Supplier Lifecycle Risk Management

A Whitepaper from D&B Supply Management Solutions
Quality issues.
Illegal business practices.
Supplier bankruptcy.
Capacity shortages.

Have any of these issues had an impact on your company’s ability to deliver products and services to market in the past 12 – 18 months? Unless you are very lucky, you’ve been dealing with any number of these challenges in relation to your suppliers.

The global economic crisis has been a crucible for the relationship between buyers and suppliers. The powerful connection between supplier stability and a company’s ability to make money by delivering goods and services became perfectly clear as markets plummeted, credit dried up and consumers simply stopped buying.

As a result, the risks associated with supplier failure have become too great to ignore. Supply chains are too lean, demand is too unpredictable and competition is too fierce. These realities are the force behind a new discipline, Supplier Lifecycle Risk Management, where the supplier relationship evolves over time and risk is proactively managed each step of the way.

Employing the Supplier Lifecycle Risk Management process with predictive data and technology gives supply management professionals the targeted insight needed to identify possible risks well ahead of impact and decide confidently about how to mitigate the exposure. This approach delivers both immediate and long-term benefits with the ability to:

- Reduce the total cost of supplier management
- Proactively improve the day-to-day management of suppliers across brands
- Manage the stability of supply and protect margins
- Meet corporate social responsibility objectives
- Automate processes to increase efficiency and improve compliance
- Protect an organization’s brand reputation in the market

This whitepaper discusses the emerging discipline of Supplier Lifecycle Risk Management, and provides actionable insight for determining how your organization can benefit from this approach.
Failure is Not an Option

In 2009, 32% more companies filed for Chapter 7 bankruptcy than in previous years.1 Unfortunately, bankruptcy numbers don’t tell the whole story of how companies fare in difficult economic times. When business failures are added into the mix, the number of businesses that cease operations grows exponentially.

The manufacturing industry alone saw 5,200 actual business failures in the 12 months ending September 2009—75% higher than the number of filed formal bankruptcies.1

Supplier risk, however, is no longer just about financial failure. According to George Zsidisin, assistant professor of supply chain management at Michigan State University, supply risk is “the potential occurrence of an incident associated with inbound supply from individual supplier failures of the supply market, in which its outcomes result in the inability of the purchasing firm to meet customer demand or cause threats to customer life and safety.”2

AMR Research/Gartner has identified and continuously monitors company sensitivity to 15 drivers of risk in the supply chain, including 5 areas with potential to directly affect supplier performance:3

- Shortage in management talent
- IP infringement
- Supplier product quality issues
- Natural disasters
- Regulatory compliance

According to the Corporate Executive Board’s Finance and Strategy Practice, over the course of three years a supply chain disruption can:

- Cause operational costs to rise 11%
- Decrease sales growth by 7%
- Decrease shareholder returns by 35%

Bankruptcy Volume Trends (As of May 3, 2010)

Breakdown of Rising Volumes of U.S. Business Bankruptcies since 2007, by chapter; source D&B1

* 2010 volumes represent counts from January – May 2010. Based on activity so far in 2010 as compared to prior years, bankruptcies appear to be trending slightly downward in 2010.
Failure is Not an Option

The Topps Meat Company learned the harmful effects of supplier failure the hard way. The company was forced to close its doors and file for bankruptcy six days after issuing a major product recall due to an E. coli outbreak linked to its beef patties. The E. coli contamination was linked back to a non-Tier 1 supplier.

In an ideal world, Topps Meat Company would have been able to track its direct (Tier 1) and Tier 2 and 3 suppliers, recognizing the risk for a problem before it could cause any harm. If any supplier involved in production had been linked to food contamination in the past, Topps Meat Company would have had the knowledge it needed to avoid the entire problem.

To overcome these risks, supply management organizations need to build business processes and disciplines for managing suppliers that provide the visibility, scalability and flexibility necessary for operational excellence, regardless of the economic situation.

Leaders in the field are increasingly engaging with suppliers, across the relationship—which spans from the time a supplier is selected and brought on-board until the supplier is no longer working with the company.

