Supplier Risk: The Gateway to Brand Risk

Programmes to manage supplier risk can go a long way to reducing overall brand exposure

Thirty years ago as much as 95 percent of the average Global 2000 company's value was derived from tangible assets; today 75 percent of that value is based on intangibles, according to Forbes magazine.

Put simply, a company's most valuable asset is its brand.

Thus, it is no surprise that protecting the corporate brand has become one of the top priorities for CEOs at Global 2000 companies, this according to survey by the IBM Institute for Business Value (IBV). Most CEOs are in a constant state of concern that their company could be involved in a damaging incident with the potential for loss of brand reputation – and revenue.

In fact, 70 percent of C-level and senior executives who were surveyed at Global 2000 companies expressed that risk has "significantly increased" over the past ten years. The operating environment for businesses today is significantly different that it was just a decade ago. Globalization, cost pressures, financial sector instability, volatility, and emerging market suppliers are all contributing to an acceleration of risk.

As risk and volatility have increased, so has the speed at which brands and reputations can be damaged. Most notably, brand and reputational risk has been amplified by the explosion in social media. News that would once take days or even weeks to surface is now rapidly transmitted across the world, leaving a company with perhaps only mere hours to respond and communicate containment and recovery plans.

The range of potential risks to a company is also exceedingly broad , consider the exposure contained even in this short list:

- Supplier risks
- Market risks
- Geo-political risks
- Emerging market risks
- Financial exposures and risks
- Environmental risks
- Employee related risks
- Corporate Social Responsibility (CSR) risks

The costs of these risks can be staggering. According to one study, a one point decrease in reputation is associated with an average market loss of $5 billion. Another study noted that a major supply chain disruption results in an average 10 percent reduction in sales – and a corresponding drop in shareholder value. Yet even another study calculated that one hour of website downtime costs an average of $3.4 million in reputation and brand damage.

The stakes for understanding and mitigating risk have never been greater, but the breadth of the task sometimes seems near impossible to manage. However, there is a common denominator for many of the potential risks a company commonly confronts.

Nearly 50 to 65 percent of the value of a business' products or services derived from its partners, vendors and suppliers, according to the Institute for Supply Management (ISM). Depending on the vertical industry, expenditures with suppliers and vendors can range anywhere from 20 to 65 percent of spending; spend on suppliers averages approximately 22 percent in banking and financial services; 29 percent in oil and gas; 42 percent in healthcare; 53 percent in consumer packaged goods (CPG) and 60 percent in the telecom and technology sectors.

As such, experts say that vendors and suppliers are the greatest and most common source of risk. Thus, the greatest chance of preventing problems and mitigating risks is derived from managing those vendors and suppliers.

A Framework for Managing Risk

Given C-level recognition of the importance of mitigating supplier and vendor risk to reducing overall risk exposure, supplier risk management has been receiving significantly increased attention and investment. Companies are moving beyond simply employing processes to help address disruptions from key suppliers – towards more proactive practices to protect the company from a broader regulatory, legal and financial perspective as well.

Given the expanded definition and scope of risk management, a first essential task is setting the parameters for a risk management program.

Based on more than 300 engagements with Global 2000 companies, the consultants at IBM have outlined a basic framework for a world-class supplier risk management program. That program involves:

1. **Risk Definition:** Defining the threats to the organization and supply chain
2. **Risk Modelling:** Developing risk models and determining thresholds for risk
3. **Risk Assessment:** Assessing and prioritizing risks
4. **Risk Monitoring:** Developing a program and framework for on-going risk monitoring and analysis
5. **Continuous Improvement:** Planning and taking steps to mitigate future risks

Companies with advanced programs are also connecting supply management people and processes across the enterprise – and moving from disparate data to centralized supplier intelligence.

Opportunities for Risk Reduction

The supply management process – the process of forming and maintaining relationships with vendors and suppliers – includes steps to find, negotiate and document the conditions of the relationship and then to monitor those conditions. Each of these processes offers opportunities to mitigate risks and\or prevent unwanted risk from entering the organization.

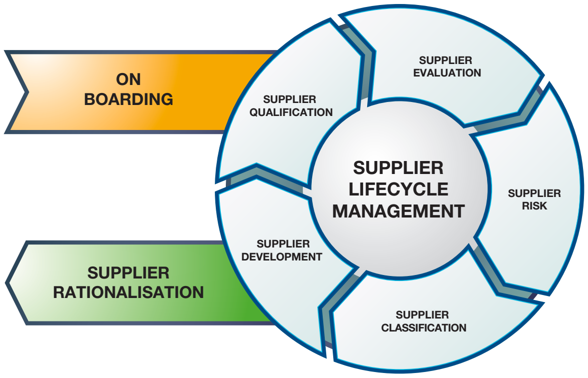

Figure 1: Supplier Lifecycle Management

There are plenty of examples of risk exposure and the consequences of those risks, but most risks can be traced to the basic supplier management processes. For instance, if a business unit engages an uncertified supplier without fully vetting their practices, the resulting brand impact can be immeasurable if, say, poor labour practices are uncovered. Not being fully aware of the supplier's known associates, litigation or financial history may put one in the position of doing business with a supplier that could violate corporate policies.

The reduction of risk throughout the supplier management lifecycle naturally starts with compliance management, ensuring that all suppliers are properly vetted in a manner in accordance with the good or service they will provide – and that they agree to comply with critical policies and standards.

Each additional step in the supplier management process also affords the opportunity to proactively prevent risk from being introduced, as well as to pre-empt or mitigate the impact of future events. For example, leading procurement organizations are utilizing the contract process to make early preparations for potential scenarios that could impact the relationship. Proactive risk avoidance language embedded in the contract can protect the organization (a) in the event of some future shortage or crisis, (b) from a 'misdeed' by the supplier or (c) provide financial protection in the event of bankruptcy or adverse financial event.

Integrating Processes, Building Resilience

Clearly, implementation of individual programs and processes will have a positive impact on risk reduction efforts. However, without a coordinated and comprehensive approach, including coordination of the flow of information across all supply management processes, sub-optimal results will be achieved.

Companies employing best-in-class supply risk management practices are achieving results in the form of reduced risk exposure and cost savings, but also leveraging data solutions that enable:

1. Global, cross-enterprise transparency of information
2. Incorporation of both internal and external supplier information
3. Coordination or integration across supplier management processes

A deep level of supplier visibility and insight can only be achieved when systems are able to share data about the supplier to deliver a 360 degree view across all key interaction points both operational and strategic.

The enhanced focus on supply risk management is no doubt a big challenge, but with that challenge comes opportunities. Integrated processes and solutions will not be instituted overnight and will not prevent all risk scenarios – but they will ultimately, significantly elevate the organization's resilience.

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