

Supply Chain Solutions

Grant Thornton Consumer and Industrial Products practice Part 2 of 3

Creating a reliable, profitable supply chain: navigating exchange rate, working capital and business uncertainties

Executive summary

Companies doing business overseas must be prepared to navigate an obstacle course that includes exchange rate shifts, supply chain disruptions, tight credit markets and nearly unprecedented economic volatility. But which hurdles are companies most concerned about? And what are they doing to maximize success during these uncertain times?

According to Grant Thornton's recent survey, conducted in partnership with *World Trade Magazine*, foreign exchange rate fluctuations and the ripple effect of exposures across the supply chain are a concern for manufacturers. More than four in 10 (42%) manufacturers report that exchange rate shifts were detrimental to their business over the past year.

“When the dollar slips in value, as it did sharply in 2008, U.S. companies sourcing and operating internationally in countries with currencies appreciating against the dollar can face rising material and shipping costs as well as increasing labor costs,” explains Tim Dumond, Corporate Advisory and Restructuring Services principal. “If rising exchange rates are not offset by increased revenue, those costs can put pressure on sourcing and pricing strategies and create operational and strategic risks,” says Dumond.

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Grant Thornton LLP collaborated with *World Trade Magazine* and the Institute for Supply Management to produce a series of three surveys concerning supply chain solutions. These surveys are intended to provide a snapshot of issues and opportunities in the supply chain industry. We hope this second survey, along with targeted recommendations from Grant Thornton's supply chain experts, offers you insights you can use as you evaluate your sourcing decisions.

WorldTrade
MAGAZINE

Creating a reliable, profitable supply chain: navigating exchange rate, working capital and business uncertainties (continued)

The Grant Thornton/*World Trade* survey also points to some interesting success strategies. Of the executives surveyed, 56 percent are taking action to optimize the working capital invested in their supply chains. With many banks reducing the amounts companies may borrow against their assets, asset-based lending is tighter than ever, which makes optimizing working capital all the more critical. Because capital can be tied up in the supply chain for days or even weeks, many companies are finding that freeing up working capital can boost their bottom line substantially.

As the supply chain continues to stretch around the globe, companies inevitably face increased risks of supply disruption. Whether they are dealing with the financial distress of a key supplier, the consequences of political unrest or even the loss of product after a shipwreck, companies must be prepared with a plan to handle these potential supply disruption risks. Six in 10 manufacturers have contingency plans in place to respond to breakdowns within their supply chains. Whether these contingency plans are effective when they are put to the test, however, remains to be seen.

Survey results

Finding #1

Exchange rate fluctuations hurt some manufacturers and help others.

Survey respondents report mixed experiences with exchange rate shifts. More than four in 10 report that the exchange rate shifts have hurt their businesses over the past year, citing issues such as increasing materials costs overseas due to a depreciating U.S. dollar.

However, nearly three in ten (29%) survey respondents indicate that the shifting exchange rate has helped their businesses at least somewhat over the past year. In many cases, this revenue boost happens because the sales volume of finished goods in Asia and Europe has been affected positively by the depreciation of the dollar with respect to those local currencies.

Recommendation

Companies that want to reduce or eliminate exchange rate risk may want to establish pricing and contracts in U.S. dollars rather than local currencies when possible.

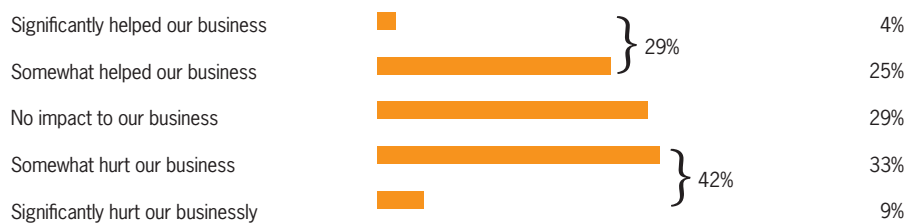
However, companies may find that many suppliers are leery of taking on all the risk and therefore may resist doing business

only in dollars, in which case implementing an effective hedging program should be considered. Before implementing such a program, companies must ensure that they have the appropriate level of knowledge and expertise. Otherwise, they may be increasing, rather than decreasing, the overall risk to the company.

