models – direct sourcing and

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indirect sourcing.

This involves regularly updated and detailed risk mapping of the supply chain.

"Mapping our supply chain risk is a very effective tool to ensure that all of our suppliers produce in a socially and environmentally responsible way, while using our resources wisely. It combines regular processes to systematically monitor and support improvements, with ad hoc tools enabling us to react quickly to critical situations as they may arise and limit any negative effects this may have on workers or the environment. Critical sources of information for risk-mapping exercises include the review of data bases as provided by governments, as well as regular engagement with civil society organisations, unions, employer federations and with workers directly," explains Adidas.

"Countries where we source product from and suppliers who we work with are regularly mapped and monitored for human, labour rights and environmental risks. Country and factory profiles determine the subject of issues to be prioritised, as well as the frequency of monitoring and remediation activities," adds the company.

Adidas explains that it applies tailored risk-mapping approaches and tools as follows:

- **COUNTRY-LEVEL RISK ASSESSMENT:** Country profiles are developed based on in-depth due diligence processes. Countries are categorised as high or low risk. Suppliers located in high-risk countries have to be audited at least once every two years.
- **BUSINESS ENTITY-LEVEL RISK ASSESSMENTS:** A business entity's actual performance as outlined in its strategic compliance plan and report cards shows its individual performance and compliance risk. This influences the frequency of performance reviews and impacts the longer-term business development.
- **FACTORY-LEVEL RISK ASSESSMENTS:** Regular audits, KPI assessments, factory risk-rating analysis. This information determines the frequency of re-audits and engagement with the factory.
- **CRISIS PROTOCOL:** Used by business entities and factories to report on the details on high-risk issues. Based on the information received, the company says that it may decide to conduct site visits, audits or other engagement with a business entity or factory on a case-by-case basis.
- **MONTHLY REPORTING:** To executive management within Adidas. Depending on the issue, this may also lead to additional action on a case-by-case basis.

Adidas also has a grievance mechanism through which workers and other parties can bring any complaints or problems to light. "We take information from workers and other parties regarding factory conditions very seriously, and take care to provide safe and easy channels for them to get in touch with us. Information we receive this way may result in additional site visits, audits or other engagement with a business entity or factory at any time," states the firm.

To help ensure the credibility of its system, Adidas also uses independent and unannounced assessments by independent third parties to provide verified information about its programme to stakeholders. As a member of the Fair Labor Association (FLA), Adidas is subject to external assessment by independent monitors. It also participates in the FLA third-party complaint system and public reporting. Since joining the FLA, more than 300 independent assessments have been conducted at Adidas suppliers.

The sports goods company also has a formal rating system of suppliers, based on three tiers.

"We audit our suppliers against our standards and rate them according to their performance. We use an innovative way to rate the supplier on its ability to deliver fair, healthy and environmentally-sound workplace conditions in an effective manner. With the Key Performance Indicator rating tool, we evaluate six fundamental elements of social compliance including management commitment, the quality of management systems in place, worker-management communication, training delivered, transparent reporting and measurement of compliance activities," explains the company.

According to the results, suppliers are assessed with a C-rating score between one and five (with five being the best rating) and then are clustered into three categories:

- **THE RISK MANAGEMENT CLUSTER:** This group includes the lowest-performing suppliers. "We help them to improve their performance and, if they respond, they are moved up to the partnership cluster. If not, we wind down and eventually terminate our commercial relationship with them," explains Adidas.
- **THE PARTNERSHIP CLUSTER:** This includes those suppliers that can benefit from significant training support. As a result, the company focuses on capacity-building programmes in collaboration with other companies and multi-stakeholder initiatives.
- **THE SELF-GOVERNANCE CLUSTER:** For those suppliers that are capably managing a programme of good industrial relations, health and safety, and employer-employee communications. These suppliers must have an internal compliance policy, and practise and transparently report these activities, states the company.

These compliance rating results are incorporated into the overall supplier rating, which influences the company's decision on which suppliers to use. "This is important, so our key business partners understand how their social compliance score impacts the business relationship. This transparency and integration with sourcing decisions is fundamental to the success of our efforts to drive improvements in workplace conditions," explains Adidas.

So, what happens when suppliers fail to reach the standards expected and demanded? Adidas explains that when suppliers fail to meet its Workplace Standards, it applies the sanctions and remedies from its Enforcement Guidelines. This includes:

- Termination of the manufacturing relationship
- Stop-work notices
- Third-party investigations
- Warning letters
- Reviewing orders
- Commissioning of special projects to remedy particular compliance problems.

The company explains that it categorises two types of non-compliance – zero tolerance points and threshold issues.

"Zero tolerance includes prison labour, serious, life-threatening health and safety conditions and repeated or systematic abuse. A finding of zero tolerance non-compliance means an immediate and urgent engagement with a supplier and, if verified, we will terminate the relationship with that supplier. Threshold compliance issues include serious employment issues, serious health, safety or environmental issues and any combination of the two. The Enforcement Guidelines for threshold issues can disqualify a new supplier or lead to enforcement actions with existing suppliers," explains the company.

"When we find ongoing and serious non-compliance and a lack of commitment on the part of the management to address the issues, we will, when appropriate, issue a formal warning letter. In very serious cases or in cases of zero tolerance non-compliance, a 'stop-work' letter will be issued, advising the offending supplier that SEA has recommended the business relationship be terminated," it adds.

All of this work has borne fruit. In 2016, KnowTheChain, which describes itself as a resource for companies and investors to understand and address forced labour risks within their global supply chains, benchmarked 20 apparel and footwear companies on their efforts to eradicate forced labour from their global supply chains.

The companies were selected on the basis of their size (market capitalisation) and the extent to which they derive revenues from corporate branded products. Among the 20 companies selected for evaluation, Adidas ranked first in the sector because of its best practices, including strong disclosure and supply chain risk mapping outlined above.

The result was also based on the company's Modern Slavery Outreach Programme, launched in 2016, as well as its published call to non-profit groups and other companies to join it in tackling modern slavery issues in high-risk countries.

Despite taking the top slot, KnowTheChain said the German sports goods company still has room for improvement. This was in two key areas. First, the potential use of sub-contractors by screened and approved suppliers. Second, it said Adidas could do more to improve the welfare of workers involved in its supply chain and help them gain a stronger voice.

On sub-contracting, KnowTheChain said: "While Adidas has a strict pre-screening process in place for new suppliers, which includes examining forced labour and migrant labour concerns, Adidas may consider putting in place a procurement selection process that considers the capacity of suppliers to meet fluctuating demand to avoid the risk of subcontracting. Further, while Adidas has in place systematic dialogue with existing suppliers on their capacity that enables level loading during peak months, the company may consider addressing subcontracting risks as existing risks, for example through a subcontracting policy.

"Adidas is encouraged to provide

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evidence of integrating its company code in suppliers' contracts, for example by disclosing the contract language. To strengthen the implementation of its code further down the supply chain, instead of merely encouraging suppliers to cascade its standards, Adidas is encouraged to require its first-tier suppliers to ensure their own suppliers implement the company's standards."

On 'worker voice', KnowTheChain said: "While Adidas engages with workers through a series of initiatives outside of the context of factories, including a women's empowerment programme which aims to help women in its supply chain to have better opportunities in the workplace, the company is encouraged to provide evidence that it engages with workers outside of the context of the factories in which they work in order to help them assert their voice, and to provide evidence of the positive impact of this engagement.

RULES RESPONSE

"It is further encouraged to expand those programmes to countries and tiers it is not currently covering. Further, Adidas is encouraged to put in place programmes for countries where free unions are not restricted but the rights of migrants to associate are restricted. The company may also consider putting in place programmes for countries/regions where there are cultural and linguistic barriers and discrimination for migrants to join or form unions."

KnowTheChain added that Adidas could also require suppliers to introduce a grievance mechanism and cascade this requirement down its supply chain. The company is further encouraged to roll out the SMS complaint mechanism that some of its suppliers in Vietnam, Indonesia and Cambodia have adopted to other suppliers and countries (*as planned, for example, for China*).

As noted above, Adidas does have a grievance process so has the system in place that can be improved and updated if needed. The company also revealed in March this year that it has a plan to upgrade its whole supply chain system during the next two years. The company is clearly keen to retain that pole position in KnowTheChain's benchmark.

