



## Single Point of Failure

### The Ten Essential Laws of Supply Chain Risk Management

#### THE SUMMARY IN BRIEF

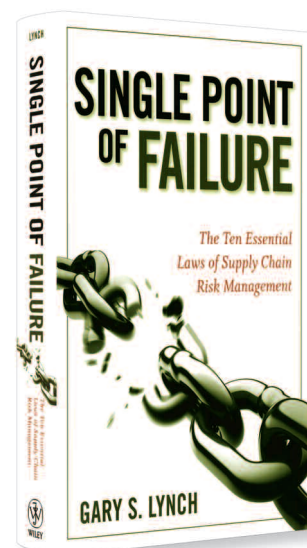
It is mind-boggling to consider what it takes to produce the products we depend on — critical drugs like blood thinners, plastic-based products such as syringes, isotopes for medical imaging and milk-based formula. Or maybe your livelihood depends on having access to your online order entry system or on the timely receipt of parts from your suppliers on the other side of the world. The occurrence of a single point of failure — whether a product contamination, labor strike, trade credit crunch, earthquake or health crisis — can interrupt the flow of goods and cause total systemic failure.

In *Single Point of Failure*, internationally recognized industry veteran Gary Lynch reveals the 10 vital laws you can use to successfully identify, measure, mitigate and finance risk. Lynch offers guidance for establishing your organization's supply risk management program, avoiding bad decisions and gathering better information and data to make good decisions.

You need to learn the root causes of problems and decide whether you have the proper systems in place to mitigate risk. Addressing risk from several points of view, this summary shows you how to remain agile to avoid risk, be resilient to absorb risk, develop sustainable methodologies and maintain risk solutions.

#### IN THIS SUMMARY, YOU WILL LEARN:

- How to establish your organization's supply risk management program.
- Why no risk strategy is a cure for bad decisions.
- What causes supply chain risk management demand to trump supply.
- Why managing the parts does not equal managing the whole.



by Gary S. Lynch

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# THE COMPLETE SUMMARY: SINGLE POINT OF FAILURE

by Gary S. Lynch

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## Introduction: Getting to the Truth

The supply chain represents the ecosystem of flows, relationships, infrastructure, labor, assets, technology and processes that drives a business. For most, it is the business — excluding the market and clients. As the supply chain concept evolved over the past decade, so did the opportunity to improve productivity, eliminate overhead, and speed the flow of goods and services.

Supply chains and supply chain management have matured and now represent the “business network” or “value chain” needed to support the innovation, creation, manufacturing, assembly, distribution, service and disposal of product.

### Risk

In an overseas product factory, a contract manufacturer actually is not dealing with unique or segregated problems; the processes at that plant exist as part of a complex supply chain, and an enlightened manager recognizes that the level of risk passes from there all the way up the chain — from the manufacturing floor in Taiwan to the customer in New York. Marketing managers, accountants and mailroom supervisors (as well as those who are directly engaged with the operations of supply chain such as logistics, procurement, production and transportation personnel) all face the same issues; they may not have the same control demands, but the concept is identical. All processes consist of a series of steps and functions that equate to a chain. But it takes only a single weak link, the *single point of failure*, for the entire chain to fail; so the risk-conscious culture must be agile, resilient, sustainable and adaptable. This premise applies everywhere and to everyone, and the simple truth of this problem cannot be ignored.

More alarming, perhaps, is the very real possibility that a supply chain could contain many weak links, and failure can (and will, based on Murphy's Law) happen at the worst time, in the worst conditions and more than once — such as a pandemic.

Remember, *believing* that all is well may be a self-deception. You need to continually analyze and evaluate the risks to your supply chains and business networks, determine and learn from the root cause of problems and decide whether you have the proper philosophy, culture and systems in place to identify, measure, mitigate and finance risk. Good business strategy dictates that you must:

- Remain agile to avoid risk.
- Be resilient to respond, adapt and absorb risk.
- Develop methodologies that are sustainable to scale and maintain risk solutions. ●

## The Laws of the Laws

Risk is a parasite that resides in every process. Thanks to globalization, the risk parasite can quickly weave its way through the logistics, sourcing and production processes that support long-tailed supply chains. The parasite can lie dormant in these processes, undetected by the organization. Then an event unleashes the parasite, creating a single point of failure, a broken link in the chain. The catastrophic outcomes can affect any stakeholder in the supply chain regardless of geographical or organizational boundaries. Whether an explosion at a natural gas plant or the availability of a single part, today's interdependent and lean supply chains as well as a fiercely competitive global marketplace leave little space, or time, for error.