Traditionally, interactions with suppliers have been viewed as transactional. But viewing supplier interactions as part of a bigger whole shifts how the relationship is managed. This approach results in companies looking beyond a supplier’s immediate financial health to the bigger picture—including operational performance, service and leadership—to determine stability.

Managing successful supplier relationships calls for constant involvement with suppliers—beyond Tier 1 suppliers—and a proactive risk management strategy at each stage, including:

- On-boarding
- Day-to-day management
- Critical inflection points in the business cycle
- End-of-life

Understanding that risk can occur at any of these stages—and be manifested in different ways—across the supplier relationship is at the heart of supplier lifecycle risk management.
Supplier Lifecycle Risk Management is a best practice approach for certifying, monitoring and analyzing suppliers—and mitigating risk. It helps organizations more efficiently and cost effectively manage the supply base, reduce risk associated with suppliers and proactively respond to changes in the marketplace.

### The Truth about Supplier Risk

1. **Risk is always present.** Reducing exposure to risk is vital to a company’s success in mitigating supply chain disruption. But when times are good, taking on more risk can provide significant business benefit. Examples of good risk could include capitalizing on an emerging market opportunity in a developing country; making an acquisition that can expand your market share; diversifying your product portfolio or escalating the time to market for the latest product innovation.

2. **Risky situations can be predicted.** While some risk factors are beyond control, suppliers do play a significant role in many of the biggest supply chain risks. Creating defensive and offensive strategies to proactively manage supplier risk can turn into a competitive advantage.

3. **A little can go a long way with suppliers.** Tough decisions have long-term effects. While providing interim loans or investing in a supplier today may seem like a short-term strategy, it can increase business value in the long run.

The Supplier Lifecycle Risk Management process consists of four primary activities: **certify, monitor, analyze, and mitigate**. It is important to note that these are not linear processes and happen throughout a company’s relationship with a supplier.
Supplier Lifecycle Risk Management: A Four-Phase Process That Changes the Rules

Certify

Choosing a supplier has inherent risk. Integrating risk mitigation into your upfront sourcing process can help ensure that approved suppliers coming into your organization can meet business requirements in order to successfully deliver the final product or service. However, risk mitigation should not stop once the contract is signed.

By implementing a certification process, companies collect information from new and existing suppliers and help validate it through 3rd-party sources. Certification with new suppliers takes place initially during an on-boarding process. Suppliers are vetted and brought into a centralized registration portal where each provides specific information/documents as identified by the certifying company. This profile information might include:

- ISO Certification
- Diversity Certifications
- Green Accreditation
- SEI Capability
- Maturity Model (CMM level 3/4/5)
- Certificates of Insurance
- Tier 2 and Tier 3 supplier relationships

The supplier provided information is stored and integrated with information received from 3rd-party sources, such as financial data and predictive indicators, business identification and demographics, corporate family relationships, deeper detail on Tier 2 and Tier 3 suppliers, government control list screening, socio-economic information and more.

The certification process allows a company to aggregate and centralize supplier data while enriching existing sources of supplier data to make better decisions in the overall sourcing and ongoing supplier management process. Equally important, it’s another quality check for maintaining a solid brand reputation.
Supplier Lifecycle Risk Management: A Four-Phase Process That Changes the Rules

Monitor

Traditionally, monitoring has meant periodically checking suppliers’ financial data to ensure financial stability—which has been mistaken for overall supplier health. In supplier lifecycle risk management, a proactive monitoring process goes one step further and delves into the suppliers’ stability and health beyond financial data. Supplier health and viability is determined by considering:

- Changes in supplier management teams
- EPA violations
- OSHA violations
- Quality issues
- Noticeable lags in response time to inquiries
- Presence on Government Control Lists—e.g. Office of Foreign Assets Control (OFAC), the Federal Bureau of Investigation (FBI), the Bank for International Settlements (BIS), and United Nations Sanctions
- Risk scores that predict the likelihood of instability or bankruptcy
- Changes in supplier payment trends
- Event indicators including ownership changes, public filings (lawsuits, liens, judgments and bankruptcies), natural disasters

Monitoring should be a continuous process that happens throughout the supplier relationship, with triggers based on the criticality of that supplier to sustain profitability. For example:

- Strategic: those who are woven into the fabric of the company
- Critical: those that could cause a disruption in a manufacturing line, services or delivery to market such as an IT consultant working on code for a new product
- Approved: a supplier that has gone through a due diligence process but one that can be replaced without severe disruption
- Used: suppliers that are low-dollar, low-value, easily replaced and did not go through a formal due diligence process

Monitoring strategic and critical suppliers with ongoing alerts allows companies to make proactive decisions based on metrics that matter most to the organization.

