

Supplier Risk Management

Do you really have the right level of visibility to minimize risk?



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Introduction

In today's complex world, supplier risk management is just as critical to your organization's financial health and competitive performance as your efforts to produce cost savings. Supplier risk management cannot be seen as just a one-time or periodic event. It must be built into your organization's ongoing supplier interaction in order to be effective.

As either a Finance or Procurement Executive, you undoubtedly spend much of your time looking for ways to reduce operational costs, produce cost savings, and generally "do more with less" – that's the way the world is today. Whether you are working to increase profits, donations or citizen satisfaction, you must focus on cost reduction and efficiency gains every day. It's a big part of your responsibility and it's easily measured.

But the other big part of your responsibility is to manage risk. The negative impact of a single event on your organization's financial position or reputation is potentially huge, even devastating. Risk simply cannot be ignored, even whilst you work to reduce costs. The day-to-day financial benefits of risk management activities are harder to measure, and investments to reduce risk may be harder to get on the appropriation committee's agenda; but unfortunately, the entire management team should be concerned about what the organization is doing to manage and minimize risk.

When it comes to the supply side of your operations, risk management clearly involves managing the risk of serious problems that could be caused directly by the actions or inactions of your suppliers.

The only way to minimize supplier risk is to maintain a high level of visibility of the information that acts as key indicators of each supplier's ability to perform, and the likelihood of a problem. Information such as:

- ④ Demonstrated qualifications and capabilities.
- ④ Quality and safety assurance processes.
- ④ Certifications and regulatory compliances.

- ④ Insurance and disaster recovery plans.
- ④ Key executives and changes to the management team.
- ④ Mergers, acquisitions and other important organizational changes.
- ④ Actual performance history and internal satisfaction levels
- ④ The list goes on...

In many organizations, the challenge to maintaining the necessary level of visibility comes from the way in which supplier information is collected, stored, and managed:

- ④ A reliance on paper information and documents that cannot be easily analyzed.
- ④ Multiple, dispersed systems containing different types of supplier information; sometimes conflicting where they overlap.
- ④ Manual and disconnected processes that don't use or contribute to a single view of suppliers.
- ④ Information that may have been accurate at one time, but is now out of date.

True visibility of supplier risk can only be maintained through consistent, consolidated and ongoing management of supplier information throughout the supplier relationship life-cycle. The situation surrounding and within a given supplier is constantly changing in both expected and unexpected ways.

The fact is it requires a variety of integrated tools and processes in order to maintain the necessary level of supplier visibility needed to effectively identify and manage risk.

What kind of risk are we talking about?

There are a wide range of risks involved with both direct and indirect procurement.



If you are a manufacturer or distributor, your procurement people dealing with direct materials are focused on managing all aspects of supply risk throughout your supply chain – they can't afford to stop producing product because of the failure of one internal or external source of supply. For them, the primary issue is the need for a steady flow of raw materials, components and sub-assemblies because the lack of even one item can shut down a production line. That can require extremely close scrutiny of and collaboration with direct material suppliers, as well as efforts to maintain contingency plans such as alternate sources of supply. But at least the total number of suppliers they must manage is relatively low.

If you are a Public Sector entity, a service business, or a Non-Profit organization; or if you are focused on procurement of indirect goods and services in any type of organization; your risk management issues are a little different. Your challenge is that you have a huge range of goods and service providers with which you do business. Every category of supplier carries a different set of risks. Some are selected using a rigorous process; others are engaged quickly to meet an urgent need. Some deliverables are high value; some are low. You may do business with some of your suppliers every week; others only occasionally; others only once for a special project. Others may be maintained primarily as contingencies in case of a problem with a preferred supplier.

But the level of risk each supplier brings may have no relationship to the amount you spend or the frequency with which you do business with them. For example, a contractor you use only once or twice a year to maintain your gas furnace could cause significant financial damage if they send

a worker who is improperly trained and causes a fire that burns your building down and you find their insurance has lapsed. Or worse yet, they send a worker who assaults a resident, student, or employee and it turns out their hiring practices had deteriorated and that person had a criminal history they were unaware of.

Unfortunately, risk never sleeps.

- ④ The supplier who was financially strong when you first qualified them may now be on the brink of bankruptcy.
- ④ The contractor that complied with all your qualification criteria last year has new management that has let critical safety or quality processes slip.
- ④ The small lawn maintenance business you contracted with last year has been acquired by a national company and no longer qualifies as local or diverse.
- ④ The company you hire to replace all the windows in a building (or even one of their subcontractors) never agreed to your standard terms and conditions and now they are suing you because they say your building was unsafe.
- ④ The company you rely on to perform key outsourced services has their facilities destroyed by a fire and will be unable to process your work for months.