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## No Boundaries

Think of the risk parasite as a metaphor to remind us how to address existing vulnerabilities and anticipate future challenges throughout the supply chain before they become catastrophic. The risk parasite knows no boundaries. It resides in every resource and attaches to every process flow.

You need to define exposure to uncertainty in terms of impact: the cost of the loss, and what that loss means in terms of stakeholders, your brand and reputation, and even to the basic ability to provide goods and services to your customers. With this definition in hand, you can better understand the practical realities, or the Laws of the Laws, to guide you with the execution of your own supply chain risk management. Consider these four concepts:

**Law of the Laws #1: Everyone, without exception, is part of a supply chain.** We live in an age of interdependency; small ripples upstream cause tidal waves downstream. Ultimately, you are responsible for risk itself (risk accountability).

**Law of the Laws #2: No risk strategy is a substitute for bad decisions and a lack of risk consciousness.** Almost all adverse impacts can be traced back to a bad decision somewhere in the chain. Bad decisions are made without accurate or relevant information (uninformed decisions), significantly influenced by emotion and not made fast enough.

**Law of the Laws #3: It's all in the details.** The details are needed to understand and manage risk in the flow of products, services, information and cash. Broad generalizations can be costly by over-allocating resources to the wrong priorities.

**Law of the Laws: #4: People always operate from self-interest.** Operating in self-interest yields short-term gains and long-term risk. The need for collaborative tools, rewards and communications vehicles and an iterative learning process is essential to migrate away from self-interest. ●

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## Law #1: If You Don't Manage and Lead Change, You Have to Surrender to It

In today's world of complex global supply chains, uncertainty itself is certain since there are so many contributions of resources (labor, technology, physical assets and relationships) that are exposed to a broader scope of threats. It is for this reason that the supply chain must be viewed in its entirety and in a level of detail that has

never been analyzed before. New operating assumptions must be applied. The operating assumptions must include:

- “Expect the unexpected” now should be considered the norm. The impact must be better understood, measured and monitored, as well as viewed in its aggregate.
- The risk of low-frequency/high-impact events and high-frequency/previously perceived impact events should not be managed separately; the consequences of both can be one and the same.

For an organization to be prepared for the unexpected, it has to identify potential triggers (whether individual events or the aggregate of warning signs), listen to the risk-conscious culture (and move qualified information quickly), rapidly escalate issues to those in authority and take action. It must also leverage existing risk programs, such as business continuity, crisis management, disaster recovery and emergency management.

## A Moving Target

Managing supply chain risk is a matter of never-ending vigilance because change is your only constant. True risk management often occurs only when you are confronted with the unexpected. The looming catastrophe sharpens your response time and often, in the direst of circumstances, you perform best. Of course, avoiding catastrophic situations is the real goal, and it is not an easy one considering the nature of change itself.

We need to revolutionize our way of thinking at the core. This new thinking is characterized by the concepts of collaboration, visibility, consciousness, measurement (quantification, modeling, prioritizing), diversity, continuous improvement, embedded monitoring, decision modeling and expedited qualified information flows. With this new and enlightened, holistic approach, risk can become truly manageable. Without it, organizations end up applying 20th-century thinking to 21st-century problems. And that will not work.

Change is the constant, and if you're not out front leading change and shaping it, then you will forever be behind trying to catch up. ●

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## Law #2: The Paradigm Should Destroy the Parasite

If your organization is like most, your supply chain risk management practices are fragmented across organizational functions and defined internally by a variety of functional or departmental managers. However, the real-

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ity of managing supply chain risk in today's constantly changing, complex global environment is that there is simply too much to manage and not enough resources to do it with — a single point of failure.

Additionally, the absence of industry and organizational policies, processes and protocols for prioritizing supply chain risk represents yet another significant single point of failure. How can the organization apply the basic principle of economics to get the greatest return from the least investment?

