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Supply chains – Contingency planning for future disruptions

The COVID-19 crisis has highlighted just how quickly and how easily unexpected events can disrupt supply chains. In a world where the trend in recent years has been for supply chains to operate on an increasingly large-scale, 'just in time' basis, with minimal 'buffer room' for error, the disruptive effects of COVID-19 have been felt widely. In this paper, we set out some of the practical steps that businesses can take to reduce the risk of future supply chain disruption. Whilst it is impossible to anticipate all the risks that businesses might face in the future, conducting proper contingency planning is one of the key actions a business can take to mitigate the scope of any resulting damage. Ultimately, this could determine its potential survival.

Supply chain mapping

All supply chains involve external organisations, and therefore have some built-in risk given that that you never have a complete overview of organisations outside of your own. The first, and perhaps most important, step you can take in contingency planning is to literally map out your supply chain. This can be a time intensive process, but the benefits are likely to be worth the effort. If time or resources are in short supply, you could focus on specific key components by revenue or importance and map those throughout the chain. For example, who are the component suppliers, who are their suppliers and so on, all the way back to raw materials. The aim is to track as many tiers of the chain as possible. The results of this exercise will enable you to do the following:

— Conduct a *risk assessment* to identify your biggest vulnerabilities. Which contracts of the most value or strategic importance to you, and what could happen if these suppliers fail? To what extent are you reliant on manufacturing/logistics/suppliers in a specific geographical region, and what happens if that region is affected by any problems? Which parts of your chain are dependent on one or few key suppliers? Have any of your suppliers sub-contracted obligations to suppliers that you have no visibility of and who may not be as reliable as the suppliers you know? Are there any clauses in the contracts that, in a time of crisis, might leave you vulnerable to a claim by the supplier?

Key considerations

— Perform a risk assessment of your current supply chain, identifying the most vulnerable points – including areas of reliance on single suppliers or single geographical areas – highest value contracts, and contracts of greatest strategic importance.

— Perform a 'health check' of your standard supplier & customer terms, as well as your key current supplier contracts, identifying any potential weak points and/or areas which you could look to benefit from more than you are currently.

— Perform regular credit risk reviews on key suppliers.

— Consider diversifying or expanding your supply chain so you are not overly reliant on a few providers or limited geographical areas.

— Prepare and maintain a disaster recovery/business continuity plan to mitigate the impact of future disruptions, as well as an effective communications strategy throughout the chain.

— Explore some of the innovative supply chain technology solutions available on the market.

For example, are there circumstances or clauses that would entitle the supplier to demand payment, withhold supply, or terminate and leave you in a precarious situation?

— Send out a *due diligence questionnaire* to your key suppliers (or take advantage of any governance meetings/channels to raise a direct dialogue) addressing any areas of concern or potential vulnerability to give you greater visibility of supply chain risk. Make it a focussed questionnaire/discussion, rather than trying to cover every potential issue, and be clear with your suppliers about what your key areas of concern are.
— Review your *business forecasts* and assess how these may affect your key supply contracts.
— Consider performing *regular credit checks* on any key suppliers you are worried about rather than just a one-off check at the outset of the relationship.
— Consider the knock-on effects of a *supplier default*. Would this give rise to any breaches of loans or financing facilities? Do you have insurance to cover the key risks, and with appropriate limits?
— Identify which suppliers are critical to you complying and maintaining compliance with *environmental, social and corporate governance criteria*. Are there any opportunities to find efficiencies or to "green" your supply chain?

Contractual tools

Dig out (and dust off!) a copy of your key supplier contracts and assess whether there are any contractual provisions of which you are not making full use. This exercise could be of immediate use during a crisis, as well as a tool for future planning. For example:

— Are there any *volume discounts* you have not taken advantage of or which are not being correctly applied?
— Are there any *priority clauses* stating that your requirements take priority over the supplier's other customers when resources are scarce? If so, are these being applied? (When applying these types of clauses, you should always ensure that you act in compliance with relevant competition laws.)
— Has the supplier agreed to certain *KPIs/service levels* that are not being met? Is there a service credit regime, or default triggers, which you can take advantage of?
— What are your *termination* rights, and what is your position if a supplier becomes insolvent? Do these clauses protect your interests?

