

## 11.4: The Benefits and the Risks of Participating in a Supply Chain

### Learning Objectives

1. Understand the major benefits to be derived from adopting a supply chain management system.
2. Understand the challenges of creating such a system.
3. Understand the technical and managerial risks associated with supply chain management.
4. Recognize the benefits for a small business in adopting supply chain management.

### The Benefits of Successful Supply Chain Management

For any small business, a commitment to developing a supply chain management system is not a small undertaking. It involves the commitment of significant financial resources for the acquisition of appropriate software. Policies and procedures must be changed in accordance with the needs of the new system. Personnel must be trained in not only using the new software but also adapting to new ways of doing business. Small businesses accept these challenges of adopting supply chain management systems because such systems are viewed as being important for long-term survival and because businesses anticipate substantial management and economic benefits.

The management benefits of supply chain management system include the following:

- **Silo busting.** By their very nature, supply chain management systems improve communication across all functions within a business. This leads to employees having a better understanding of the entire operations of a business and how their work relates to the overall benefits of the business.
- **Improve communications with suppliers and customers.** Improved communications with customers enhances the overall value provided to those customers. The improvement in customer satisfaction leads to longtime relationships, which yields significant economic benefits. Improved communications with suppliers improve the overall operational efficiency of both participants, reduce costs, and improve profits.
- **Supplier selection.** Supply chain management systems can help businesses evaluate prospective suppliers and monitor the performance of current suppliers. This capability can lead to strategic sourcing and significant cost savings plus improvement of the when- and where-needed variables.
- **Improvements in purchasing.** The automation of purchasing reduces errors and improves the economic efficiency of the purchasing function. Disciplined purchasing can allow for the full exploitation of available discounts.
- **Reduction of inventory costs.** Supply chain management systems can produce significant cost savings across all levels of inventory. Improved forecasting and scheduling will lead to increases in inventory turns and a corresponding reduction of costs.
- **Improvements in operations.** Improved quality control reduces the scrap rate, which in turn can have significant cost savings. Better production scheduling translates into producing what is needed when it is needed. The business does not have to spend additional money trying to expedite the production of particular orders to customers. The cost of goods sold is reduced in this manner. An additional benefit of supply chain management systems is that they lead to better utilization of plant and equipment. Great utilization translates into less likelihood that unneeded assets will be acquired, which has major financial benefits.
- **Error reduction.** By automating processes, billing errors and errors associated with purchasing and shipping quantities can be reduced. This not only saves money but also improves satisfaction with both suppliers and customers.
- **Improvements in transportation operations.** Accurate deliveries reduce returns and their associated costs. Sophisticated shipping models can reduce the overall cost of transportation.
- **Additional financial benefits.** Such systems can improve the collections process, which impacts customer relations, reduces bad debts, and improves cash flow.

### The Risks Associated with Supply Chain Management

The major risks associated with a supply chain management system fall into two categories: technical and managerial.

Michael Porter's five forces model is a model of the major factors that contribute to an industry's overall structure. It also points to factors that might affect the overall profitability of the particular business within that industry. The greater the strength of these forces, the greater the challenge to make above average return profits for businesses in that industry. It is useful to review two of those forces—the power of suppliers and the power of buyers—and reexamine how they might influence the profitability of any business in the supply chain.

Porter identifies the following factors that might contribute to the overall strength of each force. He argued that suppliers are powerful (see "[The Core Elements of a Supply Chain Management System](#)") when the following occurs:

- **They are concentrated.** When an industry is dominated by only a few suppliers, these suppliers generally have a greater ability to dictate terms to their customers. The mining company DeBeers, which controls more than 50 percent of the world diamond production, is able to set the selling price of diamonds for most of the world's jewelers. Mason A. Carpenter and William G. Sanders, *Strategic Management and Dynamic Perspective* (Upper Saddle River, NJ: Prentice Hall, 2008), 108. It should be pointed out, however, that in some cases concentration, particularly a duopoly, provides an opportunity for customers to force the two competing firms to compete more readily against each other. Think of the situation of Boeing and Airbus and their relationship to their customers—various airlines. At present, there are only two major producers of commercial aircraft, and airlines sometimes obtain better deals from one manufacturer because of their desire to maintain parity in market share.
- **The size of the suppliers is large relative to the buyers.** Suppliers are powerful when they are large and sell to a set of fragmented buyers. Think of the largest oil companies that sell gasoline to independent stations. The power in this scenario lies with the large oil companies.
- **Switching costs are high.** Suppliers have power when the cost of switching to an alternative supplier is expensive. Many businesses stay with Microsoft products because to do otherwise means that they would have to repurchase new hardware and software for the entire organization.

Problems may also arise from a heavier reliance on one customer in the supply chain. Even large companies need to be aware of their relative strength in the supply chain. Rubbermaid is the most admired corporation in America, as voted by *Fortune* magazine in 1993 and 1994, yet it had significant difficulties when dealing with one of its major customers—Walmart. In the early 1990s, Rubbermaid found that the cost for a key ingredient—resin—had increased by 80 percent. Mary Ethridge, "News about the Wal-Mart Struggle," accessed February 2, 2012, [www.dsaua.org/lowwage/walmart/Dec17\\_03.html](http://www.dsaua.org/lowwage/walmart/Dec17_03.html). Walmart's almost total focus on lowering its prices led it to drop many of Rubbermaid's products. This began a downward spiral for Rubbermaid, which led to its acquisition by Newell Inc. Rubbermaid went from the status of the most admired corporation to being a basket case because it failed to recognize its excessive dependence on one customer.

### Web Resources

The Benefits of Supply Chain Management

A list of benefits from SAP, a software company.

[searchsap.techtarget.com/feature/Checklist-Quantifying-Supply-Chain-Management-benefits](http://searchsap.techtarget.com/feature/Checklist-Quantifying-Supply-Chain-Management-benefits)

The Risks of Supply Chain Management

A Forbes article on the risks associated with supply chain management.

[www.forbes.com/2006/11/15/risks-supply-chain-strategies-biz-logistics-cx\\_rm\\_1115strategies.html](http://www.forbes.com/2006/11/15/risks-supply-chain-strategies-biz-logistics-cx_rm_1115strategies.html)

Risk and Rewards in Supply Chain Management

A Harvard working paper.

[hbswk.hbs.edu/archive/4971.html](http://hbswk.hbs.edu/archive/4971.html)

### KEY TAKEAWAYS

- There are significant benefits for businesses that adopt supply chain management systems.
- The benefits stem from improved customer relations, cost cutting, and increased operational efficiencies.
- The adoption of a supply chain management perspective can pose risks.
- Businesses must consider the relative power of both their suppliers and their customers.

### EXERCISES

1. Interview the owners of local businesses who say they have some form of a supply chain management system and ask them if they believe they have benefited from the system.
2. Ask them how they have benefited.
3. Ask them to identify the major problems they had with implementing and using the system.
4. Ask them if they believe they have the "power" in their supply chain or if the "power" is in the hands of their suppliers.

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