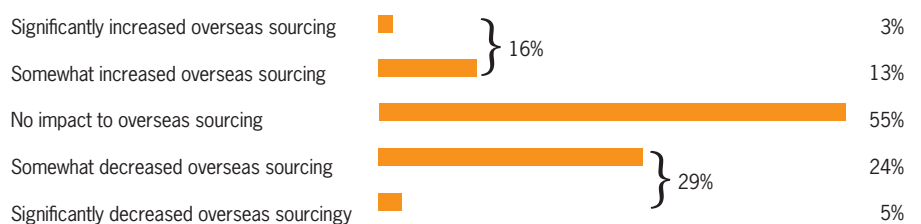
Although it is clear that exchange rate fluctuations can have a positive or negative financial impact, these fluctuations comprise only one of many factors that supply chain executives must consider when they assess vendor and customer locations. Other factors include the quality of raw materials, the expected transportation costs and the desire to enter a new market.

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Impact of the exchange rate in the past year



Impact of the exchange rate on sourcing



Creating a reliable, profitable supply chain: navigating exchange rate, working capital and business uncertainties (continued)

Finding #2

Many companies are taking action to optimize the working capital invested in their supply chains.

More than half (56%) of supply chain professionals indicate that their companies have taken action over the past 12 months to optimize the working capital invested in the supply chain. The most common actions companies have taken are extending payment terms with suppliers, streamlining inventory infrastructure and improving inventory management across the entire supply chain.

Recommendation

Companies should be working to reduce the amount of working capital required to manage their supply chains. Extending payment terms with all or most of the company's suppliers can be an effective way to defer operating cash outflows. Companies should attempt to extend payment terms with vendors as long

as possible — to 45 or 60 days rather than 30. Ideally, companies should not be required to pay for material until after they have been paid by their customers. Extending payment terms also will reduce the need for short-term borrowing.

Another popular technique is to modify contracts such that legal title to the product passes late in the process — for example, when the product arrives at the U.S. facility. Changing the terms governing the passage of title means that the clock on payment doesn't start ticking until the material has arrived. This contract modification is in lieu of the countdown to payment beginning while the product is crossing the ocean by ship. Now is also a good time to reduce the amount of inventory kept on hand, because maintaining inventory balances is a drain on operating cash flow. Inventory turnover and production processes should

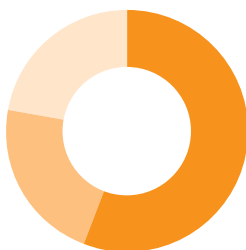
be analyzed to determine whether the amount of inventory can be decreased. Another benefit of moving inventory is that most lending arrangements advance a higher percentage against receivables than against inventory, thus providing additional liquidity.

Monitoring the financial stability of your customers and vendors and aggressively managing the related receivables and payables are critical actions as well. Thorough credit checks on new customers can reduce the negative impact of bad debts, but given today's economic environment and global business relationships, traditional credit checks are no longer enough. Reviewing recent customer and vendor financial statements is the only effective way to understand the financial health of a key supply chain partner.

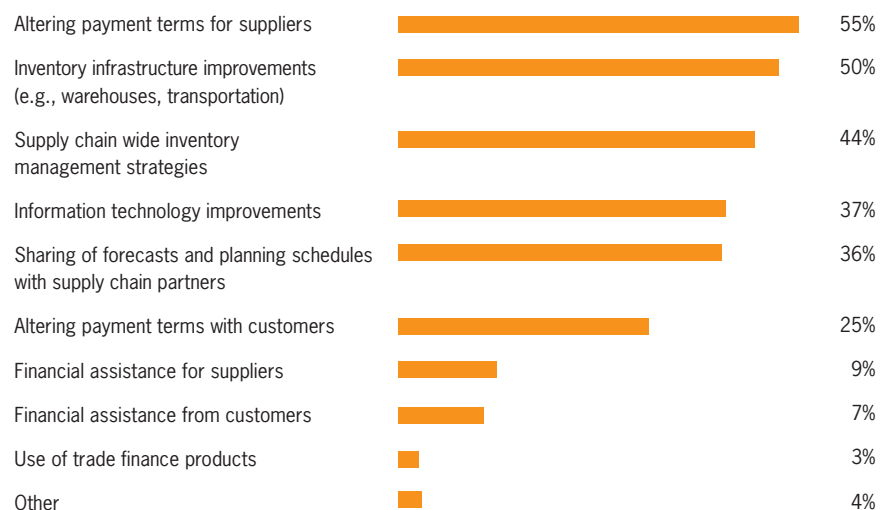
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Optimizing the working capital invested in the supply chain

- Yes **56%**
- No **22%**
- Unsure **22%**



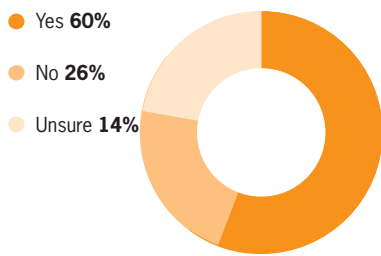
Actions taken to optimize the working capital invested in the supply chain*