Additionally, with today’s highly disparate supply chains, this process now needs to extend beyond Tier 1 suppliers, but also your suppliers’ own suppliers, and your suppliers’ suppliers’ suppliers. It’s a tangled web and most companies are not even aware of the 2nd and 3rd Tiers down the supply chain. More and more companies are discovering that the costs associated with relinquishing control to suppliers and their suppliers may be too high to bear.
Supplier Lifecycle Risk Management:
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Gathering Tier 2 and 3 supplier information through the certification process, and then monitoring those suppliers who make up the supply chain, helps ensure organizations are paying attention to risk that could impact the supply chain and ultimately the ability to deliver the final end product or service.

Finally, understanding if a supplier is part of larger corporate family hierarchy can be critical to understand and monitor risk exposure. While there may be no signs of risk with a given supplier, it may be a different picture at the parent company level. Knowing when a supplier is part of a larger corporate family allows an organization to monitor not only the direct supplier, but also its parent or related company.

Analyze

Visibility leads to better, more informed decisions. In the analysis process, companies bring intelligence to their supplier and spend data. By enriching internal supplier performance and criticality data with 3rd-party supplier intelligence, companies can gain an enhanced view of the supply base and determine the impact of supplier failure.

By periodically repeating the analysis process, companies can begin trending the information month-over-month or quarter-over-quarter, in order to gain a bigger picture as to how suppliers are performing and define acceptable behavior thresholds. That insight can be used to establish benchmarks for measuring supplier performance and to create a system for collaboration and supplier development.

Users can conduct in-depth analysis of the supply base to evaluate overall risk exposure based on the factors that matter most, e.g. dependency, corporate social responsibility, commodity/industry exposure and more. Based on the results, companies identify which suppliers to monitor and can set mitigation strategies.

Additionally, a solid analytical base becomes a very dependable asset when a triggered monitoring process highlights a potential supplier risk. Having the available supply base information at hand to analyze the potential impact, as well as identify other existing supplier options, paves the way for a more confident and informed best course of action to mitigate risk.
Supplier Lifecycle Risk Management: A Four-Phase Process That Changes the Rules

Mitigate

How an organization manages the risk associated with a particular supplier affects future aspects of the supplier relationship. This process is highly dependent on monitoring and analysis—as these processes are most likely where issues that can optimize risk mitigation will originate. Mitigation allows users to collaboratively track and determine the root cause of potential supplier performance and solvency problems. For example, companies can execute efficient supply base improvement programs using automated virtual supplier assessments, gather more information conducting supplier surveys, and discover new/alternative sources of supply on both a regional and global basis.

The best course of action is dependent on any number of criteria unique to a company but could include the given situation; how strategic or critical a supplier is to an organization; and how severe the potential risk impact could be to operations and brand reputation. Proactively preparing for these potentially damaging supplier disruptions by having alternative source strategies in place is a viable consideration. Developing supplier contingency plans by documenting competitive suppliers and continually researching new suppliers are good strategies. Working with a critical supplier with whom you want to maintain a relationship may involve negotiating new payment terms or adjusting delivery dates. Knowing your threshold for compromise can reduce unanticipated glitches.

The end goal when mitigating risk is to continue uninterrupted, sustainable, and profitable business operations; meet ongoing compliance requirements and social responsibility standards; and maintain the integrity and positive reputation of the company’s brand.
Managing Risk throughout the Lifetime of a Supplier Relationship

1. On-boarding

The Situation
Selecting and ramping new suppliers—and re-evaluating existing suppliers for new programs—can be fraught with risk. During on-boarding, a new supplier does most of the information sharing, often times giving the supply management team a localized, functional view of the supplier that may be incomplete and unvalidated against other sources.