The company said it had targeted all tier-two suppliers in high-risk countries, including Taiwan, China, Vietnam and Indonesia, for participation in modern slavery capacity-building workshops.

From 2018 to 2020, Adidas said it plans to run follow-up training sessions to create action plans with suppliers on specific non-compliance issues.

"Remedial action is based on a continuous improvement model, which aims to mitigate future risk by improving overall system practices," the firm said.

The company's update also highlighted the continued risk of unregulated recruitment agencies, and said the firm recognised the "need to do more" to enforce its zero recruitment fee policy.

For the period 2018-2020 Adidas also said it will focus on its natural rubber supply chain in Vietnam. It will partner with NGOs and other buyers including tire manufacturers to increase pressure on the sector, said the firm.

The company said it will also review social and labour conditions in countries that produce high volumes of cotton including China, India and Pakistan. The firm had previously focused on Turkey, where it worked with partners to lobby the government to open up work permits for Syrian refugees in the sector.

The company said that during these training sessions, it would explain what it has learned during its ongoing effort to ensure that its supply chain does not fund slavery. It will share best practice with delegates and explain why being an industry leader in the effort to eradicate modern slavery makes good business sense.

The sportswear giant was also proud to announce in November of last year that it was the overall winner of the second Thomson Reuters Foundation Stop Slavery Award. This award celebrates businesses that excel in efforts to identify, investigate and root out forced labour from their supply chains. Global fashion retailer C&A, US technology company Intel and UK retail and services group The Co-operative Group were the other winners of the annual award.

MORAL RESPONSIBILITY

"Whilst we have outsourced our production and manufacturing all over the world, we will not outsource our moral responsibility, which is to do right by the 1.3 million workers who make our products," said Aditi Wanchoo, senior manager of social and environmental affairs at Adidas, at the Thomson Reuters Foundation's annual Trust Conference, according to a report on Reuters news service.

Adidas was congratulated for its transparent audits, strong responsible sourcing guidelines, and robust tools to trace higher-risk supply chains.

As supply chains become ever more global and complex, in many sectors they have become the very core of the business and the main competitive edge. Mess up the supply chain and the business simply does not work. Use the wrong suppliers and place your reputation at high risk. The systems followed by Adidas are clearly not designed to simply tick boxes but actively and positively manage a critical risk and this can only be done with senior management buy-in. A great example of risk management at work.

Room for improvement in supply chain management, finds BCI report

◇ SUPPLY CHAIN

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LACK OF SKILLS AND RESOURCES IS often the main reason for failures to effectively track global supply chains but technology and big data can be leveraged to overcome these shortages, according to the Business Continuity Institute (BCI).

The BCI's Gianluca Riglietti opened *Commercial Risk Europe's* supply chain event, by sharing the key findings of the institute's annual survey of more than 400 supply chain professionals based in 64 countries. The study is carried out in partnership with Zurich, led by Nick Wildgoose, the insurer's global supply chain product leader, who has been involved in the report's development since its first edition in 2009.

Other key findings of this revealing annual survey are that insuring against supply chain losses is becoming a more popular option for organisations, although its uptake is "variable at best".

The reputational elements of supply chain disruption are still important and resonate among many organisations, inevitably driving interest in more effective supply chain management and potentially risk transfer solutions.

The fourth key takeaway from the latest survey was that business continuity remains essential to building supply chain resilience.

BUILD RESILIENCE

And finally, it is clear that organisations are challenged to integrate relevant functions, frameworks and techniques in order to build supply chain resilience.

The spread of supply chain disruptions among the 408 companies that took part in the survey last year was interesting, and showed clearly that this is a serious problem for many.

The survey found that only 25% of those surveyed had experienced no disruption during the year. Some 51% had experienced one to five disruptions, 8% suffered six to ten, 3% suffered 11-20, 2% suffered 21-50 and 1% were disrupted 51 times or more in just one year.

Participants were asked whether they record, report and measure performance that affects supply chain disruptions.

Some 31% said that reporting of incidents is coordinated across the entire enterprise, 38% said yes but not on an aggregated and coordinated basis, and a worryingly high number of respondents said not at all.

The use of technology to record and analyse disruptive incidents was surprisingly low, with only 37% saying they use technology. Of those that do use technology to help manage their supply chain, some 41% still rely on Excel spreadsheets to do the work. The second biggest category was incident response data at 13%, next came third-party due diligence solutions at 10% and then business continuity management software at 9%.

Use of technology

Clearly the technology sector has a big sales opportunity here.

What about the sources of the disruptions experienced by respondents? Not surprisingly, the bulk at 44% were immediate suppliers (tier 1). Next came suppliers' suppliers (tier 2) at 24%. Tier 3 and tier 4 suppliers still accounted for 10% of disruptions and that is surely a cause for concern.

An even bigger worry was that a surprisingly high proportion of the experts who responded to the survey (22%) conceded that they do not analyse the full supply chain to identify the original source of a disruption.

IT AND CYBER MAINLY TO BLAME

The top two causes of disruptions were, not surprisingly (given the nature of the modern global economy), unplanned IT and telecommunications outages and cyberattacks and data breaches. Loss of talent and skills was third on the list. Interestingly, 'old-fashioned' fire was the biggest gainer in the causes list, rising from 14th in 2016 to seventh place in last year's survey.

Gianluca Riglietti

The consequences of supply chain disruptions were pretty much what you would expect, and once again spark the obvious question about why this risk merits such a relatively low level of investment in prevention, management and transfer.

Loss of productivity was named as the main consequence with 55%, down 13% on the year before. Next was increased cost of working with 46%, down 7% on 2016, and customer complaints received was third with 43%, worryingly up 3%. Service outcome impaired was next at 34%, down 6%; loss of revenue was next at 32%, down 5%; and damage to reputation was surprisingly low at 31%, down 7%.

The bulk of the actual costs of these disruptive supply chain incidents was not that high, with 53% reported to have cost less than €50,000. Some 15% reported losses of between €50,000 and €250,000, and 15% and 10% between €250,000 and €500,000.

But the potential for huge losses from such events is clear, with 5% of those who responded reporting losses between €100m and €500m – scary numbers for any risk or business continuity manager indeed.

INSURANCE POTENTIAL HUGE

Mr Riglietti confirmed what was later discussed by risk managers, insurers and brokers during the conference: supply chain risk remains significantly underinsured when compared to the scale of the potential disruption and financial losses.

He reported that the survey found that just over half of respondents (51%) said none of the losses they had suffered in the previous year were insured. Some 15% said that up to 25% of losses were

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> **"It is clear that** organisations are challenged to integrate relevant functions, frameworks and techniques in order to build supply chain resilience..."

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insured, while 6% said 26%-50%. This means that 72% of respondents admitted that less than 50% of their losses were insured.

Looking forward to the next 12 months, cyberattack and data breach, unplanned IT downtime and telecommunications outages, and loss of talent and skills topped the list of concerns.

New entrants to the top ten concerns on the horizon that could hit supply chains were acts of terrorism, a product quality incident, and a health and safety incident.

As with cyber risk, supply chain risk is relatively high on the main board and top management agenda, based on this survey. But, as with cyber, this does not yet really seem to be passed down to adequate action on the front line, particularly when dealing with suppliers.

Top management may be worried about this exposure but evidently not enough to release adequate investment to tackle the risk at source or further down the chain in many cases.

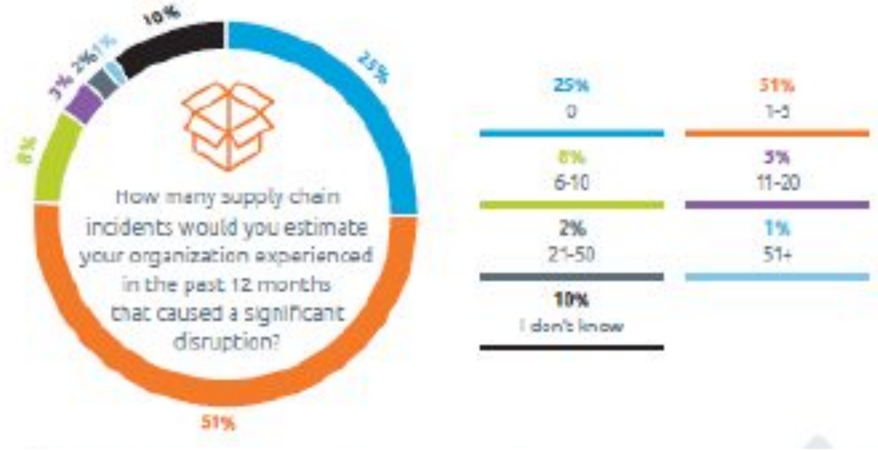
So, of the BCI survey respondents, an impressive 70% said top management commitment to supply chain risk is high (27%) or medium (43%). And some 74% of respondents said their organisation does have business continuity arrangements in place to deal with supply chain disruptions. An encouraging 74% said their organisation does ask key suppliers (existing and new) whether they have business continuity arrangements in place.

