



**Materials  
Management  
Group**

# ISM Materials Management News

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**“Financial Health of Suppliers”**

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### **About ISM**

Founded in 1915, the Institute for Supply Management™ (ISM) is the largest supply management association in the world as well as one of the most respected. ISM's mission is to lead the supply management profession through its standards of excellence, research, promotional activities, and education. ISM's membership base includes more than 45,000 supply management professionals with a network of domestic and international affiliated associations. ISM is a not-for-profit association that provides opportunities for the promotion of the profession and the expansion of professional skill and knowledge.

# MANAGEMENT

## A Bag of Rocks

By Richard G. Weissman, C.P.M.

I teach both undergraduate (younger) and graduate (older) students. I also teach adult students. All have different needs, requirements and responsibilities. Recently I've had a rash of issues with students who needed to attend to family issues, either with parents or children; sometimes both. These are not 'the dog at my homework' issues, but real life situations. You can tell it on their faces because they look you in the eye, often with a tear or creaky voice. I've been around long enough, as a manager and teacher, to know when my students are sincere, and most, if not all, are indeed so.

I think what surprises them most is that I immediately say attend to your family issues and we'll do a work around on the school work. I bring that philosophy with me from the workplace. I've been fortunate over the years to work for managers that have either had family responsibilities themselves or at least appreciated and understood them. I was able to arrange travel around family obligations, coach youth sports, attend school events, and tend to sick members of my family. Sure I had to do some additional workarounds on nights and weekends, or cover for a colleague who picked up my slack, but all in all it was a relief to think of family first. I passed that same philosophy onto my staff as well. Now I try to engrain that in my students who are future and current managers.

My adult students sometimes have work related issues that cannot wait to be resolved, especially in this 24 /7 business environment. I never ask them to turn off their cell phones, but to put them in vibration mode. Why? Because they just maybe have to take an important call from work or from a family member. Once they know that they can stay in contact with the outside world they are able to relax in class. I've never had a student take advantage and they are often embarrassed when the phone does go off and they have to take the call.

My ground rule is that they just need to leave the room to conduct their business; a simple solution to a potential uncomfortable problem. Oh, and my cell goes off from time to time as well and I take the call if I need to. I operate in the real world.

Last year I had a student in an evening class who is an overnight shift supervisor at a prison. He'd leave class at when it was over, 10 PM or later, and then go to work. One night he got a call. When he returned to the room he was a bit nervous looking. When I asked him if everything was okay he told me there was a potential riot at the jail but he said that his deputies could handle the turmoil until he got there in about 90 minutes. He went back to his desk and easily continued work on in-class group project.

Years ago I interviewed a human resources manager for a magazine article I was writing and he said that everyone comes to work with a bag of rocks. Some days the bag is heavy and on other days lighter. The rocks are family issues, sickness, financial stress, car trouble, school responsibilities, or just a plain bad mood. That concept really stuck with me and I use that example in all of my classes. The younger students may not really understand it but my older ones sure do.

I like to lighten that bag of rocks whenever I can.

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# SUPPLY CHAIN ECONOMICS

## Energy Outlook

By David Jacoby

**Energy prices are on the rise again and will seemingly go higher as the global recession eases. What are you doing to mitigate the risk of escalating energy prices?**

The price of oil appears to be rising again. The price of West Texas Intermediate Crude looks set to average \$56/barrel in Q2 and averaged \$65/barrel in June, up from an average of \$43 in Q2 on glimpses of an economic recovery. Although the price of natural gas fell on average in Q2, it is forecast to more than make up for these losses in the next two to three quarters.

What should supply management professionals do to manage the price? This is the same question that we had last year at about this time. Boston Strategies International's fifth annual white paper on sourcing strategies, "Energy Prices Re-Shaping the Supply Chain: Charting a New Course?," uncovered and ranked six possible strategies for dealing with rising energy prices: buy at the spot price and hope for the best, buy forward contracts and hope for the best, stockpile in anticipation of continued rising prices, charge a surcharge in pricing to cover it, embed increases but not decreases in your pricing (always a winner), and value engineering (which ultimately tends toward energy independence).