Some scenarios are more likely than others, of course; but it's clear that there are many risks out there at all times. And the impact of an adverse event or failure to perform, whilst hard to quantify beforehand, is often significant when it occurs.

**Managing
supplier risk
has become
a top priority
for Procurement
Executives.**

How do you manage such a diversity of risk?

With such a diverse range of suppliers and risks, how do you proactively work to minimize the chances of damage to your organization caused by supplier non-performance or non-compliance?



Once a year risk assessments don't do the job, take too much time and cost too much. Paying attention to only the top 10-20% of your suppliers doesn't cover enough of the potential. Focusing only on initial supplier qualification doesn't take into consideration the rapid rate of change in today's business environment.

The only way of effectively managing supplier risk is to put in place ongoing processes that make supplier visibility and risk management a natural part of everyone's daily activity, and a natural part of your ongoing engagement with your suppliers. To be truly effective, your risk management processes must be thorough; they must be consistent; they must be continuous, and they must cover virtually all of your suppliers in all of the following ways:

- ④ General supplier qualification.
- ④ Supplier selection for a specific purchase, project, or contract.
- ④ Monitoring of ongoing supplier performance and compliance.
- ④ Rapid access to alternative suppliers if/when a replacement is needed.
- ④ Thorough supplier engagement documentation if/when a problem needs to be addressed.

The only practical way to do that is to employ the aid of information technology – it's just not possible in most organizations to do a proper job of supplier risk management manually. Support systems to automate and standardize much of the process are required so that your people need only focus on exception situations and on activities that truly require person-to-person supplier interaction.

One other requirement is that the processes you put in place cannot over-burden your suppliers either – you can't be continuously asking them for the same information over and over to the point where they are spending more time responding to the same form letters and re-sending the same documents than they are delivering the products or services you buy from them.

**A high percentage
of Procurement
Executives plan
on implementing
a formal supplier
risk management
program in the next
12 months.**

The key elements of an effective supplier risk management support system

With the proper support tools, effective supplier visibility and risk management is, in fact, very practical. And the good news is that the tools needed are the same tools that help you find and realize cost savings opportunities, and that help you reduce operational costs in Procurement and Accounts Payable – electronic sourcing, portal-based supplier communications and centralized contract management.



The key elements of an effective supplier risk management support system are some of the same key elements of what we call supplier management:

- ④ A centralized supplier directory, contract register and information repository.
- ④ Automated supplier qualification tools.
- ④ Automated sourcing and supplier selection tools.
- ④ Automated supplier and contract monitoring.
- ④ Supplier self-service information maintenance with controls and alerts.

You may also incorporate other tools such as subscriptions to external sources of supplier information and change alerts; and you may invest resources in development of formal contingency plans to speed response to the potential failure of your most critical suppliers.

But in any case, these basic elements form the essential framework that is needed in order to make it practical for you to implement and sustain a reliable approach to supplier risk management.

Central supplier directory, contract register and information repository

Collecting and maintaining accurate and complete supplier information is critical to effective supplier risk management. When supplier information is scattered across many different departments and held in many different forms, it is virtually impossible to institute consistent information gathering or monitoring processes. A central supplier directory with standardized information, all scored questionnaire responses, and links to all associated documents provides the fundamental visibility needed for supplier risk management, just as it does for effective sourcing.

Such a directory can provide an easily accessible source of supplier intelligence, including a record of certifications and specialties, policy and procedure documents, insurance policies and expiration dates, product or service categorizations, questionnaire and RFx response documents, previous and upcoming review dates, and any other relevant information. Similarly, a central contract master can contain all of the information relevant to specific product or service delivery contracts with various suppliers.

A single go-to repository of supplier data and documents provides the informational foundation for all of the supplier risk management processes described on the following pages.

Supplier qualification tools

The supplier qualification process is typically used to gain a thorough understanding of supplier capabilities, certifications, policies and procedures; and to collect other information considered essential by the buying organization. This is the first level of protection against avoidable supplier risk. The purpose is to certify them as a suitably qualified supplier for a specified range of products and services – not necessarily to select them as a preferred supplier or to award a contract.

Supplier qualification questionnaires must be well-targeted, thorough and consistent in order to effectively identify potential risk. Appropriate criteria, questions and information requests should be designed for each category of supplier, and then used consistently for all suppliers in a given category. Scoring of responses, too, must be consistent and objective. The entire process must be transparent and in compliance with legislated requirements should questions of fairness ever arise.

Electronic supplier qualification tools make this practical. They enable collaborative questionnaire development among all stakeholders, including end users, procurement specialists, legal and technical experts. They make it easy to maintain and use a library of standardized questionnaire templates categorized for different types of suppliers. And they typically provide automated response scoring with controlled and audited override capabilities. Automated scoring helps keep out human bias whilst reducing time and effort. An electronic process also provides a complete history as a natural by-product.