CONTINUITY QUESTIONS

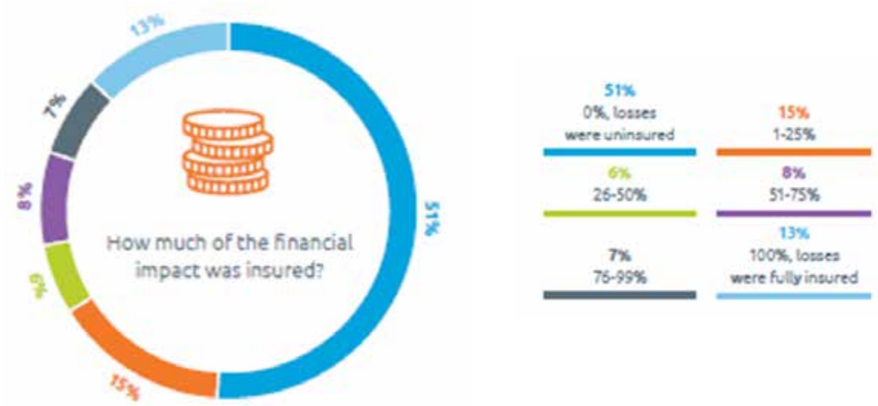
But when asked what percentage of key suppliers they believe have business continuity arrangements in place to address their own needs, some 53% of respondents said less than 50%, with 19% saying less than 10%.

Asked whether business continuity features as a part of supplier contract discussions, only 43% said it is an integral part of the procurement process. Some 24% said yes but only where the contract risk is deemed to be high, and 15% said yes but only after the purchase decisions have essentially been taken – in other words, an afterthought. Some 18% said no.

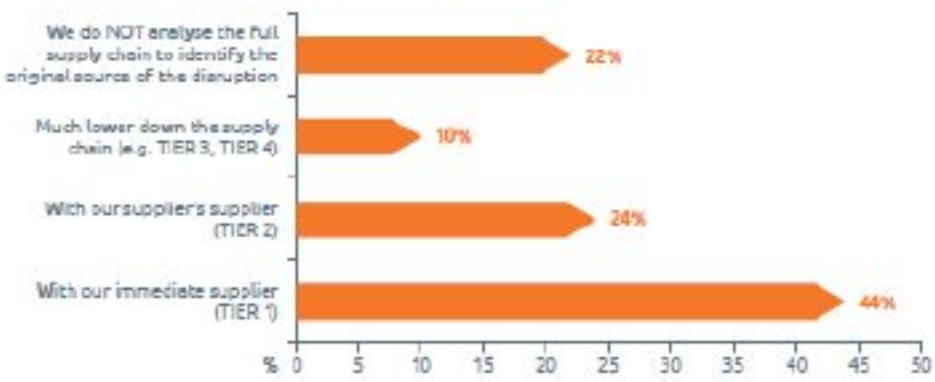
Number of disruptions



Insured losses



Source of disruption



CONCLUSION: CAN DO BETTER

Mr Riglietti said the key takeaways from the 2017 report showed that there are encouraging signs of progress, with the use of proper business continuity planning and management and use of risk transfer tools such as insurance to deal with what is obviously a critical risk. But clearly, much more work also needs to be done, not least in the field of insurance.

"Technology and big data can be leveraged to overcome the skills and resources gap that hampers the effective tracking of global supply chains. Insuring against supply chain losses is becoming a more popular option for organisations, although its uptake is variable at best. The reputational aspect around supply chain disruption is still important and resonates among many organisations," said Mr Riglietti.

"Business continuity remains essential to building supply chain resilience. Organisations are challenged to integrate relevant functions, frameworks and techniques in order to build supply chain resilience," he concluded.

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Governance, standards and captives key to cyber supply chain risk management

◇ SUPPLY CHAIN

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RISK MANAGERS AT OUR SUPPLY chain conference told delegates that governance, standards and captives are the best route to help mitigate cyber risk within the supply chain and deliver quantification sought by top management.

Philippe Cotelle, head of Airbus Defence and Space insurance risk management, said cyber is one of the many supply chain risks that need to be carefully managed. It is a pressing matter, said Mr Cotelle, who sits on Ferma's board and is vice-president of the cyber commission at French risk management association AMRAE.

Philippe Cotelle

INVESTMENT RATIONALE

Top management is asking for help from risk managers and others to quantify cyber exposures and deliver rationale for investment decisions on mitigation steps, he said. Ferma is working to help risk managers deliver on this through its work on cyber governance and other measures, Mr Cotelle added.

"Management wants to know if they invest money in cyber protection where the key priorities are, and in an efficient manner. It is very complex and that is why governance is one of the key elements to be able to provide some answers," said the cyber expert.

He explained that Ferma is working to define cyber risks and is collaborating with the CRO Forum on this issue. "We need to have a common reference and language. The taxonomy of cyber risk is really important," said Mr Cotelle.

He went on to stress that contractual relationships are vital to manage supply chain risk, including cyber. He said that when working with big cyber players in the supply chain, such as GAFAM, it can be hard for organisations to secure the contracts they would like because of the clout such firms possess.

"We have to try and make sure those kinds of contractual relationships allow us to fulfil our legal obligations, and this is not always a given," said Mr Cotelle.

When it comes to relationships with smaller suppliers, there must be a degree of trade-off between putting measures in place to transfer cyber risk to partners and foisting too much liability onto firms that may not have the resource to take it on board, he continued.

"With smaller suppliers, we larger firms must be able to compromise when transferring cyber liability. We cannot expect them to take full liability in all cases, and must ensure any transfer of liability is measured. We must be there to support them and help implement any new measures," said the risk manager.

Part of the solution is better cyber standards said Mr Cotelle, who noted that Ferma believes this cannot be left to regulators alone and needs input from industry on a sector-by-sector basis.

"This is not something that can just be on the regulatory side because the process would be too complex and not cope with changing technology, or be able to catch the specificities of each and every sector. It is something that should probably be promoted industry by industry and sector by sector, with industry leaders agreeing on standards specific to each sector that can go down through the supply chain," said the Frenchman.

CYBER STANDARDS

"We have to encourage suppliers and make clear it is in their interest and their larger supplier partners' interests. In the future, we will look for suppliers that have certain cyber standards," added Mr Cotelle.

Fellow risk manager Tracey Skinner told delegates that captives can play an important role in helping to get to grips with cyber risk within the supply chain.

"There is real work to be done in terms of risk identification within suppliers. The captive can help play a role here because it has a lot of information about suppliers. It is clear to me that when protecting your organisation's network, a cluster of supplies has the ability to cause huge impact globally, because they are doing the same things for many companies around cyber protection. So, this is an area that really needs to be given some focus," said Ms Skinner, who is director of insurance and risk financing at BT Group.

Extortion claims could rise under GDPR and blockchain problems lie ahead: experts

◇ GDPR

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THE GENERAL DATA PROTECTION REGULATION (GDPR) MAY WELL BRING higher extortion for compromised data because its potential for huge fines could give criminals more bargaining power, warned an expert at CRE's supply chain conference. Others at the event suggested that blockchain technology will not be the panacea some expect, because scalability problems potentially limit its uses.

Peter Johnson, cyber advisory leader, senior vice-president at Marsh, said the GDPR, which comes into force across the EU this May, could increase cyber extortion.

The GDPR introduces new fines on organisations that fall foul of its rules, of up to 4% of global annual turnover. This will potentially leave criminals that have obtained or stolen data in a better bargaining position to leverage more money from the organisation they are extorting.

