About Perfect Commerce

Since 1994, Perfect Commerce has been automating spend management initiatives—offering world-class sourcing and procurement solutions to the enterprise and public market sectors. Globally, we serve more than 300 businesses, most in the Fortune 500, providing a true end-to-end platform that greatly enables cost reduction while easily increasing operational efficiency and minimizing risk. Our proven, reliable suite of software and services solve even the most complex industry challenges—throughout the spend lifecycle.

Trust Your Suppliers, Manage Your Risk
The Importance of Third-Party Supplier Visibility
Your objective: sell 250,000 shirts.

Market research has indicated that in order for the shirts to sell, they need to be made of superior quality cloth, manufactured so that they can be sold at a lower price point than your competitors, and packaged to reflect marketing strategy.

Optimize margins and volume, maximize profitability — a familiar mantra.

Your solution: find an off-shore manufacturer with a low enough labor cost to allow execution of your strategy. So far, so good. You won’t be losing any sleep.

The next morning, after your peaceful night of sleep, the newspaper headlines show a grave industrial accident leading to a significant loss of life. There, on the front page, are pictures of shirts with your logo resting in the ruins of a factory — a place you didn’t even know manufactured your shirts.

Unbeknownst to you, your supplier outsources sub-components to their suppliers. Working conditions were found to be deplorable; certainly not something you would have condoned, if you had known. The CEO gets a call from the chairman — how would they explain the impact to brand, reputation and valuation to the public and to the shareholders?

Let’s look at another example. A data breach at a large merchant processor cost a company more than $84 million and precipitated its removal from the global registry of a major card issuer. In fact, a survey by the Ponemon Institute found that more than 41% of companies surveyed sustained a data breach caused by a third-party. The consequent loss of brand value typically ranged from $184 million to more than $330 million.

Globalization has dramatically changed how manufacturers operate and disastrous events like these have become more frequent and their consequences more costly.

Sure, there are benefits to outsourcing — from lower costs to heightened efficiency and a sharpened focus on core business objectives. But if suppliers lack strong safeguards and controls, your company can be exposed to fiscal, operational, regulatory and reputational risk. How far can you take risk management with your supplier’s suppliers, especially if breaches impact your reputation, brand and revenue, not your supplier, or their supplier?

Executive Summary
Managing Supply Chain Risk

Supply chain means different things to different people. Different aspects of risk carry different degrees of importance dependent on whether you’re a banker, a manufacturer, a chemical producer, an airline, or a restaurant.

But it all boils down to the following:

1. Risks have to be identified;
2. Risks have to be managed;
3. Without risk assessment and management, the impact to your brand, reputation, and cash flow could be disastrous.

There are no “easy” buttons to push. However, there are things you can do to identify, manage, and mitigate supply and supplier risks.

Here are our suggestions:

1. Develop a comprehensive inventory of suppliers, and in cases of outsourcing, their supplier.

As companies continue to expand globally, operational decisions will be made regardless of whether all the right information is available. Unfortunately, if the proper communication and collaboration systems aren’t implemented, a lack of data correlates directly to an increase in risk. When organizations don’t have the right information to make an informed decision, the risk of an undesirable outcome increases.

In the financial world, regulators are mandating that banks know their third parties, if and how each interacts with your clients, and what activities are performed. That’s easier said than done — many firms do not have this information readily available. In the manufacturing world, while there are no regulatory mandates, it’s just plain good practice to understand and identify risk.

A good first step is to cleanse your supplier database. Outsourcing, processing, joint ventures, co-branded partnerships, sponsorships, and similar relationships can account for up to 80 percent of spend assigned to suppliers. But these relationships are often managed in ways that emphasize commercial goals, with only a secondary (or none at all) focus on risk assessment. What’s more, in international companies, most geographic business units have different ways of tracking suppliers, making visibility difficult across an entire organization.

Our recommendation: clean your database and consolidate suppliers (we have seen up to 12 entries for the same supplier, identified under different names or acronyms, or sequence of corporate names).

2. Identify and segment third-party risks.

You can't manage all suppliers all of the time. But which suppliers do you focus on? Once you have a complete inventory of third-party suppliers and the risks they pose to customers, you can segment suppliers by risk level. Even a simple system of high-, medium-, and low-risk categories can be useful.

