

IT SEEMED LIKE SUCH A GOOD IDEA: single source contracting.

On paper, contracting out work to one vendor makes good economic sense:

Lower cost in return for giving the vendor 100% of the work.

Ease of administration.

What about corporate risk management?

Arthur Warren, J.D. is a Board member who consults with Compensation Committees of Boards of Directors. He recently gave a talk where he predicted that Board members would increasingly ask CEOs tough questions if they engaged in single source contracting.

Corporate failure to consider risk management when signing sole source contracts is illustrated in this WALL STREET JOURNAL story about the automobile industry:

THE WALL STREET JOURNAL

Car Paint Shortage in Japan Hurts Auto Industry
Greg Stacy

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A car paint shortage in Japan is causing new problems for the auto industry. A type of shiny pigment widely used in car manufacturing is only produced at a single plant in Japan.

The pigment is called Xirallic and is only produced at an Onahama plant owned by Merck KGaA, a German chemical company. Onahama is a town on the Japanese coast where citizens are still struggling to recover from the devastating earthquake and tsunami that struck Japan earlier this month. In the wake of the tsunami, the town has been exposed to the radiation leaking from the Fukushima nuclear reactor.

Many major auto makers, such as Ford Motor Co., Chrysler Group LLC, Volkswagen AG, BMW AG, Toyota Motor Corp. and General Motors Co., employ Xirallic to give their metallic paints a sparkling appearance. The troubles in Onahama have forced them into a desperate search to find some other type of paint they can use.

Last week Chrysler told dealers that the company plans to limit orders for vehicles in 10 different colors that employ Xirallic pigment. Ford had already told dealers it could no longer take orders for F-150 trucks and other models using "tuxedo black" and three shades of red. Onahama is about 130 miles to the northeast of Tokyo and approximately 35 miles south of the Fukashjima reactor. The government in Japan has instructed citizens within about 20 miles of the reactor to evacuate, while the U.S. government is advising Americans to stay at least 50 miles away.

Merchik company spokeswoman Phyllis Carter told the Wall Street Journal that the production halt at Onahama "could last for at least some weeks and might cause shortage of some types of pigments."

The disasters in Japan have shut down production at most auto plants, although some are expected to resume operations in the coming days. Auto industry experts believe that Toyota, Honda Motor Co. and Nissan Motor Co. have enough inventory to last for a few more weeks, but due to the production stoppages dealers should begin to suffer shortages by mid-April of models produced by Japan.

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