### Establish Priorities

The process begins by establishing priorities. Today, supply chain risk activities are typically driven by, first, functional risk groups (security, environmental, health and safety, continuity) within an organization, working with business or operational stakeholders (security group and the head of distribution work together on managing a security risk such as product shrinkage or theft); and second, executive management via an executive mandate, normally defined at the top and communicated down through the organization by a senior executive such as the chief executive officer (CEO) or chief financial officer (CFO).

While both are important, there is yet another often-overlooked source for prioritizing the organization's supply chain risk. It is the owners of the risk, more commonly referred to as the external stakeholders. These owners represent customers, investors, regulators, underwriters, rating agencies and, in some instances, the government. They have the most to lose; they are responsible for setting the risk priorities or what might be referred to as the *risk paradigm*. The external stakeholders *define* the risk expectations that the organization must *execute*. This is a subtle but critical distinction that, if not conformed with, can lead to significant operational inefficiency or, worse, to a single point of failure.

### A Risk Paradigm

A risk paradigm set by the stakeholders rather than the organization yields more aligned, efficient and resilient supply chain risk management.

The risk paradigm is non-negotiable and represents a contract between the owners and the custodians (those who will execute). When managing supply chain risk, the organization has little say in setting risk thresholds and priorities.

The internal priorities are established once the external stakeholders set their risk expectations.

Engineering efficiency into the supply chain is mandatory and so is the effective and efficient allocation of risk

## Threats and Vulnerabilities

Effective supply chain risk management requires not that you focus only on the functional stages of the supply chain, but that you also understand the threats and vulnerabilities relevant to your extended supply chain — the market, value drivers, flows, processes, functions and resources that make up your organization.

Your supply chain risk (and its reliance on the process of Define, Narrow, Act) has to be viewed, and continuously re-reviewed, through a macro-threat lens. You need to pick apart the entire DNA of the risk parasite and destroy its effectiveness, remove it or neutralize its destructive force in minute detail.

resources. The identified risk paradigm will receive the investment benefits of resources, capital, management attention and time. ●

## Law #3: Manage Your Business DNA in a Petri Dish of Evolving Risk

Just as billions of human DNA collectively create a living being, the big picture for the organization relies on infinite supply chain configuration possibilities.

To map supply chain DNA and to truly understand behaviors that form the basis of how risk is being managed throughout your supply chain requires an understanding of the beginning and the end.

### A New Definition of DNA

DNA can be redefined to create a model for aggressively mastering the risk challenge. Remember, your supply chains are your business in every sense of the word, so you need a three-pronged attack to get rid of the risk parasite within the chain itself. This new kind of DNA is: **Define, Narrow, Act**.

The three-pronged attack — *Define, Narrow, Act* — has to be applied systematically on multiple tiers of your and your supplier's organizations. The problem in many situations is that each function, department, segment, company and even individual operates within its own defined universe. The solution to supply chain risk management is to be able to view the entire organizational chromosome and then understand how your own universe fits into the larger picture.

The *Define, Narrow, Act* approach encompasses not

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only the immediate responsibilities and routines, but it is holistic and inclusive of every piece of the supply chain from end to end. The supply chain is everything in this regard, because it is the route along which everything — product, information, cash and the risk parasite — travels. But while the supply chain is everything, it can also be nothing without a dynamic, effective and insightful series of initiatives.

Everyone managing supply chain risk needs to develop an appreciation for the larger organizational universe. Once that is understood, then the collective priorities — *Narrow* — can be pursued. It is a form of multidimensional thinking. ●

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### Law #4: In Supply Chain Risk Management, Demand Trumps Supply

Supply chains are slaves to demand. As demand unexpectedly increases, supply is depleted. In response to the shortage of demand, the organization will seek other means to fulfill and move supply and the network design of the supply chain will be permanently altered.

Extreme volatility in demand over short time intervals will have magnified effects not just to supply but to the strategic design of existing supply chain configuration, such as the location of key suppliers and warehouses. On the other side of the equation — if the threat is there and the market and/or customers lose confidence, then demand evaporates.

Two other demand factors have a significant and permanent effect on supply chains: product obsolescence and loss of confidence.

Organizations will need to establish greater visibility and transparency into the supply side of the chain. Just as critical, organizations need to begin the demand view by establishing visibility downstream — into the demand side.

