9 Steps to More Effective
Supplier Risk Management

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Executive Summary

- Supplier Risk Management is becoming increasingly important in today's globalized business environment, where supply chains often involve multiple partners and sourcing and offshoring activities are becoming more extensive and sophisticated, which in turn has increased the likelihood of supplier risks

- Supplier risks can be significant and varied, and may include **reputational, resilience, information security** and **privacy, regulatory,** and **commercial risks**

- To manage supplier risk effectively, businesses need to have an overall framework that provides a structured approach to identifying, assessing, and mitigating risks throughout the sourcing lifecycle

- To serve that purpose, we have launched this eBook series to equip readers with a comprehensive understanding of supplier risk management and the necessary tools to develop a robust framework that can assist in effectively manage supplier risks

- Part 1 outlines **nine steps to managing supply risks effectively** and will also provide in-depth understanding into the various types of supplier risks, the detrimental effects of poor supplier risk management, and outline best practices for managing supplier risks effectively

- Part 2 entails applying these steps and ensuring a high standard of risk management practices & processes. To close the loop on a smooth supplier risk management function, what are **the 7 key considerations** you should factor in for your organization's procurement tech landscape and adopt established best practices.

The cost of being blindsided by a supplier issue is always higher than the cost of preventing it!

Supplier Risk Management is a critical aspect of supply chain management that has gained immense importance in recent years. However small, supplier risks have always existed, and have disrupted many an organisation's operations.

> The incidents of the Tottenham Hotspurs football team's illness and the Foxlink factory fire in India serve as reminders of the importance of managing supplier risks. In the mid 2000s, the Tottenham Hotspurs football team experienced a bout of illness ahead of a crucial match, which was later attributed to contaminated food. The incident, known as "Lasagna-gate," was traced back to improper care on the part of their supplier. The incident had far-reaching consequences for the team. More recently, Apple's supplier, Foxlink, halted production at its Indian facility after a massive fire.

These incidents highlight the risks associated with managing suppliers across multiple geographies. In today's globalised business environment, supply chains often include multiple partners, and sourcing and offshoring activities are becoming more extensive and sophisticated to capture cost savings and processing efficiency. However, without adequate supplier risk management processes in place, organisations face unexpected risks that could result in significant financial and reputational damage.

Businesses are becoming increasingly reliant on third-party suppliers; making it critical to have a comprehensive and robust supplier risk management framework in place to manage and mitigate the risks associated with supplier relationships. By implementing effective supplier risk management practices, organisations can identify and manage risks, ensure business continuity, and ultimately capitalise on the potential benefits of strategic supplier relationships.

The main objective of this eBook series is to equip readers with a comprehensive understanding of supplier risk management and the necessary tools to develop a robust framework that can assist in effectively manage supplier risks. This eBook will delve into the various types of supplier risks, the detrimental effects of poor supplier risk management, and outline best practices for managing supplier risks effectively.

Complex Supply Chains Demand Strong Supplier Risk Management

The increased use of sourcing and outsourcing arrangements in modern business operations has led to more complex and extensive supply chains, which in turn has increased the likelihood of supplier risks. These risks can be significant and varied, and may include:

Reputational risk

This type of risk arises when a supplier fails to deliver on agreed service levels or quality standards, resulting in service or supply interruption. This can lead to a loss of confidence in the organisation and can damage its reputation in the eyes of its customers, stakeholders, and the public. Reputational risks may also arise from a supplier's business practices, such as an overseas supplier with substandard employment arrangements.

Resilience risk

A supplier failure can cause an immediate interruption to business, leading to resilience risk. The ill-fated decision of one of the largest automotive manufacturing company's CEO, to rapidly increase the number of robots in their factories is an example of this risk. Despite investing billions of dollars in a joint venture with Fujitsu-Fanuc, the robots proved to be faulty, resulting in decreased productivity, increased costs, and a decline in market share. This type of risk is not limited to supplier failures but can also be caused by labour strikes or plant shutdowns.