"At the moment, extortion claims that we have seen are quite low level – a few bitcoins or tens of millions of dollars if it's a bad extortion claim. Next year, it is effectively worth up to 4% of global revenue. So what we might see, although we don't know, is an increase in extortion claims as a result. We might see extortion claims rise next year, which will bring a whole raft of problems," said Mr Johnson.

Fellow panellist Martin Overton, cyber risk specialist at AIG, said the GDPR should be affirming best practice and not a huge change for companies that are on top of cyber risk. But this is not proving to be the case at some firms, he added.

"I feel the GDPR is just rationalising a lot of best practices that should have been in place for years – things most companies should already be doing. So, it shouldn't really be a wakeup call but, unfortunately, for some companies it appears to be exactly that," he said.

Other experts taking part in the panel debate warned that blockchain and its lack of scalability may limit the technology's use and create as many problems as it solves.

Currently, all blockchain protocols are limited because every fully participating node in the network must process every transaction. The number of transactions the blockchain can process can never exceed that of a single node participating in the network. As the size of the blockchain grows, the requirements for storage, bandwidth and computing power to fully participate in the network increases, and can cause problems in terms of speed of access to information and power issues.

In a traditional database system, the solution to such a scalability problem is to add more servers to handle the added transactions. But in the decentralised blockchain world, where every node needs to process and validate every transaction, more computing power is required for every node, for the network to work faster.

Responding to questions from delegates about the prospect of blockchain contributing positively to some of the cyber challenges, Peter Armstrong, cyber risk expert at Munich Re, offered a cautionary note.

"Blockchain requires more and more internet bandwidth right at the time where we want faster and faster aggregation of data across increasingly distributed (cloud) databases in this world of big data and analytics. I worry that what we are doing is going to slow down the internet and the ability to derive meaningful value from big data by exploiting the blockchain technology. For sure, the power usage associated with blockchain will set back organisations that have been taking serious steps to address the green power agenda in IT," he said.

Adding: "So do I think blockchain is a panacea? No, I think it is part of the problem. We just have to fast forward five years to understand the burden it will add. Are there solutions to these things? Probably, but not yet. I think blockchain is more of a problem than a solution. It is disruptive in terms of processes and the intelligent value-added components of people's work, however if that disruption is not supportable long term, maybe we are not making considered organisational decisions today."

AIG's Mr Overton said the challenge with blockchain as it is currently designed is its scalability. "I think there are ways around it but there is still a fundamental design issue with the way blockchain can store this vast amount of data and it's constantly aggregating. It's a great technology and has real uses, but I do think there is an issue with its scalability," he said.

Hyperconnected value chains demand hyperconnected cyber risk management

◇ SUPPLY CHAIN

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DESPITE SOME SCEPTICS, CYBER RISK "is one of the great issues of our time", but business is failing to properly articulate and manage the threat with problems multiplying down the supply chain, warned Peter Armstrong, cyber risk expert at Munich Re, during CRE's recent supply chain conference. Hyperconnected value chains require hyperconnected risk management, he told delegates.

Mr Armstrong began his presentation by noting that, based on current projections, 3.5% of global GDP could be lost to cybercriminality by 2020. "That is a global recession," he said.

But business is struggling to respond to this threat and articulate the challenge "in any meaningful way", the expert said in a stark warning.

There is a lack of understanding over the scale of the threat and it certainly cannot be described in language the board understands, said Mr Armstrong.

"We are all increasingly aware of the challenge of cyber threats, even though awareness is not necessarily shaped by knowledge or understanding. This is shaping conversation in the boardroom and we are not communicating therefore on this issue. It is very difficult to have confidence in investment decisions if we are not able to compare like for like. And today, too often in the boardroom, we are having a conversation comparing apples with Wednesdays," he said.

The problem is accentuated in the supply chain, where there is generally little security in place, continued Mr Armstrong. "Do we have confidence that our supply chains are secure? It is a laughable concept, and the genie is already out of the bottle. What are we going to do about that?" he said.

GOVERNANCE STRUCTURE

The expert believes much of the problem arises because organisations are not using well-established enterprise risk management or governance structures to tackle cyber risk.

"Ceding this corporate, enterprise-wide risk to just a cyber risk expert is not good. We are lacking governance structure," said Mr Armstrong. "For every other risk we quantify the exposure, decide how to balance capital spend by either retaining the risk, mitigating the risk or transferring the risk, and then measure the reduction in residual risk outcomes. But for cyber risk companies tend to just engage the big four consultants, hoping they will provide the magic sauce, do not do a good job of quantifying the incremental exposure, and focus on prioritising mitigation action through spending more money on technology or consultants. All this means organisations cannot measure residual risk outcomes and we don't consider other capital options," he said.

Adding: "We are not applying adequate and consistent governance to cyber in the same way we do for everything else. You cannot manage the risk it if you can't measure it. If you don't know what to measure, because you haven't got a meaningful and consistent governance approach, it is probably going to fail."

Mr Armstrong said the work of Ferma and ECIIA on a consistent framework for corporate governance of cybersecurity is important in this area, and builds on OECD recommendations for digital security risk management.

But he stressed again that hyperconnected value chains need hyperconnected risk management and laid out key questions for risk managers to tackle:

- How are we controlling standards for the IoT?
- How are we addressing cyber surety of goods and services in the value chain?
- How will we assure goods and services are fit for purpose within a connected value chain and, as risk champions, do we attend and influence connectivity product development?
- How will we determine capital allocation for cyber risk?
- Cyber insurance is not meant to be a substitute for good risk management, so how do we derive value from insurance in this context?

Solutions on hand to identify, map and model supply chain risk

◇ SUPPLY CHAIN

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- **80%** of businesses with significant business interruption impact from a major incident either never reopen, or close within 18 months
- **43%** of businesses closed by a catastrophe never reopen; **28%** of those that do reopen, experience financial failure within three to five years
- **50%** of CBI losses from catastrophes involve sub-tier suppliers
- **70%** of flood claims from the Thai floods in 2014 were at facilities within seven industrial estates, resulting in a loss of more than $25bn

SOURCE: Kenneth Travers presentation

EXPERTS TAKING PART in the supply chain risk identification and modelling discussion said risk managers are still struggling to get on top of exposures, particularly when it comes to contingent business interruption (CBI), but growing help is at hand.

According to Kenneth Travers, technical hazards team lead and global business specialist at AIG, more efficient supply chains have made them more fragile to large, high-severity events, and many companies simply do not know how to map their risk. Things are even tougher when it comes to CBI, he added.

But Mr Travers said new data-gathering techniques and analytic models mean we have a more robust understanding of both business interruption (BI) and CBI risk today to help companies solve this conundrum. "It's all about data, data and data," he said.

Presenting on supply chain risk identification, modelling and CBI challenges, Mr Travers said that mapping the supply chain remains a challenge for many organisations. He said most clients he deals with know their tier-one suppliers but roughly 80% have limited or no visibility beyond that.

'SECRET SAUCE'

In many cases this is because information further down the chain is protected by tier-one suppliers "like a secret sauce", said the insurer. "They don't want to give that up and pass it up the chain to the ultimate manufacturer, so this presents a real challenge. Trying to understand who the tier twos are, and then the tier threes and fours, is the number one challenge," he said.

On top of that, companies need to know where and how suppliers operate. "How those products and components are moved through a supply chain on a daily or weekly basis, and which routes they take, is important. Then there is the infrastructure they depend on such as ports. All these data requirements are really built into how we need to look into this problem," said Mr Travers.

Obtaining this data is not easy and requires input from risk managers, insurers and, increasingly, third parties.

"First off, of course, we look to the client to provide us with as much as they can. Unfortunately, most of the time they give us their tier ones but not much beyond that. But we start with what information they have. The insurance community maintains a pretty broad database of exposure information of clients we have either insured in the past or looked at in the past. Many of them are suppliers. So we can get some data from our internal global exposure databases. In addition, third-party data is becoming a real and critical reality. AIG has been partnering with data providers to try and help us solve the problem. There is not a panacea here, or one data provider you can use to fill in the gaps. But we are really taking, and need to take, a multifaceted approach," said Mr Travers.


Julia Graham

Risk identification and modelling is exacerbated when measuring, managing and potentially transferring CBI risk, where losses stem from impact to a client's supplier, he continued.