Specifically, the organization should establish a clear line of sight and better understanding of:

- Customer and demand
- Market trends (local and global) and competition
- Distribution and sales channels (ability to get the product to the market)
- The external environment and the macro economic, cultural and geopolitical factors that impact it, such as a financial downturn, protectionism/trade restrictions and geopolitical instability.

### Design

The design of an effective risk management system requires that the supply chain be completely understood, from source to final destination. This of course must start with an understanding of demand. This requires that everyone in your organization:

- Question their own basic assumptions about the business
- Broaden their organizational view to include not only the immediate environment but also the remote environment of suppliers, vendors and even customers
- Evolve this level of comprehension to understand where demand comes from
- Engage all parties, upstream and downstream, to collectively manage risk.

### Everyone's Customer

Remember that the customer, whom a majority of employees never meet and whom few even understand, is the original driver of the entire supply chain; and all of the risks that your organization faces as part of that supply chain are traced directly back to the customer.

Risks that threaten the customer perception of your company and its presence in the market are risks you cannot afford to suffer. ●

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### Law #5: Never Set Up Your Suppliers for Failure

Failure at the genesis of the supply chain moves throughout the entire system, and failure can mean a specific delay, damage or price increase; or it can mean overcapacity problems that could last for years. Failure can be caused by, but is not limited to, poor economic and financial conditions. The failure of the environment in which the supplier operates, such as an infrastructure problem caused by a natural hazard or a geopolitical event, can also result in severe consequences.

### Trust but Verify

In the mood of creating an effective partnership with your suppliers, you need to get your organization thinking in a different way about the whole supplier relationship. For example, your suppliers are not really *outside* of your supply chain or your organization.

An enlightened and holistic view accepts the simple reality: You cannot separate your organization from its suppliers. It's part of the same risk paradigm and cross-reliance.

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In this newly recognized partnership between yourself and your suppliers, you need to adopt a new view of the entire system. A “trust-but-verify” concept has to replace one of the two more common points of view: trying to completely control suppliers and imposing restrictions on them without corresponding compensation, or ignoring the risks entirely and considering those risks as belonging to someone else. Neither of these models work, however “trust but verify” is more likely to help make the supply chain operate more smoothly, with less risk, and in a win-win environment.

### Two Reform Ideas

Here are two ideas for reform going along with this:

**1. Financial consolidation.** Create joint venture partnerships, rather than strict vendor relationships, with suppliers demonstrating strong financial positions. By entering into relationships with solid companies, rather than with questionable suppliers offering low cost but low stability, you avoid the unpleasant surprises that are most likely to come up during recessionary times.

**2. Increased exposure for customers.** You may need to contend with the problems of recessionary times by simply requiring customers to live with longer lead times for some products. This affects your ability to compete and may also directly affect your markets, notably when your products are sole-sourced. But unless you can solve the problems of sole sourcing and financing issues, this could be the only alternative left to your organization. ●

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## Law #6: Managing Production Risk Is a Dirty Job

What are the risks relevant to the manufacturing, fabrication, construction, assembly or subassembly production processes, resources and systems, such as the enterprise or manufacturing resource planning applications? Here are a few: labor strikes, workplace violence, cyber attacks, rising water, wind damage, machinery failure, obsolete technology and inventory, failed relationships, shifting earth, sabotage, pandemics, intellectual property theft, material and product shrinkage (theft) and infrastructure failure.

We must also take a closer look at all that can be exposed to uncertainty (vulnerabilities). The scope of resources includes labor, intangibles (knowledge, experience, corporate memory), process, technology, data, communications networks, machinery, boilers and physical assets, hand tools, vital records and public filings, inventory and relationships.

### External Risks

What about the risks that the manufacturing process presents others in the community? In December 1984, a Union Carbide (now part of the Dow Chemical Co.) plant in Bhopal, India, leaked 42 tons of toxic gas. The actual death toll has been disputed, but Greenpeace cites a conservative number of 20,000. In the end, the presence of this manufacturing facility in Bhopal resulted in significant loss of life and damage to the environment. Sites that support production operations — especially manufacturing, processing and construction — are ground zero for environmental disasters and the rapid reproduction of the risk parasite.