Sourcing and supplier selection tools

The sourcing process goes beyond general qualification to evaluate suppliers for their ability to deliver a particular set of products, or to perform a particular project or service. In addition to focusing on selecting the supplier who offers best value in terms of price, quality and performance criteria, this process should focus on specific areas of risk that might be involved with that particular activity. For instance:

- ④ Selection of a contractor to construct a new building to house a laboratory might require verification of special employee skill sets or certifications, and might warrant collection of additional information about sub-contractors to be used on the project.
- ④ Selection of a food service supplier would likely involve verification of conformance to health standards.
- ④ Selection of a school bus service may require a description of the company's background screening processes used for hiring of drivers.

Some evaluation processes can be quite complex with many steps and a large amount of information to be obtained. Ensuring that all proper steps are taken, and that all required information is collected, reviewed and retained, can be a challenge.

Again, electronic workflow-based tools for sourcing event management, RFx document development and supplier response evaluation can make this process far more consistent and thorough whilst also helping ensure it is done in a timely manner, with full visibility and a complete audit trail. No sourcing process is 100% guaranteed to identify and avoid all potential risk, but the more consistent and thorough that process is, the better.

Supplier self-service profile maintenance with controls and alerts

Today's cloud-based technologies make maintenance of a large portion of your supplier information easier for both you and your suppliers. A supplier portal can enable your suppliers to maintain much of their profile information themselves. They may make updates based on established agreements (e.g. whenever they modify operational procedure documents) or when triggered by requests from you (e.g. an email generated by your monitoring process to provide evidence of re-certification).

You will always want to maintain your own monitoring process to ensure required updates are made at the right time, but a considerable amount of effort can be eliminated by enabling suppliers to do many of the actual updates themselves. You may also want to implement alerts to appropriate internal people when certain updates are made by the supplier (e.g. the new procedure document or a change in management) so that you can assess any potential risk associated with that change.

Again, no process can eliminate 100% of the risk, but the use of automated, alert-based systems, and appropriate direct supplier involvement make it practical to cover a lot more of the bases on a day-in, day-out basis.

Automated supplier and contract monitoring

Initial qualification of suppliers and evaluation of suitability for specific deliverables is just part of a full supplier risk management process. Everything that is checked, and all information that is gathered, is subject to change over time. The level of risk involved with a given supplier can become dramatically different within a single year, or even months, of initial qualification. Ownership can change, key people can leave, insurance policies can expire, certifications can fail to be renewed, important legal action can be taken against the company, desirable contracts can expire and undesirable contracts can automatically renew. And of course, it's possible the supplier will simply not live up to agreed performance criteria.

Without the help of automation, it's virtually impossible to monitor all of the possible changes, all of the required actions and all of the actual performance of all suppliers. But fortunately, this type of automated monitoring is quite possible. The central supplier directory and contract register are used to record key information such as:

- ④ Insurance, certification and contract expiration dates.
- ④ Facility, policy, performance and general business review frequencies.
- ④ Other time-based events.

Using this information, an automated system can continuously review the dates as time passes and alert appropriate people when the need to perform some type of check or review is approaching.

They can even be used to do a certain amount of load levelling to help even-out the load on procurement personnel and can use workflow and document templates to partially automate the review processes that are initiated. For instance:

- ④ Form letters or emails can be sent to suppliers asking them to confirm renewals.
- ④ Performance history collected by various operational systems can be automatically gathered and summarized.
- ④ Internal stakeholders can be sent a questionnaire asking key questions about their level of satisfaction.

Making sure you review key supplier capability, compliance and performance information on a frequent basis is probably one of the biggest keys to successful risk management. It involves monitoring a lot of details, but the process need not be onerous if it is methodical, ongoing and largely automated.

Proactis as the foundation of your supplier risk management process

Proactis Spend Management solutions provide all of the key supplier risk management support system elements described in this paper, and more.



Proactis applications for Procurement Control such as Supplier Management, Contract Management and Sourcing integrate supplier visibility and risk management capabilities with the tools you need to identify and realize cost savings and gain operational efficiencies. In most cases, they are actually one and the same, meaning effective risk management can be accomplished with little extra effort over and above your efforts to reduce costs.

In addition, Proactis Procurement applications are tightly integrated with Proactis Purchase-to-Pay applications for a seamless spend and risk management framework that spans your entire organization.

Effective risk management can be accomplished with little extra effort over and above your efforts to reduce costs.

A well-orchestrated process using clear documents also makes everything easier for the supplier, making it more likely they will offer the best possible value.

And another benefit is that the entire process is automatically documented should anyone need to conduct an audit for policy compliance and fairness.