Assessing CBI risk requires a strong understanding of the overall insured's network of supplier flows, revenue streams, internal and external dependencies. The best approach is to reduce the initial assessment to top products or product lines, advised Mr Travers. This will generally enable stakeholders to gather a manageable amount of data and information on the biggest threats, he added. To fully achieve this, tier levels must be identified, along with all supplier locations and relevant splits of supplies or components, said Mr Travers.

Developments in analytics modeling is helping to assess CBI risk, he told delegates. It can help determine the severity and frequency of potential CBI losses, supplier risk contributions and the events that really matter, he explained.

But like other risk identification techniques, analytic modelling requires large amounts of data, said the insurer. On the client side, it requires key tier location data, supply chain mapping, product family identification and critical parts taxonomies. Insurers then need to identify potential location data on manufacturing end-point sites, physical and location data on tier suppliers and key physical nat cat modeling data. Third-party data can deliver internet of things information on supplier locations, supply chain mapping and supply chain configuration, as well as parts and raw materials throughput.

There are huge benefits from using analytic modelling, said Mr Travers. It can provide quantified risk assessment for modeled perils, develop CBI average annual risk by peril, tier level and individual supplier information, risk rank CBI risk contributors within the client supply chain, and identify the highest-risk contributors within the client's supply chain.

This process can also identify for which component parts and suppliers a client may need alternatives, highlight potential CBI risk mitigation strategies, develop cost/benefit for potential CBI risk mitigation strategies, support more robust CBI risk transfer needs and integrate results into the supplier selection process when building out a product supply chain.

Following on from Mr Travers' presentation, other experts taking part in a panel debate gave their advice on how to best identify and map supply chain exposures.

John Davies, head of analytics and managing director at Marsh, advised risk managers to work at mapping the supply chain and then its financial overflows, before focusing on any potential loss trigger. He also said clients don't need to map every single part of the supply chain and can prioritise key risks.

"People don't map financial flows through the supply chain very well. It is easier to map the supply chain, but harder to map financial overflows on top of that. Once you understand the financial flows you can understand the severity and impact, but the likelihood is the challenge. You can use proxies for likelihood and then you can calibrate the model to different scenarios. I think there is enough data out there and past experience to use as proxies for frequency," said Mr Davies.

He said risk managers should partner with people who know how their company's supply chain operates, such as the purchasing department in manufacturing firms, to help do some of this work.

"It is about partnering with other parts of the business. Work with people that understand the organisation and the financial impact of disruption. And overlay the trigger later, don't focus on the cause of loss at the beginning. I wouldn't initially worry about loss, I would focus on disruption," added Mr Davies.

Julia Graham, Airmic's technical director and deputy CEO, advised risk managers not to reinvent the wheel when it comes to identifying and mapping supply chain risk.

KNOW YOUR SUPPLIERS

"There are a couple of very good sources you can use. Use your GDPR process to enhance your supply chain risk management because that will show where data is held. A great byproduct of the disaster recovery part of business continuity is that it requires you to know about your supply chain. Make use of that," she said.

Fellow risk manager Xavier Mutzig, board member of Ferma and Airmic, as well as group insurance and insurable risk manager at Johnson Matthey, said visibility across the supply chain is a big problem and can take years to map. He, like others, therefore suggests prioritising.

"The first step is to define the relevant scope to address as a priority. Trying to address all supply chain activities and risks would require resources that are not always available, so it is important to prioritise the products or services based on the impact of a supply chain failure on the strategic objectives of the organisation. Don't try to map your entire supply chain at once," said Mr Mutzig.

For his part, Monty Roach, president and CEO of Ausum Systems, pointed out that without the correct input, analytic models will not deliver the goods.

"So we need enough of the right type of data. Models are all built on past data and predicting what will happen in the future based on what happened in the past. So the models will be wrong and not get the information you require unless the right data is supplied. This is very important to remember," he said.

Too many organisations still working in silos on supply chain risk

◇ SILOS

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THERE ARE STILL TOO MANY ORGANISATIONS operating in silos when it comes to managing supply chain risk, Julia Graham, Airmic's technical director and deputy CEO, told delegates at CRE's 'Supply Chain Risk: Identification, Measurement and Mitigation' conference.

She and fellow risk manager Xavier Mutzig urged organisations to boost collaboration on supply chain risk, advising attendees to use enterprise risk management (ERM) standards to drive the process and suggesting how best to get boards' attention on this pressing matter.

JOIN THE DOTS

Ms Graham, who is also a former Ferma president, worked in business continuity before entering the world of risk management and remains a member and fellow of the Business Continuity Institute (BCI). So risk managers would do well to take note of her appraisal that some organisations still do not join the dots when it comes to supply chain management.

Ms Graham warned: "It always amazes me that there are still silos operating in companies and other organisations, where the insurance manager, risk manager, business continuity manager, procurement manager and legal team don't necessarily talk to each other and collaborate as well as they should do when it comes to supply chains."

She said these individuals and their teams must work together to understand the bigger picture.

"There is no excuse for coming up with different views of what recovery times look like for your business interruption cover and what your recovery times look like for your business continuity plan. But there are plenty of organisations out there that still have those differences," said the former risk manager.

Fellow speaker Mr Mutzig, who is a board member of Ferma and Airmic, as well as group insurance and insurable risk manager at JohnsonMatthey, agreed that collaboration between the different teams is vital to manage supply chain risk. The risk manager's role is to facilitate this teamwork and embed risk management across the supply chain, he added.

"We, as risk managers, really need to embed a risk management culture within every step of the supply chain and with all the various functions involved in managing the supply chain. Collaboration between all internal stakeholders is a key factor to build a resilient supply chain as each stakeholder holds a piece of the information and shares some responsibility in the process. The role of the risk manager is to conduct the exercise to enable all the various functions to share the information and collaborate.

"Another key element is continuous improvement in supply chain risk management. Learning from past failures and even from near misses and minor events in the supply chain will provide valuable information to detect and prevent future major disruptions. Another way to draw lessons and test your supply chain resilience is to organise loss scenario workshops, crisis simulation and stress testing." Mr Mutzig told those gathered at the Millennium Hotel in Mayfair.

He advised fellow risk managers to use recognised ERM standards to help map supply chain risk, quantify the threats and put in place mitigation measures.

FINANCIAL METRIC

Ms Graham also advised risk managers to flag any supplier upon which an organisation relies that would cause greater financial harm if lost than the organisation's risk appetite allows for. This metric can be validated in financial terms and therefore is a good way to get the board's attention on supply chain risk, she explained.

"If there was a metric I would give to a board to put in their dashboard and get their attention, it is the risk appetite of an organisation and any dependency on any supplier that is bigger than that risk appetite. When I did that exercise, people were really shocked to find that they had dependencies in certain countries on one client that were enormous. If that client disappeared, they realised they were in big trouble. So that sole dependency when bigger than risk appetite, is one metric that boards can understand because you can explain it in financial value," Ms Graham said.

Balancing ERM with keeping things simple for the board

◇ MITIGATION

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MANAGING SUPPLY CHAIN risk is no easy task and demands an enterprise-wide response, agreed senior risk professionals speaking at our Supply Chain Risk: Identification, Measurement and Mitigation conference. But how is this best achieved? The experts said risk managers need to involve all the necessary stakeholders, including strategy, and obtain the wide range of information needed to properly get a grip on this risk. But this must be balanced with keeping things simple when reporting up to top management and the board, they advised.

All risk managers speaking during the panel debate on how best to tackle supply chain risk said it requires an enterprise risk management (ERM) approach. The risk is simply too large and complicated, while involving too many different business functions, to tackle in any other way.

The question is: how can organisations, led by their risk managers, achieve this goal?

According to Daniel Winter, senior risk manager at British Gas, the enterprise risk team needs to be aware of all the different risks and business units linked to the supply chain and then join the dots.

"The enterprise risk role has to ensure that risk is being managed holistically across the whole of the business. I think it is that awareness that we need to provide and need to make sure is consistent across the business. How you make that happen is being aware of what the different business units need to achieve and then adapting your process to work with them, while not losing sight of the overall principals of the framework you are using," he said.

ALIGN FRAMEWORK

Mr Winter advised risk managers to align the ERM framework with other processes led by units such as procurement, and then lean on them to help get the message across.