The best strategy depends on what type of production operation is being run (continuous versus batch or project), and the degree of alignment between costs and pricing in your company. Luckily there is time to plan which strategy is best for your company. Although we may see a bright patch, the problems in the banking sector are still deep, which will restrain demand and may make for a prolonged recovery. Sluggish demand could keep oil prices from rising significantly for some time.

## SUPPLY CHAIN ECONOMICS

Given the adequate planning time horizon and the long -run potential for a return of inflationary oil prices, now may be a good time to practice value engineering, or reengineering of transportation and logistics processes, to reduce your company's energy footprint.

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*David Jacoby is president of Boston Strategies International, a Wellesley, MA based company focusing on global supply chain strategy consulting, global cost and pricing intelligence, and global market data.*

# WHITE PAPER: RAPID RATINGS INTERNATIONAL

RapidRatings

Financial Health Ratings

**This white paper is supplied to ISM MMG courtesy of Thomas Sculley of Rapid Ratings International.**

The financial health of a corporation's suppliers is of paramount importance and self interest. Lack of financial health transparency in the supply chain increases risk in many vital ways. Over reliance on key, Tier 1, suppliers creates risk concentration and Tier 2 and 3 suppliers can create supply chain volatility. Until recently the focus on supplier risk had resided within the procurement department that has responsibility for direct spend. Today, with the expansion of the Enterprise Risk Management process, the management of counterparty risk has garnered more focus from the C-suite. However, the sources and products used in evaluating supplier risk have not advanced much beyond the rudimentary data sources that rely on simple credit scores and quality of payment information.

The need for more insightful and forward looking information, analysis and tools has started to take a more prominent role in the management of counterparty risk. In turn, this greater level of scrutiny is becoming key in demonstrating more comprehensive corporate governance and firm-wide risk mitigation sophistication. The chief procurement officers and the supply chain managers need to seek additional inputs to upgrade their credit evaluation process to address their need for better information .

# WHITE PAPER: RAPID RATINGS INTERNATIONAL

Below are some observations about the role for better financial data:

1. **Credit Analysis needs to be expanded.** Risk managers need a better evaluation method that considers more than traditional credit rating agencies, market based default models, credit scores, quality / frequency of payment information and limited cash flow analysis.
2. **Higher quality financial information is needed from counterparties.** Doing business with public corporations affords the ability to access publically available financial statement information. Where the process fails is with private companies. The effect of increased defaults and bankruptcy filings has brought home the need to be able to analyze private company counterparties and public companies on the same basis into a cohesive risk mitigation strategy.
3. **Insert Financial Health Analysis into Supplier Selection and Rating Process.** Some major corporations require supplier evaluation reports in their selection process. These evaluations should be expanded to incorporate a more substantial analysis of a supplier's financial health, using more insightful and predictive tools. The annual rating process should also be expanded in similar fashion.
4. **Realization of Cost Reduction Measures.** Since volume buying levels are not met in low demand times, it would be helpful for procurement to be able to go to its healthy suppliers to negotiate the reduction of volume vs. jeopardizing shipments from a financially risky supplier who may promise the discount but not be able to deliver.
5. **Supplier degradation.** Without the capability of monitoring the financial health of counterparties, a company can leave itself vulnerable to a large percentage

When the financial health of a counterparty is deteriorating, two things are happening: A decrease in financial health gives rise to an increase in the probability of default and the chance a counterparty will not be able to fulfill contractual obligations. For financial counterparties this directly translates to increased financial risk, and for suppliers this translates to a significant business continuity risk. The overall quality and timeliness of the goods and services they are providing you is likely to suffer as they become concerned with their own state of affairs and survival, and begin cutting costs.

Addressing these vital areas will allow for better transparency and help eliminate risks in a corporation's supply chain. By recognizing the issues that emanate from counterparty risk and demonstrating the willingness and capability to improve the process, a corporation can communicate to its shareholders a commitment to a fully integrated Enterprise Risk Management posture. However, for most risk managers it is a challenge to undertake an in-depth analysis for every counterparty.

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*Rapid Ratings™ is a unique financial services company utilizing a proprietary quantitative system to rate the financial health of corporations and financial institutions. Rapid Ratings™ has none of the biases or conflicts of the incumbent rating agencies and has a unique methodology for evaluating the FHRs™ of companies that is not only early and insightful; it is timely and actionable by credit and equity market professionals.*

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