Internal Control Over Your Supply Chain

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I interviewed Marinus de Pooter who discussed Internal Control Over Your Supply Chain.

What is internal control over your supply chain?

Internal control deals with the management actions and control measures you have in place as a management team responsible for running a business. There is a vast variety of opportunities and risks impacting your supply chain. Examples include very tangible external safety risks like earthquakes, storms, floods, wars and piracy. Certain areas in the world are known for their political instability. Your operations can also be severely impacted by employee fraud, theft, strikes, sabotage, labour shortage, incompetence of management and staff, etc. On the other hand, innovations regarding mobile communication, data storage and big data analytics, can help you to better achieve your company objectives.

Third parties play important roles in your supply chain. How dependent to you want to be on specific suppliers and customers? Dealing with large parties may be more efficient, but it can easily lead to undesirable effects, such as inequalities in the power balance and serious disruptions. Another important area of management attention and a potential business differentiator is information technology. Your supply chain is heavily dependent on the quality of your IT infrastructure and data management.

How should companies respond?

How do you organize your business as a management team? How do you get and stay 'in control' over your supply chain? Which policies and procedures do you need for that? Who within your organization can decide about which rules? Do you only take a short term perspective or a much longer term? How vulnerable do you want to be by having small inventory buffers? As a team you need to make this call, balancing the benefits of lower working capital with the increased possibility of no sales, when you've run out of stock? Are you prepared to pay bribes in order to obtain profitable contracts? The key question is about governance: who is going to make these decisions? Internal control is all about making business choices and balancing interests of stakeholders. At the end of the day, it's all about the distribution of power within your organization.

Do you care whether your merchandise originates from sources involving child labour or substandard working conditions for the employees? Are you prepared to use ingredients that could be harmful to your customers, consumers, or the environment? As a management team you need to provide clarity to your people. You may earn higher margins by squeezing your suppliers, but how sustainable is that? It can hurt your reputation as a company. And those suppliers will likely be cheating on you, e.g. delivering lower quality than agreed, as you are not prepared to pay them a fair price. In my view, it's more beneficial to go for stronger business partnerships, focusing on the common interests and allowing you to join your innovation forces.

How is it done in practice?

Internal control comes down to ensuring that you have the right management actions and control measures in place and to make sure that they work in practice. Typically they are reflected in charters, policies, procedures, protocols, instructions, manuals, the "house rules". These are the safeguards in your processes that you need to ensure achievement of your strategic and operational objectives. It's about your alliances, security systems, background checks, supplier evaluations, firewalls for your networks, limitation of access, training programs, etc. etc.

All these measures cost money and potentially delay your operations. They also limit the autonomy and freedom of your colleagues involved. Controls can have unwanted side effects, too. Hence, they need to be balanced. Take for example cloud computing. Undoubtedly, there are advantages of storing data off site and having accessibility from any location you wish. However, the potential downside includes dependence on the provider, information security and privacy issues, loss of critical data, etc.

How can this be achieved in practice?

I recommend taking a structured approach to optimizing your internal control. It starts with defining your scope: which entities/ locations are you going to look at? Which business processes are involved? For supply chain management the core processes include: Procurement, Production, Delivery and Logistics. They are dependent on a series of support processes, like Facility, Security, HR, IT, Quality, Customs and Finance. Another key question is: which aspects of internal control are you going to analyze when optimizing your supply chain: profitability, efficiency, information security, turnaround time, integrity, stability, sustainability? Answering these questions requires a thorough understanding of the interests and expectations of your key stakeholders.

The practical steps that I suggest to your management team are as follows:

1. Ensure clear coordination of your "rules of the game".

   Governance is key to effective internal control. Who is in charge of balancing the costs of your control measures like quality checks and the delays they may cause with the anticipated benefits of these controls? And based on what are you going to make adjustments? Coordination also includes ensuring you have the right company culture. Your employees need to have the opportunity to report misconduct, to challenge unrealistic assumptions in business plans, to analyze near misses, etc.

2. Obtain a clear view of the expectations of your stakeholders.

   This includes the boundaries set by legislators and regulators. Stakeholders typically have conflicting interests and expectations. As a team you need to prioritize which interests you are going to serve.

3. Set clear business goals and objectives.

   It also means explaining to everyone involved what are the outcomes that you consider acceptable? It requires communicating of the bandwidths reflecting your risk appetite and control ambition.

4. Get a clear overview of your daily business activities.

   What are the key activities that are executed, both in your managerial, value chain and support processes? It is my observation that many team members have rather limited knowledge of the daily activities of their colleagues. Producing a high level 'map' of your entire organization creates a shared perspective for your team and fosters mutual understanding.

5. Establish clear insights in your opportunities and risks.

   Is there a shared understanding of your chances of success and your risk exposure? What can help or hamper the achievement of your business objectives? Risk managers tend to approach your business mainly from a negative angle: they focus on things that could go wrong. This easily causes misunderstanding and alienation from business people. Always remember that opportunities and risks go hand in hand.

6. Design clear control measures for achieving your objectives.

   You need to ensure that the minimum safeguards are in place in order to seize your opportunities and to mitigate your risks. There is a vast arsenal of control types available. Which are the right ones for your organization? And again, who is going to make this decision?

7. Pay attention to the clear implementation and execution of your 'rules of the house'.

   Explain do's and don'ts to your employees involved. When handling dangerous materials, the safety protocols need to be followed. Your house rules must be translated to the activities on your shop floor. Training and coaching are important here. If not done properly, the services to your customer will be impacted.

8. Make sure you arrange clear monitoring and evaluation of your controls.

   Are your rules being followed in practice? Do they only exist on paper (or in digital format)? And how are you going to establish their operation as intended? As a management team you have many options varying from management-by-walking-around to external inspections.

Where have you seen success?

The integrated and holistic approach that I promote is relatively new. I see many companies trying to optimize specific business aspects in isolation, such as increasing efficiency and trying to squeeze out even more cost out of their supply chain. In my view it is more sustainable to consider other important factors as well, such as partnering and closer cooperation to improve quality and to foster innovation. That requires trust and acceptance of failures as part of the collective learning process. Effective learning from mistakes also requires that incident management ("**** has happened") and risk management ("**** could happen") are integrated. Life is complex and so is supply chain management. When cutting through this complexity, it comes down to creating a well functioning permanent improvement cycle within your organization.

Summary

Taking a holistic approach to internal control over your supply chain requires close cooperation of the line managers and staff experts involved. That in turn demands effective governance and coordination. As a management team you need to find the right balance between trust and control. Companies that are good at this are able to create and preserve value for their stakeholders, allowing them to become way ahead of their competition.

Brief background of Marinus de Pooter

Marinus has extensive experience in management and advisory positions in finance, internal control, risk management and internal auditing. As an independent consultant he provides ‘value management’ services to organizations, i.e. the integration of performance and risk management. In his view business is all about the value that you create and preserve for your stakeholders, e.g. margin, speed, ease, continuity, customer enthusiasm, etc. Value management basically encompasses all areas and aspects of business.

The solutions that Marinus offers are particularly relevant for those companies that have operations at multiple locations. Their leadership needs to make conscious decisions about the level of autonomy and freedom that they want to give to local management. He believes that the headquarter – subsidiary relationship evolves around finding a suitable balance between trust and control. It is about reconciling dilemmas like entrepreneurial freedom versus standardization.