"You need to reflect on the fact that supply teams and procurement teams, particularly across a large group, are suffering the same sort of challenges as us in the ERM group. We are trying to get a risk framework out consistently across different parts of the business, in the same way a procurement team is trying to get a consistent process across different parts of the business. So that challenge is shared and understanding that is useful when getting an ERM framework to be in line with other processes," he told delegates.

> **"The enterprise** risk role has to ensure that risk is being managed holistically across the whole of the business..."

He also stressed that ERM is about ensuring that risks, including those in the supply chain, are not managed in silos. One of the key risks is the risk itself not being managed effectively, he added.

"What is interesting about ERM is it gets a bit meta sometimes because you are not just manging the risks but the way the risks are managed. So one of your risks might be that risks aren't managed effectively. To some extent, the role of an enterprise risk framework is to see if risk is being managed in a silo, which is a risk in itself. This is something to consider when managing supply chain risk," said the risk manager.

Fellow panellist Francesco Morelli, head of corporate protection at Terna Group, said his firm chose to use a bottom-up approach for its supply chain ERM. Terna Group began by analysing the supply chain processes and then set up working groups with the risk owners.

"Together we work out what are the most impactful risks for each process and decide together what the controls are. We then use our governance, risk and compliance platform to generate automatic reports for top management on risk exposures and key risks," said Mr Morelli.

The sole insurer on the panel explained that many clients he deals with are trying to develop more simplistic ERM dashboards that

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allow easy flow of information and, crucially, reports for top management and the board that are easy to understand and act upon.

"I see firms trying to develop very simplistic ERM communication dashboards where they can take data being produced and make it available in real time, which can then be distilled and fed up to the CEO and the board. There are of course a lot of things going on at the same time, but you have to make it fairly quick and simple to get that data in, distilled and the message to the board for a quick decision. So there is a move towards more simplicity here," said Kenneth Travers, technical hazards team lead and global business impact specialist at AIG.

Mr Winter said simplicity is key, but made clear that too little or too much information are both dangerous when it comes to managing supply chain risk.

"Too much information can cause board members to rush for answers to questions that aren't really going to be a problem. Too little information means you don't tell them about things that you have to go back to them on later. Identifying which information is key is difficult. I think it is all about relating it to the things that matter. Involving strategy in some of these discussions

George Ong, Northern Ireland Water

is very important," he said.

Mr Winter said this issue is further complicated when organisations join with new third parties because suddenly their supply chain and related risks are taken on board.

DATA INTEGRITY

"Getting that information on third parties can be very difficult. You have issues with data privacy, for example, and trusting the integrity of that data. So that can present some real challenges about what information you can and do present," he said.

Jonathan Blackhurst, head of risk management at outsourcing business services company Capita, stressed the importance of engaging with the whole business on supply chain risk management. To do otherwise runs the risk of things falling through the gap, he said.

"The key here is it is an enterprise approach. So the real question is: who wouldn't you work with? You really have to engage the whole company and suppliers – be it on the operational or strategic side. You must deal with every party at a given point in time. I think focusing in on who are the most important people to work with can be quite dangerous. If you miss people out, you run the risk of missing things. So bear in mind, whatever size your enterprise, there will allways be stakeholders you have to identify across the enterprise. If you don't, that is where you can start falling down," said Mr Blackhurst.

It is also critical that the ERM team ensures that ownership of any risk or activity lies with those in the front line, continued the risk manager. "You need to ensure the ownership of any activity is with those people that are managing relationships and operations involved. We need to ensure that they are not the second line, background individuals," he said.

George Ong, head of corporate governance and chief risk officer at Northern Ireland Water, said risk committees are very important when tackling complex threats such as those in the supply chain. The risk committee can give very clear and precise information to the board after taking a more in-depth look at the issues, he said. "Boards simply don't have the time to do all that work," explained Mr Ong.

He added that supply chain risk board reports must focus on opportunities as well as threats. "How many reports focus on risks and opportunities? Not many. So we need to ensure both sides of the risk equation are considered and stress that ERM can provide upside benefits, as well as managing downside risk," said the chief risk officer.

Fire and water remain key threats despite rise of cyber and digital age

◇ DISASTER RECOVERY

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Cyber risk and IT failure may have taken over the agenda in the risk management, resilience and business continuity world but fire and water remain critical threats to supply chains the world over.

Risk management and business continuity experts should also bear in mind that so-called secondary damages – such as corrosive soot and gases following a fire at a plant – are actually more damaging and costly than the initial incidents themselves.

These were some of the key points revealed by Martin Schachtschneider, business development, international key accounts at the German operation of international disaster recovery specialist company Belfor.

To kick off his presentation, titled 'Impact of Fire and Water Damages on Supply Chains', Mr Schachtschneider reminded delegates of a recent high-profile and high-cost supply chain disruption for Daimler in Germany and other leading auto companies, which was the result of a fire at a key auto component supplier at the start of 2017.

The disruption was sparked by a heavy fire at a Czech supplier – Recticel International – during which one of three warehouses was totally destroyed and two were heavily contaminated with flue gas. The entire plant was shut down for health and safety reasons.

Recticel's damaged interiors division is the sole worldwide provider of patented polyurethane sprayed skins for car interiors.

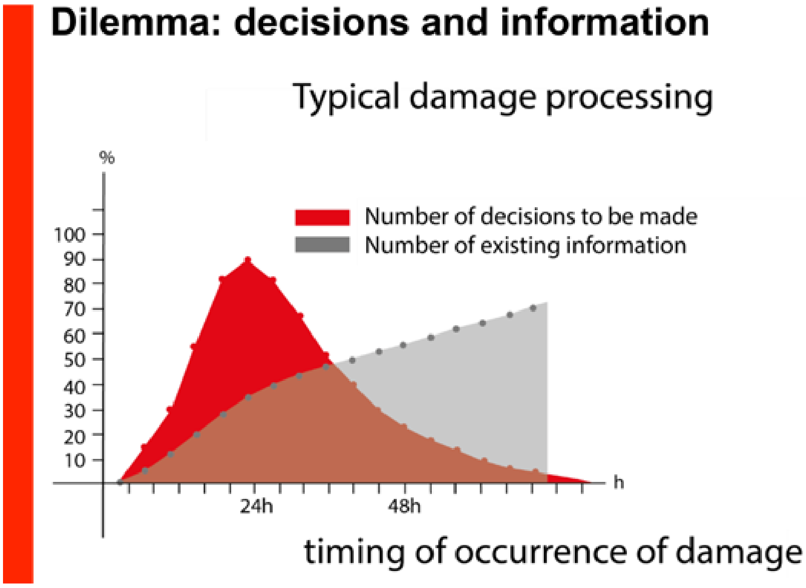
LAYER CAKE

Tier 1 and also tier 2 auto suppliers were badly hit. The vendor announced 'force majeur' a few days later and, in the end, production at Daimler's operations in Sindelfingen, southwest Germany stood still for days. Other manufacturers – such as VW, BMW, Renault and Peugeot Citroen – were also affected by non-delivery and were forced to halt production.

Mr Schachtschneider pointed out that examples such as this and a recent incident that forced VW to cease production for three weeks in Emden, Germany because of an incident at a supplier in Belgium, show that trends in the global economy and complexity and interdependencies brought by new technological advances are adding to supply chain exposures.

"Global competition leads to consolidation among suppliers. This often results in single-source supplier on different levels," he pointed out.

Some sectors are clearly more exposed to this risk than others. One example of a high-risk sector that is important for many production areas is the plastics injection moulding sector.



"Tools are often unique because of their costs and long delivery times for new equipment/replacement. This involves highly precise and sensitive functional surfaces that are partially nitrided or polished. The injection pressure is up to 2,000 bar and plastic temperature 200 to 300 degrees Celsius. This business also involves very high pressure hydraulics (for example 1,000 tonnes), continuous operation often with few staff and the risk of fires due to short circuits in electronics," explained Mr Schachtschneider.

"Further, high automation requires constant control of processes. Plastic waste has a special fire load, often with flame retardants, and by this [produces] corrosive fire products if burned," he added.

The German insurance association (GDV) produces a lot of valuable statistics about losses. Without decent statistical analysis of loss causes and effects, then lessons cannot be learned and loss prevention improved.

