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In today's globalized economy, companies rely on a large and increasingly complex network of suppliers. These complex ecosystems can offer undeniable advantages for the business: they can unlock cost efficiencies, enable unparalleled scale, and propel value-add activities.

But a complex supply chain means risk isn't just a probability, it is an inevitability.

Any one of these suppliers, or the supply chains that support them, can be associated with a variety of risks, with operational, financial, geopolitical, regulatory, and environmental sources. Addressing the inevitable risks in the supply chain is a reality every procurement team has to face.

Companies are constantly walking a tightrope between extended or distributed sources of supply and the difficulties associated with managing them. Every news story about supply chain disruption, regardless of industry, may highlight a new threat that has not been evaluated. The most effective supplier risk frameworks are dynamic, and they are kept alive and aligned by the teams who manage and oversee them.

In order to be leaders in the supply chain risk space, executives need to expect disruption and develop a structured way to anticipate and manage risk. Having a framework in place that enables procurement to scan for new threats, update mitigation plans, or strengthen alternatives, and then move on to the next risk event is not only key to their success, it is essential to the success of their company.

This whitepaper, written in partnership with the team at YCP Consus, will explore the critical role of risk assessment as well as how supply management professionals can create a framework for approaching comprehensive risk assessment and develop mitigation and monitoring strategies to continuously scan for risks that are on the horizon.

## SCANNING THE HORIZON: THE CRITICAL ROLE OF RISK ASSESSMENT

Fortunately for procurement, the processes for assessing and monitoring risk can be built on techniques and approaches that are used to manage spend in other ways. Best practices include establishing a baseline and moving on to supplier segmentation before developing an action plan.

Procurement will always have more suppliers and areas of exposure than there is time or resources to apply to either. Conducting a broad assessment can identify geographies or suppliers of concern, and procurement can concentrate their attention in those places.

The ongoing effort to monitor risk then becomes a cycle of preliminary assessment, outlier identification, selective but comprehensive assessment, and mitigation strategy development.

### Preliminary Risk Assessment

Evaluating the risk(s) associated with each contracted supplier creates an opportunity for procurement to manage and mitigate disruptions to which the business has already been exposed. Even if those suppliers were scored for risk at the time they were selected, that information is likely to be out of date. In order to be effective and actionable, risk determination and monitoring need to be ongoing activities rather than steps contained within a snapshot in time.

Common categories of risk include: financial, legal, regulatory, reputational, competitive, and geopolitical. In some cases the risk will be associated with the specific supplier in question, and in other cases it will affect all suppliers in a given geography or industry. Standard evaluation frameworks such as SWOT analysis (strengths, weaknesses, opportunities, and threats) can often be used to identify risks and determine the level of control each supplier has over the threat. Then a determination can be made about how to act.

Although procurement will likely start by evaluating incumbent supplier risk, a risk-oriented mindset is hard to shake off. Any sourcing projects that are underway will probably receive greater risk scrutiny once the risk assessment process begins. This is an opportunity to snapshot and compare the risk associated with competing suppliers, as well as to set expectations for risk tolerance and oversight that will impact the term of the contract for any suppliers that win contracts.

## **Looking for Outliers**

Although tight competition often means that risk levels will be shared by similar suppliers, this is not always the case. Challenging macro conditions create the opportunity for differentiation, and individual management teams can make or break a company. Procurement should be on the lookout for outliers of all kinds, leaders and laggards alike.

Good outliers are suppliers that are able to bolster their resilience against threats, even threats that are beyond their direct control. High inflation provides a good example of this. Suppliers that effectively manage their working capital and cash flows, keep debt low and manage inventory levels, will fare better than competitors who fail to do the same. The decisions and conditions that define good outliers are often based on long-term strategy. These are suppliers that are worth partnering with and learning from.

Bad outliers elevate their own risk. Perhaps they overhire or overextend their resources. They may end up in a situation where they pay their own suppliers late, jeopardizing the operations of their customers. And it is fair to point out that they are also subject to the same macro risks as all other suppliers in their industry. The difference is, they will be far less resilient when trouble strikes, shortening the distance between a disruption and the impact on their customers. These suppliers should be identified and monitored closely, and - if circumstances do not change - slated for replacement.

## **Comprehensive Risk Assessment**

Just as there are many sources of risk, there are many reasons to dig beyond preliminary information and do a more comprehensive assessment of certain suppliers. Examples of situations that justify a deep-dive risk evaluation include:

### *Industries, categories, and geographies that are inherently risky:*

Procurement cannot afford to shut their eyes to systemic risk. In some cases, the best they can hope to do is monitor risk, picking the least bad option and then monitoring it like a hawk. Long-term and short-term strategies should be pursued in parallel, trying to mitigate short-term disruption while changing the operation as necessary to lower the level of risk that must be accepted.

*Products and services that are strategic or critical:* One of the lessons many supply management professionals learned during the pandemic is that a supplier may just provide a small, inexpensive part, but if that part is critical to a product design – or even multiple product designs – they are an elevated risk concern. This often defies total spend, the method that many procurement teams use to segment their suppliers into “strategic” and “tactical.”

Regardless of the reason that a comprehensive risk assessment is required, procurement will need to gather information from multiple sources, including the supplier, third party information sources, and points of contact within the buying company. In order to be comprehensive, the assessment must include depth and rigor, but also a 360-degree look at the supplier’s operation.

### **Developing Mitigation Strategies**

Whether procurement is focused on specific risks and disruptions or trying to improve their resilience generally, having considered potential mitigation strategies in advance can be a critical differentiator.