There are long-term benefits to a focused level of due diligence at this early stage—well beyond getting a new relationship off to the best start. Gathering a robust and multi-dimensional profile for a supplier in one place—and sharing that information with all those in the organization with a vested interest, including engineering, manufacturing, legal, accounts payable, and quality—supports an integrated and holistic strategy for managing supplier relationships and potential risk.

The Process—Certify
At the on-boarding stage, best-in-class companies put suppliers through a due diligence process to become certified as an approved supplier by requiring them to provide a defined set of information. That information is then combined with additional insight from a trusted, independent 3rd-party source. And certification doesn’t end once the supplier is on-boarded. Having the means by which to store and provide access to the information, where re-certification can be done with some level of frequency, can significantly reduce risk.

Real World Best Practices
Like many F500 companies, a large utility company’s corporate social responsibility (CSR) commitment included a strong plank for diversity in its supply base. The company embarked on an ambitious program to increase the percentage of business it did with certified minority, women and veteran-owned businesses—all the while maintaining tight budgetary control over the sourcing and on-boarding process.

Replacing an existing internal supplier portal with an innovative supplier-funded portal model, the company significantly streamlined and increased the accuracy of the process of identifying, qualifying, monitoring and analyzing its suppliers. The certification process required the ability to collect pertinent information from suppliers, including:

- Contacts
- Diversity status
- Tier 2 suppliers
- Customer information
- Ability to have all information and documents in one centralized location

Within just five weeks, the team hit its target of 30% of suppliers registered, successfully meeting both its CSR and budgetary goals.
2. Day-To-Day Management

The Situation
Daily operational activities, such as procuring supplies to build products or stock shelves, can uncover risky situations. Once a supplier is categorized as active or certified, they should be continuously monitored for changes in behavior or in the market. For example, a supplier that initially delivers on time and then becomes habitually late, or is suddenly unable to fill a standard order, could be a red flag that something more is happening with the supplier and requires a closer look.

The Process—Monitor, Analyze, Mitigate, Certify
Operational excellence, which implies the ability to deliver products and services as promised, requires that a company’s suppliers meet service level agreements and comply with agreed upon requirements. Equally important is not to get caught off guard by events that impact the supplier’s own business continuity—whether it’s M&A activity, leadership changes or natural disaster.

Awareness of potential changes in the business condition of a supplier is a critical line of defense in reducing the likelihood of an unexpected—and potentially damaging—disruption. Alerts that are automatically raised based on triggers defined by the company can provide the time needed to evaluate and take action. Analysis gives companies the intelligence needed to drive appropriate action—based on the severity of the issue and the criticality of the supplier. Mitigation techniques, like having a backup supplier on hand, can make the difference between making the quarter—or not. And, implementing a periodic re-certification process helps ensure companies are re-checking that suppliers are maintaining requirements to retain their approval status.

Real World Best Practices
One multi-billion dollar manufacturer of gas, oil and petrochemical and process equipment systematically sought to reduce supply interruptions from critical suppliers to zero.

For its most critical suppliers—sole source and those who provide innovative and proprietary products—the company defined a set of key indicators relevant to its business that were consistently monitored—including predictive risk scores, financial indicators, and public filing indicators like suits, liens and judgments. When a supplier fell outside the desired range of the indicator, an alert was emailed to the relationship manager. The situation was analyzed for impact through communication with the supplier, audits and in some instances on-site visits. In the case of significant damaging impact, mitigation strategies such as a change in source, on-site management or new payment terms were considered and implemented.

Since the company embraced new business processes and technology to support a robust supplier risk management strategy, it experienced no disruptions, having successfully identified, analyzed and intervened in time.
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3. Critical Inflection Points in the Business Cycle

The Situation
Ramping up to meet increased demand, a new product introduction, or expansion into new markets are all areas that expose the supply chain to possible risk. Companies need to ask whether current suppliers are equipped to handle the additional requests and may need to vet new suppliers to meet demand.