Information security and privacy

The risk of sensitive data, including customer data, being compromised by a cyber-security breach or failure in a supplier company is an ever-present danger in modern business operations. Such risks can lead to significant financial damage.

Regulatory risk

The risk of non-compliance with regulatory requirements or commercial undertakings associated with sourcing, outsourcing, or offshoring arrangements in the jurisdictions a business operates can result in significant penalties, fines, and legal costs. For instance, the consequences of violating Germany's new Supply Chain Due Diligence Act (SCDDA) include fines of up to 2% of a company's annual global revenue, highlighting just how important it is for organizations to adhere to these new regulatory mandates.

Commercial risk

The risk of financial loss or cost overruns due to poorly managed sourcing arrangements, supplier failures, and inaccurate billing from outsourced parties.

Regardless of the type of supply, sourcing or outsourcing arrangements can involve multiple supplier relationships that are not visible to the end-client. As such, it is crucial for businesses to have a robust supplier risk management framework in place to identify and manage these risks effectively.

Effective Responses: Steps for Managing Supplier Risks

Supply risk management is an essential strategy for any organization that aims to proactively identify events that may adversely impact their supply chain. To manage supplier risk effectively, businesses need to have an overall framework that provides a structured approach to identifying, assessing, and mitigating risks throughout the sourcing lifecycle. This includes not only the initial selection of suppliers but also ongoing monitoring and management of supplier relationships.

Organisations must understand that risk and opportunity go hand in hand. They must identify which risks are worth taking and manage them appropriately to create value. Fig. 1 (below) outlines nine steps that aid in managing supply risk. However, while, due to the nature of risk – being partially unpredictable – you cannot completely eliminate risk, this framework will help minimize risk to a considerable extent.

Each step requires an upfront expense against the potential of a future benefit. For risks that do not materialize, the mitigation effort is unnecessary and expensive. Conversely, it may not make financial sense to mitigate every known risk. In practice, the decision involves determining what actions to take and how much to do while considering the effectiveness.
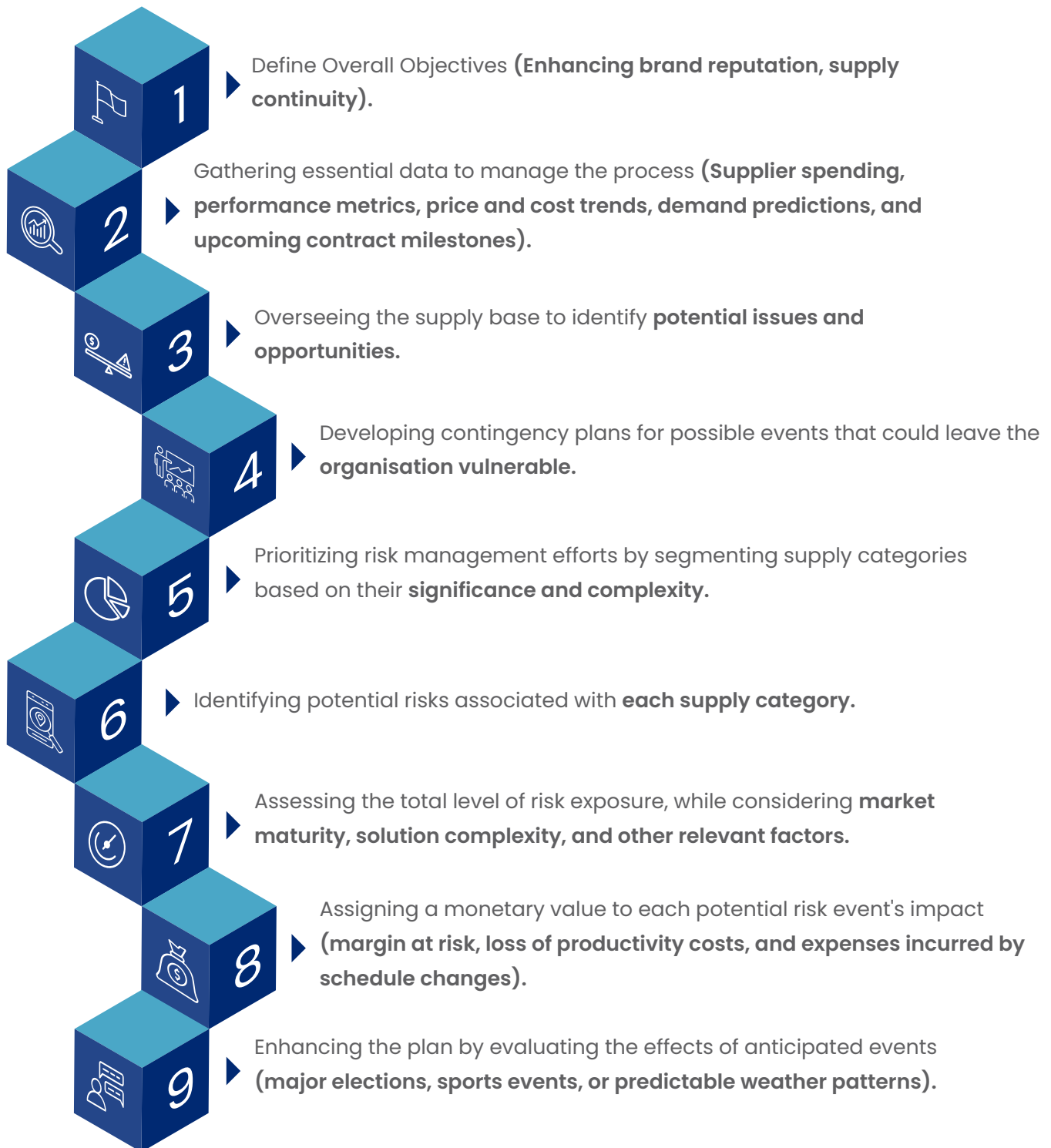
1. Define Overall Objectives **(Enhancing brand reputation, supply continuity).**