You should perform a review of your standard contract terms (both supplier and customer terms), and ensure they contain provisions offering you the best possible protection. Consider including the following in your supplier terms:

— A most *favoured customer* clause obliges a supplier to offer the customer as favourable a price as it grants to any of its other customers for the same (or similar) products and services, in the same (or similar) commercial circumstances. Again, it is important to comply with competition laws when applying these types of clauses.
— A contract *break clause* can be triggered under specific conditions or thresholds, for example if you are worried about the future viability of the contract or the solvency of the supplier. This might be accompanied by clauses requiring the supplier to assist with transitions to a replacement supplier, including sharing information and documents.
— A *force majeure* clause, carefully drafted to protect your interests, aims to suspend (or potentially end) performance of obligations where a party is prevented from performing by events outside its control. As a customer, you are likely to want the clause drafted narrowly to ensure that the supplier cannot seek to rely on it in too many scenarios. For example, you may wish to consider specifically calling out any anticipated events (e.g. future pandemics) which you do/do not consider should prevent a supplier's performance under the agreement.
— Similarly, an appropriate *indemnity* protects your interests and may include requiring the supplier to indemnify you if certain events or risks arise, including in relation to third parties. If drafted carefully, indemnities can be useful leverage to improve a supplier's performance including managing third party risk and mitigating loss. It may also give clear or powerful enforcement rights.
— A clause requiring visibility and control over *sub-contracting*, as well as a clause specifying that the supplier is responsible for any acts or omissions of its sub-contractors.
— Appropriate *information* and audit rights to give you more visibility over your suppliers (including audit rights over any key sub-contractors).
— Adequate *performance monitoring* provisions, including service levels or KPIs, setting out clear measures for supplier performance. This might include service levels or KPIs designed to help you meet environmental, social and corporate governance criteria.
— An obligation for key suppliers to produce and maintain a *business continuity/disaster recovery* plan.
— Consider including *step-in rights* in major outsourcing contracts, providing a mechanism for you to 'step-in' to the position of the supplier and assume performance (or management) of the services in certain defined circumstances.
— If you think you may ultimately need to rely on *dispute resolution clauses*, check that these allow you to take steps to enforce quickly, easily and in the jurisdiction of your choice. This may be particularly relevant if your supplier/s are internationally based, but a particular jurisdiction or governing law offers you greater protection. Depending on your relationship with the supplier, you may wish to incorporate dispute resolution mechanisms that are relatively more informal and encourage negotiation or a commercial resolution.

Diversification

If your supply chain is dependent on a few key suppliers of a limited geographical area, you may wish to consider diversifying your network to spread the risk. As this can involve additional costs, it is ultimately a commercial question of balancing risk against commercial value. Depending on your budget and risk appetite, implementing some of the following may be of value:

- Consider using *local suppliers* or suppliers based in *more than one region*, to avoid potential transportation/logistical delays.
- Have *back-up solutions* in place for storage, supply and production in case any of your current solutions fail.
- Consider *pre-booking* logistics capacity to minimise potential cost increases during periods of high demand.

Business continuity/disaster recovery plans

You should create or update an appropriate business continuity/disaster recovery plan to ensure you are prepared and everyone in the business understands their respective role in the event of a crisis. Conduct test-runs of the plan to test its effectiveness.

A clear *communications strategy*, which applies throughout (and links up) your supply chain, allows you to liaise effectively and quickly with key suppliers, and to be kept informed in real-time of what is happening 'on the ground'.

Supply chain technologies

Several digital products on the market are designed to make supply chain management easier. Some use smart software to match supply and demand in real time, which can be useful for logistics purposes. Blockchain technologies (distributed-ledger systems that underpin crypto-currencies) are now also used for supply chain applications. It is worth considering whether any of these solutions may be useful (and easily applicable) for the type and size of your business. However, technology is ultimately not a substitute for good management practices, which are key to keeping a supply chain running smoothly. You also have to consider the cost-effectiveness of implementing new technologies that may still be relatively expensive.

Conclusion

No two supply chains are identical. Tools and solutions that may be effective for one business may not be useful for another. However, every organisation can take some immediate action to minimise the impact of any future disruption to its operations. Businesses that take stock and learn from the recent crisis will ultimately be the ones most likely to thrive, or at least, to 'weather the storm' in the long run.

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