*Multiple responses allowed

Creating a reliable, profitable supply chain: navigating exchange rate, working capital and business uncertainties (continued)

Establishment of contingency plans



Finding #3

Most companies have established contingency plans to respond to breakdowns in the supply chain. Six in 10 (60%) supply chain professionals indicate that their companies have established contingency plans to respond to breakdowns within the supply chain. Contingency plan scenarios include the failure of a key supplier, a natural disaster, a shortage of critical materials or ingredients, a supplier violating the company's code of ethics or conduct, political instability and terrorism.

Contingency plans addressing risk scenarios*



*Multiple responses allowed

Recommendation

As supply chains continue to lengthen and grow in complexity, many organizations are developing business contingency plans to respond to a range of scenarios, for example: financial distress at a key vendor, infrastructure breakdowns, natural disasters, political instability, intellectual property infringement, and ethical or governance risks. However, when business contingency plans are put to the test, they may not be sufficiently robust.

“A good business contingency plan needs to start with identifying all possible risks throughout the organization's supply chain, including a thorough analysis of all vendors. It's also critical to consolidate all information on all the products the company depends on from its supply base in order to understand the range of risk exposures,” explains Dumond.

To be effective, the contingency plan also must outline internal response protocols for varying scenarios, including who in the supply chain management

organization responds initially and how they notify the appropriate parties. The breadth of the potential issues also may require support from professionals outside the normal supply chain organization, including accounting and legal functions.

Supplier insolvency is a growing concern; therefore, companies must have effective plans in place to prevent the effects of insolvency from rippling across the supply chain. It's important to line up viable replacements or alternative suppliers, particularly for a product or service that is essential to the company's operations. If no alternative sources exist, companies must be prepared to offer programs and incentives to maintain the flow of those products from key suppliers. Carrying additional inventories of crucial products can offset supply risk to some extent, but executives must keep in mind the increased carrying costs for these inventories and strike a balance between optimizing cash flow and managing supply risk.

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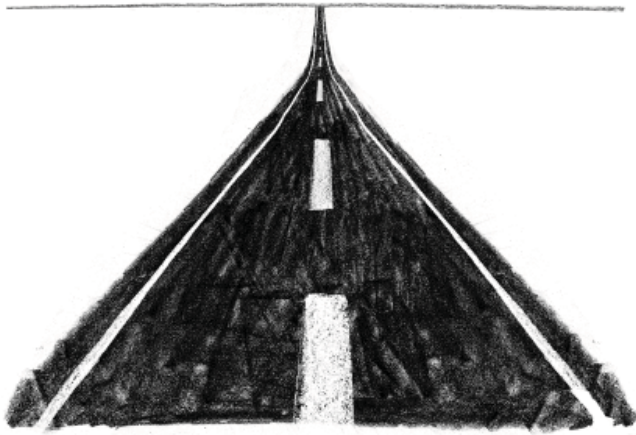


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Looking ahead

The growing intricacy of the supply chain has clearly put an increasing premium on managing supply chain risk. Major exchange rate fluctuations and currency devaluations can have positive or negative consequences for companies that are moving product from one country to sell in another. At the same time, executives must be ready at a moment's notice to respond to many possible contingencies that might disrupt their supply chains.

Executives must manage their operations as efficiently as possible, reducing inventory to conserve cash and optimizing the working capital required for their operations. And they must maintain sufficient flexibility and agility in their supply chains to meet customer demand. It's a tall order. Yet given the supply chain's impact on a company's bottom line and the many factors that can wreak havoc on the company's profitability, effective supply chain risk management has never been more challenging — or more important. •



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About the survey

Grant Thornton partnered with Clear Seas Research, a subsidiary of BNP Media, to produce this original research about current and planned sourcing strategies. More than 200 responses from readers of *World Trade Magazine* and members of the Institute for Supply Management were gathered from March 23 through April 6, 2009.

About Grant Thornton's supply chain advisory services

Grant Thornton provides a broad continuum of supply chain solutions: commodity planning, sourcing process evaluations, pricing reviews, technology solutions, supplier assessments, supplier action planning, risk response protocol analysis, inventory and asset management solutions, and consolidation and resource management.

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World Trade Magazine is a business-to-business logistics journal delivering news and information to U.S. subscribers active in domestic and international trade. *World Trade Magazine* covers every aspect of the global supply chain from the movement of products across the U.S. to the procurement from and delivery to international markets.

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