Supplier-specific risk mitigation is likely to be focused on alternate sources of supply/service, but the transition plan will differ by supplier. For instance, when the provider specializes in products and materials, procurement will need to ensure that alternate suppliers do not share the same supply chain as the primary provider. Otherwise, their plan B could be just as risky as their plan A. When a service provider’s operation is in question, procurement should focus on capturing processes, ensuring that standard documentation is used, and maintaining a central source of data or truth that the company has direct access to.

When disruptions impact an entire industry or geography, it may not be possible to swap in an alternative supplier. In addition to constant monitoring, procurement will want to have thought through their communications in advance:

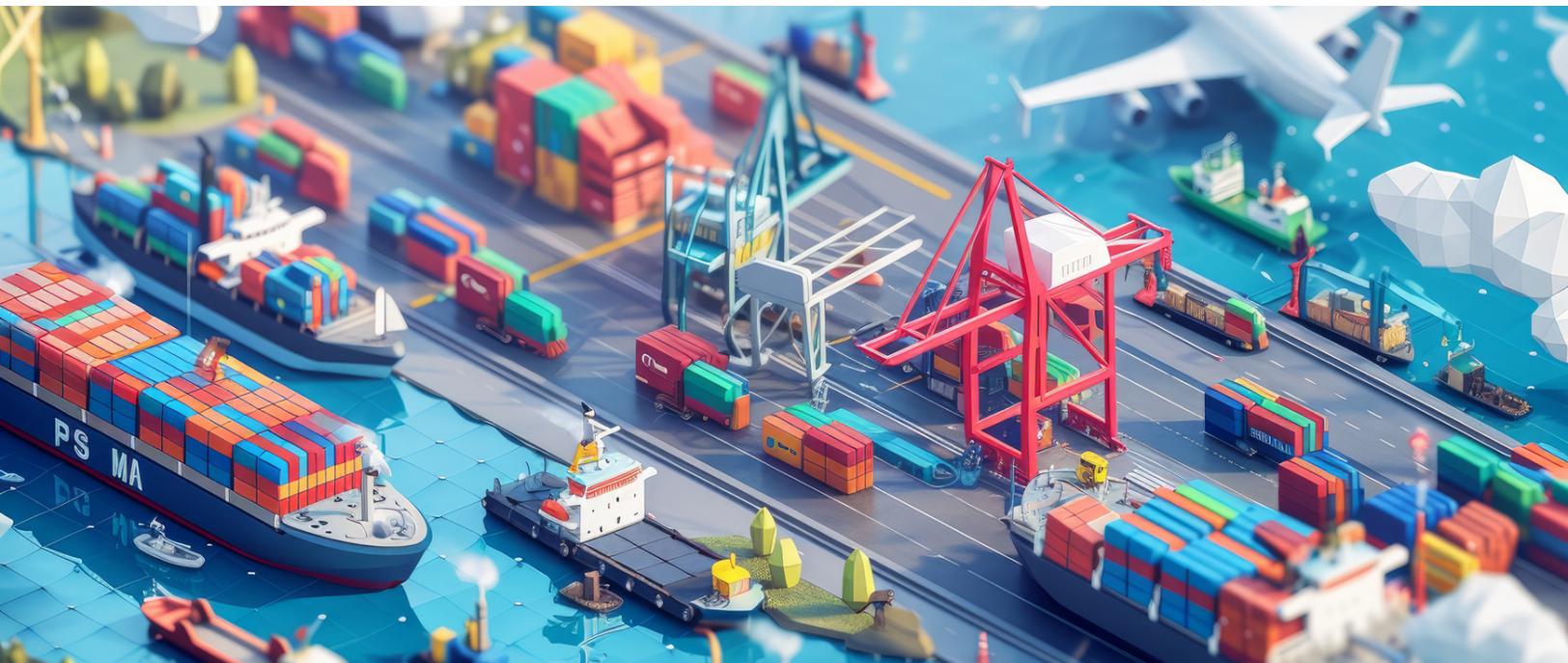
- Internal communications – Focused on stakeholders and decision makers whose roles and responsibilities will be impacted by the disruption.
- External communications – Detailing the message that is to be shared publicly, with customers and partners.

It is also wise to have a plan for communicating with the suppliers that are affected. They will likely be bombarded with requests for updates, and so knowing how they plan to distribute information as it becomes available to them is just as important as what procurement will say to stakeholders and customers about disruptions and resolution.

## The Need for Ongoing Monitoring and Optimization

Risk assessment is a continuous process, and supplier risk levels should be expected to evolve over time – both in the course of a business’s lifecycle and thanks to external events. As the conditions in the world change, so does each supplier’s relative potential for risk. As such, it is essential to re-assess these risks, determine which suppliers are associated with elevated threats, and revise mitigation plans accordingly.

Procurement must ensure that the proper attention is paid to risk mitigation and management strategies, both in terms of supplier performance and also from the perspective of business continuity. Procurement team members should be well acquainted with the risks that are likely to impact their suppliers and or categories, and regularly consult suppliers as well as third party information sources that can inform their monitoring and mitigation strategies.



### Conclusion

There can be no denying that risk assessment and management play a huge role in procurement’s value proposition. And since it is unrealistic to expect that risk levels will decline, or that disruptive events will become less frequent, procurement must be prepared to walk the tightrope between complex supply ecosystems and predictable – but less innovative – operational choices on a daily and ongoing basis.