2. Gathering essential data to manage the process **(Supplier spending, performance metrics, price and cost trends, demand predictions, and upcoming contract milestones).**

3. Overseeing the supply base to identify **potential issues and opportunities.**

4. Developing contingency plans for possible events that could leave the **organisation vulnerable.**

5. Prioritizing risk management efforts by segmenting supply categories based on their **significance and complexity.**

6. Identifying potential risks associated with **each supply category.**

7. Assessing the total level of risk exposure, while considering **market maturity, solution complexity, and other relevant factors.**

8. Assigning a monetary value to each potential risk event's impact **(margin at risk, loss of productivity costs, and expenses incurred by schedule changes).**

9. Enhancing the plan by evaluating the effects of anticipated events **(major elections, sports events, or predictable weather patterns).**
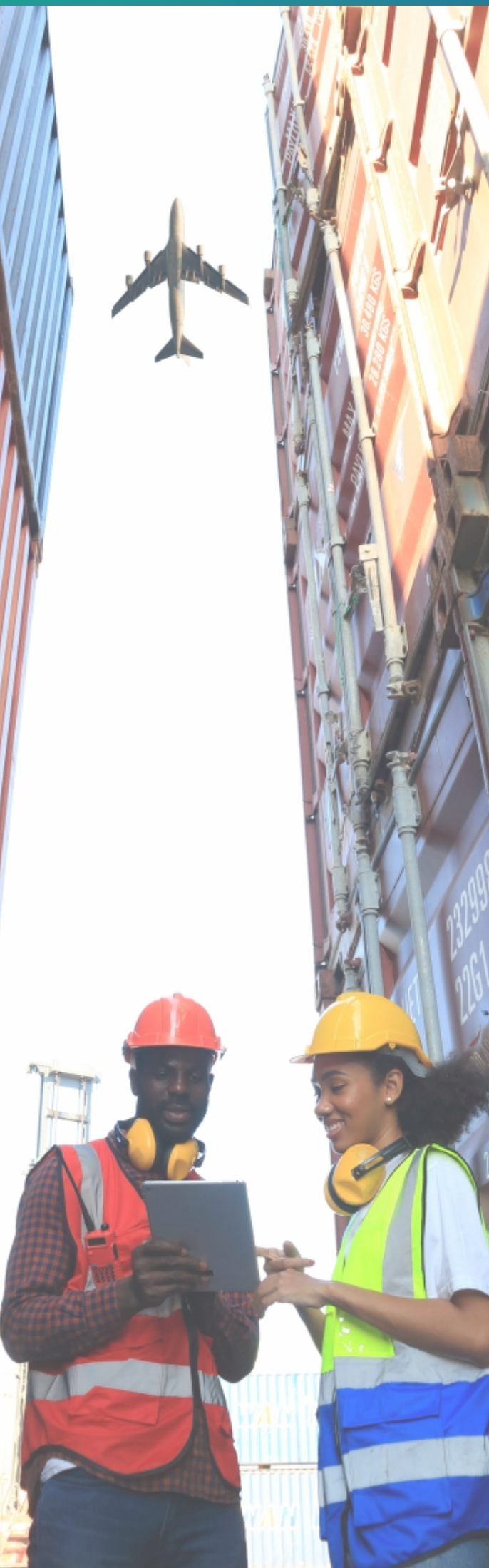
Fig 1. 9 Steps for managing supplier risks effectively