A possible way to reduce production and labor risk may include shrinking the size of the supply chain while, at the same time, creating diversification in the routes of the chain itself. The solution should be based on where vulnerability exists and how big a priority the organization assigns it. That solution has to include, at the very least, these six absolute requirements:

1. Don't centralize warehouse and manufacturing or single point of failure manufacturing processes.
2. Never outsource without knowing where and who is involved, and without inspecting thoroughly and regularly.
3. Don't sleep. Don't assume you can fix the problem and then walk away; you can't.
4. Don't assume that you are the most important player in your suppliers' supply chain. This may occur in regions where prices are low, but the countries involved are piracy-friendly.
5. Never assume that insurance will make you whole or protect your reputation after a loss; it won't.
6. Expect to be on your own locally for the first 24 to 48 hours after a disaster, and longer if the disaster involves regional outages as well. You need an emergency plan to offset the down time and loss of productivity, protect valuable assets and ensure worker safety. ●

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## Law #7: The Logistics Risk Management Rule

Managing the parts does not equal managing the whole. Logistics management involves the integration of information, transportation, inventory, warehousing, material handling and packaging, safety and security. A ripple effect of missing a logistics target never diminishes in severity; it always increases as it spreads throughout your supply chain.

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## Movement and Uncertainty

The movement of goods creates uncertainty and logistics is all about movement. Before goods become final product, raw materials are extracted from the ground, forests, water and fields and then transported to suppliers. The goods (materials, components, liquid) are later shipped to manufacturers, assemblers or refineries. The goods are typically converted into work in progress or finished products. These goods are constantly moving through the product life cycle, with an occasional stop in a warehouse, distribution center or factory. The speed, frequency and size in which the goods move through the supply chain are dictated by demand and controlled and coordinated via logistics networks.

During the journey, goods are exposed to a continuous barrage of risks, including theft, destruction, delays, spoilage and even obsolescence; thousands of vulnerabilities, single points of failure, are presented throughout the life cycle of global supply chains.

Managing logistics risk requires an integrated view, one that parallels the flow and goods, cash and information across the supply chain. Functional risk management is still essential, as in the case of managing cargo security. But the functional elements must be integrated into the risk intelligent supply chain. One technique for managing product risk is to conduct a root-cause analysis to identify sources of risk. The organization can then assign responsibility to the appropriate functional unit for additional analysis, measurement and resolution.

Once the risk analysis is completed, successful practices can be implemented.

## Priorities and Economics

Keep in mind that the goal of logistics risk management is not to try to eliminate the insurmountable number of risks that exist throughout the supply chain network. Instead the goal is to effectively and efficiently allocate precious risk resources against the greatest priorities — the single points of failure that will have the greatest impact. Simply stated, it's a case of economics — getting the greatest return from limited risk investments (resources allocated to the task). ●

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## Law #8: Mitigation

If supply chain risk management isn't part of the solution, it will become the problem.

The concept of *mitigation* — reduction of risk to a manageable level — is central to your supply chain risk management program. This idea may be thought of as managing the risk parasite to a level where it can no

longer continue to damage the body of your organization. Like an actual parasite, you may not be able to remove it, but you can neutralize its damaging effects.

## Building an Action Plan

Those managing risk in the supply chain should have systems for capturing and escalating these risk decisions or, more to the point, for forcing a risk decision. The range of choices in response to any risk includes avoid, accept/retain, mitigate, transfer or finance — but the choice has to be made. Second, a system for monitoring the action and ongoing exposure is essential to make sure the risk is managed in the desired way; this is especially important if you decide to mitigate a specific risk.

Although multiple views may be brought to bear, supply chain risk must be viewed from one vantage point, and it involves a short list of two critical questions:

1. *Who is responsible for understanding and managing threats?* You need to identify not only functional methods for mitigating risk, but also to decide how to communicate the importance of these steps to the decision makers.
2. *How can my organization build the required attributes and change its traditional view of risk?* The key to avoiding or reducing risk in the new, interrelated world is to develop the intelligence and the flow of information — anticipating, avoiding through agility and flexibility, or reacting to warning signs, containing and responding. The resiliency of your organization is going to be defined by how effectively you are able to identify, seize and build on these required attributes. ●

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## Law #9: Financing

Financing risk exposure takes many forms; uninsured risks can be catastrophic if your organization has failed to ensure that its true exposures are adequately covered.