Martin Schachtschneider

Of particular interest to the supply chain risk manager is the German association's Damage Prevention in Non-Life Insurance 2015/2016 report, produced by the GDV's asset damage prevention committee, said Mr Schachtschneider.

One major conclusion from the association's latest analysis was that secondary damage makes up more than 50% of total damage volume, based on analysis of major damage statistics for 2004-2013.

"[This analysis] of fire damage shows the largest proportion; 53.3% is attributed to secondary damage (eg corrosive soot and gases, and poisonous or hazardous byproduct contamination). In terms of damage value, secondary damage accounts for 52.6%, making it not only the biggest problem but also the most costly," reported Mr Schachtschneider.

The disaster recovery expert also noted that, on average, operational interruption accounted for 33% of total damage costs between 1996 and 2015, based on GDV figures. "One thing is very clear: if you can't produce, you can't deliver, and if you can't deliver, loss of earnings occur. A vicious cycle develops that requires considerable financial staying power and can only be broken with quick reactions and a targeted recovery strategy," commented Mr Schachtschneider.

Commercial Risk Europe's annual Risk Frontiers survey regularly finds that natural catastrophe risk remains very high up the risk manager's agenda despite the rise of more 'trendy' risks such as cyber and reputation. The disaster recovery expert concurred with this view, as he pointed out that weather extremes are still potentially devastating to the fragile modern global supply chain, as proven in 2011 by the Japanese tsunami and Thai floods.

RISK TRANSFER:
As with cyber, transparency is all

◇ RISK TRANSFER

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JOHN DAVIES, HEAD OF analytics and managing director, Marsh, was the facilitator for the presentation and panel debate on risk transfer in the supply chain field.

The broker played devil's advocate by kicking off the session with a challenge to all parties, not least risk managers, to offer more to help improve the identification and analysis of these risks and thus make them more readily insurable.

"The market has clearly made significant strides to map and manage these risks, especially non-damage business interruption (NDBI). But I lay the gauntlet down: the market is not doing enough. But, having said that, I do not think that it is the insurer's job to pick up the slack if the risk management community cannot provide the data. Do not expect the insurance market to provide you with everything you want on this basis. The market cannot provide the solutions you need and want without the information needed to properly assess the risk," said Mr Davies.

INADEQUATE DIALOGUE

Before the debate about how this market could and should work more effectively together commenced, however, Dirk Schäfer, senior underwriter at the special enterprise risks unit of Munich Re and board member with responsibility for supply chain risk of the Risk Management Association (RMA) in Germany, took the floor to give a presentation.

Mr Schäfer agreed with Mr Davies, stating that dialogue and communication about this critical business risk needs to be significantly improved if the risks are to be more effectively identified, modelled, managed and transferred.

"We have found that one common error among companies is that they look at supply chain risk from a headquarters perspective and not the plant that actually produces the goods that could be interrupted. The problem is that people do not talk to each other frequently enough within organisations – risk management, supply chain management, the purchasing department or even supply chain risk management – there is simply not

John Davies

enough dialogue between these key functions," said Mr Schäfer.

The underwriter said the basic problem appears to be motivated by cost. Companies of all types understandably want to buy their supplies as cheaply as possible. This makes sense, of course, so long as the products actually arrive. But, as Mr Schäfer stressed, this can end up being a very costly strategy if the supplies fail to turn up.

DATA IS KEY

The key to appreciating the potential exposure, identifying its potential impacts and costs and thus potential risk management and transfer solutions is, as with all insurance products, based in data capture and analysis. Progress is being made in this critical area, said Mr Schäfer.

"There are quite a few tools that have been developed in recent times and that can be used to effectively to manage exposures. Munich Re, for example, has developed the NATHAN Risk Suite (Natural Hazards Assessment Network), based on global hazard data gathered over the last 40 years. This helps assess the risks of natural hazards around the world, from the location-based individual risk through to entire risk portfolios," he said.

The supply chain insurance expert explained that this unit has developed a system to map supply chain. But he pointed out that the longer the chain is, the more difficult it becomes to acquire the required information – largely because of data protection rules. This makes underwriting challenging.

"At the fourth tier, it becomes very difficult and, in such cases, offering cover is not easy. We do have clients that are very good at showing how well they manage their supply chain risks, use expert consultants and the like. We offer implicit cover for such risks that have not been impaired but the risk management needs to be very sophisticated. We offer explicit cover for own and named exposures but these are generally smaller companies that are generally dependent upon one supplier, which enables us to model it really well. What we don't like as a carrier is companies that do not really know their exposure and want broad cover. In these cases, we walk away," explained Mr Schäfer.

The underwriter explained that supply chain risk has become more important, generally because of the tendency of companies of all types to keep as low stock levels as possible. Greater outsourcing also significantly increases the exposure, he added.

NEW LINE

Mr Schäfer explained that supply chain insurance is really at the start point as a standalone line of business.

"How can we establish a new line of business with the critical mass needed to offer significant capacity like cyber now and D&O before? The company has to be aware of the fact that they have a potential supply chain risk with suppliers or customers. Biotech companies, for example, generally have one or two products and outsource their production, and so need to balance the business model. We have a product for this business that works well," he said.

One-off solutions can be built for specific circumstances such as regulatory shutdown of the company itself or a supplier leading to NDBI losses. "Such one-off solutions can be adapted for other clients. If the customer is big enough then you have the potential to do this," said Mr Schäfer.

Above all, stakeholder awareness of the risk and the potential damage it can bring is the key to the further development of the line of business. If demand is sufficient then that can lead to scalable, more standardised and thus cost-effective solutions, though this is far from guaranteed in the supply chain area, said Mr Schäfer.

> "There are quite a few tools that have been developed in recent times and that can be used to effectively to manage exposures..."

SEVERELY DISRUPTED

"This is what has happened with cyber. Business leaders are now fully aware that cyber is a real exposure because there are stories in the newspaper every day about significant losses. Headlines grab attention. But I am not quite sure that supply chain insurance will develop in the same way as cyber. There was a big focus on this problem back in 2011 following the Thai floods that so severely disrupted global supply chains, particularly in the auto sector. But the focus fell away over time," said Mr Schäfer.

"Obviously there are some sectors – such as automotive – that need this cover more than others. But I am not sure that this market will ever be as big as cyber. People lose their jobs when incidents occur but it is not the same in supply chain. I am not aware of anyone who has lost their job because of a supply chain failure!" he added.

At this point, Mr Davies took the microphone back and asked the obvious question that most risk managers in the room were surely asking themselves, just as they often do with cyber: "Why invent a standalone supply chain policy? Why not add the cover to existing policies as an endorsement?"

Dr Alan Punter, visiting professor at Cass Business School, City University of London, and a former senior executive at Aon in London, was clearly not sure that this risk would or should generate a

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standalone market as with D&O and cyber.

He said that clearly there has been a growth of interest in the NDBI market, particularly since 2011, and the focus generally has shifted from property cover to business interruption. He said he had carried out an analysis of the market in 2012 and found there have been developments in the cover such as key supplier cover and named perils. "But this was not going very far. Airmic published an interesting report on supply chain failures in 2013. But, at the end of the day, you have to ask the question: who is going to buy this cover?" asked Dr Punter. Daniel Winter, senior risk manager at British Gas, said he sees interesting parallels between cyber and supply chain insurance but, as pointed out by Dr Punter, he wonders whether the cover is actually really needed as a standalone product.

"You have to ask whether it is covered already. Do I need it? I have BI cover already so what is new? You could get into a legal rabbit hole with this. But it is difficult to see whether you would need this cover in the first place. The other point to consider of course is that there are other ways to manage risk besides buying insurance. If a supplier is in trouble then you just need to find out where else you can buy the parts, preferably in advance of any interruption," said Mr Winter.

The risk manager did also point out, however, that in many industries it is not just a matter of finding an alternative supplier of a simple pump. "This can, however, no longer be so simple. Options are becoming more restricted as the economy becomes more diversified, technology more complex and securing supply chains can be more difficult. I think that what risk managers really need is greater clarity and help about what is really on offer here from the insurance market," added the risk manager.

JOINT EFFORT NEEDED

Joe Trotti, head of property and special risk at AIG, agreed with Mr Winter that supply chain has become a very complex and difficult to quantify risk in the fluid, interdependent global economy. He pointed out that there is now a "host" of different contingent business interruption policies that cover supply chain liabilities and cyber in different ways.