For any business, supply assurance is a fundamental requirement, and procurement plays a vital role in anticipating and mitigating supply risks. In fact, according to our **survey on Supplier Management Performance, 42% of companies identified ensuring supply continuity as the most critical driver for creating a supply risk management program.** This includes preventing supply bottlenecks, logistics issues, low stocks, and unexpected breakdowns that may negatively impact business operations. **Additionally, for 34% of respondents, ensuring regulatory compliance was identified as the most critical driver for implementing a supply risk management program.**

With a proper SRM framework, your organisation can gain a more reliable and consistent process for managing supplier risks, which can lead to improved operational efficiency and reduced costs through centralised contract management.

Now that you have a comprehensive 9-step program to identify and manage risks, you are ready for Phase 1 of your organization's Risk Management program.

Phase 2 entails applying these steps and ensuring a high standard of risk management practices & processes. To close the loop on a smooth supplier risk management function, you should factor in key considerations for your organization's procurement tech landscape and adopt established best practices.

Head over to Part 2 of this eBook series to discover how the 9-step framework can be implemented and what are the 7 key considerations that you need to keep in mind while mitigating the supplier risk effectively, its potential maximized, and how Zycus is the best partner in your risk management journey!

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Zycus is the pioneer in Cognitive Procurement software and has been a trusted partner of choice for large global enterprises for two decades. Zycus has been consistently recognized by Gartner, Forrester, and other analysts for its Source to Pay integrated suite.

Zycus powers its S2P software with the revolutionary Merlin AI Suite. Merlin AI takes over the tactical tasks and empowers procurement and AP officers to focus on strategic projects; offers data-driven actionable insights for quicker and smarter decisions, and its conversational AI offers a B2C type user-experience to the end-users.

Zycus helps enterprises drive real savings, reduce risks, and boost compliance, and its seamless, intuitive, and easy-to-use user interface ensures high adoption and value across the organization.

Start your #CognitiveProcurement journey with us, as you are #MeantforMore.

Merlin AI Suite diagram: Supplier Risk & Performance Management, E-Procurement, E-Invoicing, Spend Analysis, E-Sourcing, Contract Management, Supplier Information Management; inner ring: Merlin for Risk, Merlin for E-Procurement, Merlin for E-Invoicing, Merlin for Spend, Merlin for E-Sourcing, Merlin for Contract, Merlin for Supplier Onboarding; center: MERLIN A.I. SUITE; base layers: InsightStudio, Supplier Network, Project Management, Request Management, Savings Management

World map with office locations: Chicago, Princeton, Atlanta, London, Amsterdam, Dubai, Tokyo, Mumbai, Pune, Bengaluru, Singapore, Melbourne