The Process—Certify, Monitor, Mitigate
Being confident that suppliers are positioned to support business initiative requirements is absolutely essential in highly competitive markets, where the window for maximizing margins is getting tighter and tighter. Both new and existing suppliers need to be evaluated, not only based on the information they provide, but also on 3rd-party objective insights. In some cases, changes in demand or the marketplace can affect a supplier’s performance and health, leading to supplier probation.

During this period, new suppliers should be certified and existing suppliers may need to be re-certified. Suppliers need to be monitored to help ensure the level of supply will continue to be maintained. Mitigation activities like surveys and assessments for more detailed information, as well as identifying additional sources of supply should current suppliers be deemed unable to meet requirements, are all viable actions to consider.

Real World Best Practices
One global teleconferencing company learned the hard way that suppliers are not always truthful when it comes to sharing bad news. In the middle of a new product launch, rumors flew that a sole source supplier of a critical component was in financial difficulty. When confronted, the supplier assured the team that all was well, only to file for bankruptcy shortly thereafter.

Now, during launches and increased production cycles due to rising demand, the team closely monitors critical suppliers and when receiving an alert, promptly does a 3rd-party source check to better understand the situation and implement the best mitigation tactics to solve the issue at hand.

The new practice came in very handy when the company got word that one of its key suppliers reneged on a commitment to deliver 2,000 parts by a defined due date. The supplier extended the delivery date which meant a delay that would shut down operations for nearly an entire quarter. The company reviewed 3rd-party information about the supplier, discovering they were in bankruptcy. Contact was made with the supplier. The order was reinstated and the parts were received within 48 hours—securing enough parts to last through the quarter, buying the team critical time to put alternative inventory strategies in place.
4. End of Life

The Situation
The end of a supplier relationship is increasingly a cause for concern. A supplier can be phased out for several reasons, including it provides an older technology that is not widely available; there are operational problems with the supplier (it doesn’t meet criteria set by the customer); or alternate sources have become available that better meet the company’s needs. It is here that the entire lifecycle comes full circle.

The process—Monitor, Analyze, Mitigate
A unique combination of monitoring, analyzing and mitigating supplier risk are critical when it comes time to discontinue a working relationship. How a company handles the risks associated with severing ties with a supplier will impact operation of the supply chain moving forward and the resurgence of supplier lifecycle risk management, including vetting and on-boarding new suppliers.

Real World Best Practices
This discipline is a nascent one in the area of supplier risk management. Building strong processes and practices, cultivating teams to deploy those processes and knowing technology around the previous stages, affords companies the skills to move from simply cutting a supplier relationship off to a smooth transitional approach that reduces risk and ensures continuity of supply.
Winning Ways

As business adapts to ever-changing and complicated market realities across the globe, supply management professionals need to continually consider and refine how they view supplier relationships, and the risk associated with them. Companies can no longer afford to view supplier interactions as transactional, separate exchanges. Those interactions are part of a larger and ongoing supplier relationship—and with this dynamic comes the responsibility of managing risk over time using multiple risk dimensions.

To stay ahead of the curve, supply management leaders will develop a forward-looking view of supplier risk by:

- Systematically certifying new suppliers and re-certifying existing suppliers
- Reducing exposure to disruption by proactively monitoring the supply base for a wide range of risk indicators and managing by exception
- Integrating 3rd-party data to expand visibility and deepen risk analysis
- Deploying successful mitigation strategies, including regular, automated supplier assessments and surveys, as well as having alternate sources of supply at the ready

In parallel, companies will need complementary supplier risk management tools to identify the risks at play and establish a plan for handling risk that is in line with the company’s overall goals.

Through the supplier lifecycle risk management process, companies who depend on suppliers to deliver goods and services to their customers obtain greater visibility into supplier operations, supply chain scalability and the ability to better respond to demand fluctuations, and the flexibility required to address unexpected situations.

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1 D&B database activity; May 2010
3 “Risk for Manufacturers and Retailers Shifts from Recession to Recovery According to AMR Research’s Quarterly Supply Chain Risk Survey,” AMR Research; Sept. 2009