He said data analysis is improving in this field but more work is needed, and stressed that this work needs to be on a collective basis involving all parties including the risk managers themselves. "It is not just a question of insurers advancing this – customers too need to be involved. It is a joint task," he said. Mr Davies said he agreed that progress is being made and there is rising capacity, especially for named perils. But he said one of the biggest problems is the price. "The question is not whether this coverage is available but for what price you get it. You can find contingent capital at 8% so you are not going to spend 12% for this cover," he pointed out.

Mr Winter pointed out, however, that with supply chain, as with cyber, risk managers are not only interested in the cover. The add-on services that come with it are important too. "If you think about cyber, the cost of replacing a system is one thing but restoring your reputation is another, more significant, thing. The value-added services are very much as important as the cover itself. If you have a loss and are compensated for it through insurance that is fine. But you are still not delivering to customers, so a useful side benefit of the cover would be to help ensure access to a new supplier. This is real added value and not just replacement of a loss," explained Mr Winter.

Just as with cyber, it is clear there is big potential value in the supply chain insurance market but, even more so than cyber, there is also a good deal of work to be done by all parties in the risk transfer chain to make it a truly viable long-term product. It could well be that because of the complexity and diversity of this risk, this may never become as mass market and standardised as cyber, which is evolving quite rapidly as demand soars. But for certain sectors, this surely offers a valid option with added services bringing extra value, so long as the price is right.

Lessons to be learnt from past experience

◇ CLAIMS

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THE WHOLE POINT OF insurance is to receive claims payment when something goes wrong, but of course this is not always as easy or plain sailing as risk managers would like. Expert speakers at our supply chain conference explained where problems can occur when it comes to business interruption (BI) cover and how risk managers and insurers can improve things moving forward.

Mark Wing, partner at Clyde & Co, gave a presentation focused on the Ted Baker vs AXA case that went to the UK's court of appeal in 2017, which highlighted what can go wrong in supply chain-related business interruption claims. Ultimately, the BI claim was declined and there were large legal costs for both sides.

STOLEN STOCK

The case revolved around a Ted Baker employee who had stolen more than £3m-worth of apparel from the clothes manufacturer during a four-year period. Ted Baker's fidelity insurer covered the lost stock, but a battle ensued to recover loss of gross profit on stolen stock from the BI insurer.

Ted Baker notified AXA of the claim and the insurer then requested information and documents related to the case, some of which were difficult to obtain and would require specialist help. The insured decided not to respond until the insurer had confirmed cover.

Because there were different interpretations over whether employee theft was covered under the BI policy, AXA declined the claim. It went to the UK Commercial Court in 2012, which judged that employee theft was covered. But instead of being the end of the matter, wrangling then took place over how the claim had been processed and managed.

Mr Wing explained there were two main points of contention. A condition precedent in the policy said the insured should provide documents that were reasonably required. If these documents were not provided, the insurer could decline liability with proving any prejudice.

In addition, the policy had a £5,000 deductible for each and every loss. Because the theft had been going on for four years and involved many different incidents, it was almost impossible to calculate how muck stock was taken, and profit lost, during each theft. The policy had been set up to respond to one business interruption event – such as a fire or flood – and therefore it was hard for the insured to prove it should trigger beyond the £5,000 deductible.

Last year's UK Court of Appeal ruling on this case threw up some interest judgments, said Mr Wing.

"On the condition precedent, the court said, first, it is reasonable to require an insured to provide documents that they readily have. Profit and loss accounts, management accounts and the like should be provided without any question. However, it also said it is unreasonable to require an insured to provide documents that they have to spend a considerable amount of time and effort collating until policy coverage has been confirmed," explained the lawyer.

"The second interesting thing from the case is that the court imposed a duty to speak on the part of the insurer. So the request was made, the policy position was reserved and then declined. At no point did the insurer actually say to the insured: 'although we declined the claim because we don't think the loss is covered, you still need to provide us with those documents we have asked for'. The court basically said that the insurer at that stage had a duty to speak," he added.

Mr Wing said the case throws up a number of pointers about what a good or bad claim might look like, which risk managers can draw upon.

First, it shows the importance of understanding obligations of both insured and insurer, either under polices or law, he said. "It is important you understand what those obligations are at each stage – whether it is the notification stage, the policy trigger stage or adjustment stage," said Mr Wing. "At the same time don't get hung up on process. Don't think because you can't get over one hurdle you are excused from dealing with the other steps – take a pragmatic approach," he advised delegates.

Second, the case shows that claims often involve different teams and individuals, highlighting how that interaction can affect the outcome.

"If they work well together, you tend to get a good claim outcome. If you get a point of friction anywhere in that process or team, you tend to encounter problems. It is important to understand who has what responsibility at what stage in each process or step," said the lawyer.

The case illustrates other key requirements that everyone should keep in mind for a successful claim and how to best manage the process, he continued. "It is about a degree of

Mark Wing

common sense, sharing information and ensuring clear channels of communication. It is about making sure there is early notification through the claim," said Mr Wing.

Finally, it shows how insured and insurer should try and work together to avoid heavy legal expenses that are sometimes higher than the claim itself, he stressed.

"The insured didn't recover under the BI policy. But perhaps more significantly, although the claim varied in value over its lifetime, in the end it was probably worth less than £1m and all the parties spent well over £5m arguing about all the points in this case. This is extreme, but shows the value of working in harmony," he noted.

Fellow Clyde & Co partner, Henning Schaloske, explained during a panel debate following Mr Wing's presentation that many of the issues thrown up by the Ted Baker v AXA case, and problems with BI claims in general, are encountered in continental Europe.

SKILLS GAP

"The discussions we often see are about calculation of losses. It's about perceptions. We see people still think there is coverage for loss of market share or reputational losses, when typically there is not. Proving losses requires a certain level of information and transparency in relationships between insured and insurer, regardless of where the claim originates. This is the major issue," he said.

Mr Wing went on to say that the Ted Baker case highlights a skills gap when assessing BI and supply chain losses at both insureds and insurers.

"Supply chain is an indemnity policy and will only indemnify you if you can prove the loss of profit and increased costs of working as a result of disruption. Sometimes that can be hard to do when the incident is close to you. But if you add in the complexity when that occurs at suppliers far away or several steps removed, proving that disruption becomes a lot harder. So I do think there is a skills gap there," he said.

Fellow panellist Paul Dawson, property and energy major loss adjuster at AIG, said many clients still do not realise the size of their supply chain exposure. It is only when you start digging into the issue that the size of the risk becomes clear, he added.

He advised insureds not to take anything for granted when it comes to supply chain exposure and related cover.

"Too often, policies just get renewed year after year without much consideration. Just because you have had a policy for 15 to 20 years and haven't had a claim, don't assume that you won't have one. It is worth investing time to sit down with your broker and insurer. Just ask 'what happens if?'," he said.

Involving claims people in this process is crucial and is less prevalent than it should be, he continued. "Don't just talk to the underwriters, get the claims people involved as well. We can provide a lot of insight. More attention needs to be given to the likelihood of a claim and how the policy will perform. Often, claims feel like the elephant in the room. It's important not to ignore claims," said the expert.

He went on to note that AIG would like to get more take-up on its claims workshops. "So I put it to risk managers to take up these opportunities. Through these workshops, we can help you understand how a policy will perform and how a claims scenario might play out," Mr Dawson said.

The claims expert also said that denying claims on the basis of honest misunderstandings in the underwriting process should be avoided.

"From our perspective, the basis of how the risk was written is how you deal with the claim. I think we recognise that these are not simple claims and therefore you have got to look at them with an open mind. If there is a clear reason why a claim shouldn't be paid, then get it out on the table as quickly as possible and explain why. If there is an element of greyness about a situation you cannot punish a client for sometimes not knowing – there is a real difference between not knowing and not telling. Our aim is to listen and give our clients a fair platform to put their case," said Mr Dawson.

Robert Lewis, head of risk management claims and senior vice-president at Marsh, said the sheer breadth of supply chain risk and unpredictable nature of losses can make the underwriting and claims process for related insurance extremely challenging. He flagged recent losses from Hurricane Harvey as an example.