Suppliers Squeezed Too

At the same time, suppliers are under pressure to continuously cut costs and optimize production and delivery systems, focusing on serving niches rather than being generalists. So a company that in the past produced a specific auto part now makes one component of that part, and then passes it on to another supplier in a different country for additional assembly. One small piece can pass through six, eight, or ten suppliers in as many countries before it lands in the hands of the final assembler.

The sequential, multi-country production model is what dominates now, and it is a model where little bits of value are added here or there so it is hard to see the country of origin. A consequence of the rise of the modern, highly dispersed supply chain is that many manufacturers—let alone consumers—have little idea where their purchases originated and it can be a costly process to figure it out. Most consumers are likely not to care until they try to buy an iPod and discover they are unavailable because of a shortage of lithium-ion battery components.

A number of companies are already making investments in redundancy. Canon is considering a move to diversify its production base by expanding its under-construction Hita factory in Kyushu in southern Japan and increasing production lines at its two factories in China's Guangdong province.

According to analysts, manufacturers in mainland China, Taiwan, South Korea, and Thailand are reporting increases in orders as companies look for alternate sources. We learn in statistical process control applied to supply logistics that it is better to have fewer suppliers which results in less volatility and better quality. In economics, we learn that fewer suppliers mean higher economies of scale and lower costs. However, a disaster of the magnitude of the Tohoku Earthquake brings "the black swan" to mind and teaches us that there is no single best way of doing things and what seems the best way under given conditions, may prove wrong when conditions change.

Look for the second part of this article in next month's newsletter and find out how contingent business income insurance can lessen the impact of a supply chain interruption.

GET THE FACTS!

- Overall losses in 2010 were more than three times insured losses.
- Over 50% of Fortune 500 profit comes from overseas.
- The longer the chain, the greater the likelihood of a weak link.
- In a competitive environment, we all know he who hesitates is lost.
- Even though companies are exposed to natural and manmade disasters, their ability to handle these scenarios will either put them at a disadvantage or ahead of the game.
- A global auto maker had to halt production at all its factories in one country for a week because of earthquake-induced damage at a major parts supplier.