Best practice is to develop a comprehensive catalog of risks relevant to your business. The risks you measure could be financial viability, impact to brand or/and reputation, impact of political events to supply disruption, impact of geographic events to supply chain, impact of third parties performing activities on behalf of your prime suppliers, impact to environment, and so on — depending on your industry. The results of these assessments form the basis for scorecards, audit routines, and other monitoring activities.

In our experience, firms typically use either the score-based or rules-based approach. Using the score-based approach, a company conducts due diligence across all dimensions and uses the results to develop a composite risk score. Although very thorough, this approach can be onerous and resource intensive for many organizations. In other circumstances, firms might consider using a rules-based approach, whereby a firm identifies specific rules or criteria for each segment — streamlining the process of assigning suppliers to risk categories.
3. **Conduct a rules-based due-diligence test.**

Investors are increasingly sensitive to strategic and reputational risks created by third parties. Traditional approaches align specific due-diligence activities with the risk category identified by the risk-based segmentation. For example, a supplier in the high-risk category is subject to all due-diligence investigations. Like the score-based segmentation approach, this one can be overly onerous and resource intensive. Thus, the rules-based approach can be a better answer because it triggers an appropriate set of due-diligence activities for the identified risks. For example, even if a third party is deemed to pose a high risk, an information-security or data-privacy screening is unnecessary if the supplier does not hold information that personally identifies customers.

4. **Develop and implement an effective supplier relationship management infrastructure.**

Organizations can no longer operate in isolation, if indeed they ever could. You ultimately depend on the excellence of your suppliers because if they fail, your company fails. Forming enhanced commercial relationships with all of your suppliers is just impossible. However, it’s necessary to identify the ‘critical few’ that merit some form of enhanced relationship or partnership to drive value from these select suppliers.

Even without this kind of analysis, some suppliers immediately stand out as worthy of some kind of closer working relationship. These include:

- Suppliers to whom you have outsourced all or part of the internal process.
- Suppliers with whom you have a joint venture in which assets and resources to create value are shared.
- Suppliers that provide critical services or materials without which your organization cannot function.
- Suppliers that provide capabilities or services that could directly impact your organizations’ commercial differentiation, for instance, shorten go-to-market cycle times, gain market share or optimize margins.

5. **Governance framework and escalation process.**

Governance can be centralized or decentralized; both models (and some hybrids) can be successful. In the centralized model, most major risk decisions reside within a single group, such as procurement or shared services. While the centralized model identifies a clear and accountable “owner,” it can sometimes lead to tension between the business unit that has a working relationship with a third party and the centralized body accountable for risk assessments. In the decentralized model, the business unit that owns the relationship also manages the risk.

This arrangement can sometimes result in a duplication of resources: several business units may, for example, assess a major third-party supplier for similar contracts. In some cases, the application and alignment of risk standards can be inconsistent in a decentralized model: the groups managing, say, procurement and operational risk could have different perspectives. A hybrid approach, carefully tailored to the organizational context, can help mitigate challenges associated with the two models as long as risk ownership is clear.

An escalation framework is critical to resolve issues—such as requests for exceptions and the resolution of third-party breaches—that exceed the decision-making limits set out in the governance structure. Each organization must find an appropriate approach given its appetite for risk and its own culture.
Conclusion

What does this all mean when something goes wrong or there is a supply chain disruption? Because of globalization, it means there is an increased likelihood that companies will be exposed to and impacted by more adverse events, such as natural disasters, political and economic instability, supply disruptions, economic volatility and more.

As a result, the value of supply chain visibility has significantly increased. This capability helps to substantially minimize risk of loss, order delays and reduced quality. Manufacturers that take a wider, more holistic perspective across operations can better manage complex supply chains. By implementing technologies that can increase visibility into the supply chain, manufacturers can more easily collaborate and communicate with suppliers. Not only will processes instantly improve, but the ability to prevent (or at least minimize) disruptions will help to increase the bottom line.

In the end, a global marketplace has been both a blessing and a curse, to an extent. While new markets have opened up, greater risk now exists, which could potentially impact the survivability of your company. Some of these risks could impact others; thus, it is now critical for manufacturers to increase their visibility into not only their own operations, but those of their suppliers. With this much risk in play, any system that can help mitigate excess risk is well worth the investment.