Insurance as a supply chain tool for managing risk is a crucial and important element of any program, and has been for centuries. In fact, for more than 500 years, insurance has made logistics possible when it would otherwise have been too risky to take a chance on losses. The expansion of supply chains both geographically and technologically makes insurance more important than ever.

## Insurance and Its Role in Supply Chain Risk Management

Risk financing and insurance can be categorized in five dimensions, each of which has significant impacts on your organization. Examples of these are:

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1. *Disruption of the supply of goods or services and inadequate coverage levels*, which causes a failure to satisfy a customer's requirements on time and exposes the organization.
2. *Price volatility* may result in difficulties in passing on price changes and impact profits.
3. *Poor quality* of products or services, either upstream or downstream, which impact on the customer's financial satisfaction and include future financial consequences.
4. *Reputation damage*, which arises from problems within the supply chain, such as environmental threats. There is insurance for reputation risk; however, coverage is not broadly available and is expensive.
5. *Unnamed perils (in the absences of physical damage)*. In most policies, unnamed perils are not covered. For example, in 2009, the Influenza A (H1N1) outbreak was probably not covered unless your policy included a very specific clause specifying coverage for infectious or communicable disease outbreaks. ●

### Law #10: Your Supply Chains Are All Independent but Unique

We all live with risk. Risk doesn't exist at a distant port or in a warehouse in another country; it is everywhere. However, risk is manifested in a unique way for every industry, geography, organization and individual.

If you apply the rules of organizational supply chains to your own behavior, you reduce your own risks and the risks to the organization of which you are a part.

#### Questioning Old Assumptions

What if the premise on which your organization is built is no longer valid? The point is not that it is a troubling idea, but that it is not asked often enough. The same thing applies to you personally. We humans do, indeed, need to continually evaluate and reevaluate our premises, the assumptions on which we operate and the beliefs that drive our activities.

On a personal level, risk is not meaningless nor should it be ignored, as it has been by so many people on the organizational level. But there is a danger. Just as organizational risk has lost its association as a negative or even as a threat, it has become easy for us as individuals to ignore or forget the supply chain risks we all face.

You can mitigate and eliminate risk only by (1) being aware of it, (2) measuring its impacts, (3) recognizing the course of events, materials and information, (4) deciding what steps have to be taken today to avoid

### Introducing Supply Chain Insurances

The idea of developing products specifically to address modern threats is being actively considered by a number of insurers. A new product needs to be designed in such a way that it derives exposure limits, retentions and the premium calculation parameters directly from the insured's profit and loss statement, but also in response to the realities of today's global markets — while also addressing the specific requirements of the modern supply chain and realistically addressing the threats faced within it.

Insurers have historically been reluctant to offer realistic forms of protection because insufficient data have been available to reliably assess the financial risks that accompany the launch of a new supply chain insurance (SCI) product. The reduction in value suffered by a number of companies from a supply chain failure minus the price for SCI insurance represents the value added by such an insurance product.

future exposure and (5) constantly monitoring it.

#### Unavoidable Reality

The unavoidable reality of the globally connected supply chain means that single points of failure are found everywhere and not just within organizations. All of the troubling aspects of supply chain risk that we face are better managed by awareness and cooperation with other stakeholders. This is the most important point of all. Risk does not exist in isolation or elsewhere in our personal or organizational lives. We cannot escape it, but we can manage and mitigate it.

The degree to which you can manage risk ultimately determines how well you identify single points of failure and then pinpoint the steps you can take today to avoid dangers in the future. ●

#### RECOMMENDED READING LIST

If you liked *Single Point of Failure*, you'll also like:

1. ***Proactive Risk Management*** by Preston G. Smith and Guy M. Merritt. Dramatically improve the way you handle project risks using the practical, easy-to-use, fact-based approach contained in this book.
2. ***The Complexity Crisis*** by John L. Mariotti. In this far-reaching study, Mariotti shows readers how corporate America can "keep it simple" and avoid the complexity of crisis.
3. ***The Solutions Focus*** by Paul Z. Jackson and Mark McKergow. You may not have to uncover the root of the problem in order to arrive at a good solution. Change experts use these proven techniques to get results.