Supplier risk management
Time to take control

80% of respondents believe they have or may have been over-billed by their suppliers.

55% of participants have experienced a significant supply chain disruption in the last three years.

Only 39% of organisations have communicated their required controls and operating principles with key suppliers.
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We believe our study can play a valuable role in helping organisations reassess and revamp their SRM approaches to achieve greater business benefits.

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A new focus on supplier risk management (SRM)

The current global economic environment requires today’s supply chains to balance efficiency with resilience in the face of continuing volatility and heightened levels of uncertainty. Outsourcing, offshoring and strategic sourcing have become key priorities for many Australian companies, who are increasingly seeking to outsource non-core activities for which they lack a distinct competitive advantage and in some instances, partnering with specialist suppliers to gain a lead on their competition. As a result, many businesses are beginning to rely on a complicated web of relationships and dependencies for everyday operations.

Business executives are wrestling with the challenges that include managing a more complex network of suppliers and an increased scrutiny by a range of stakeholder groups including regulators. At the same time, they are dealing with major business disruptions caused by external providers.

These challenges led us to our first PwC Supplier Risk Management (SRM) Study in Australia, which is a detailed look at how major Australian companies are addressing the key issues and risks arising in their supply chains.

In considering the findings, we were pleased by the number of organisations that have elements of an effective SRM. Many respondents are reaping the benefits of effective sourcing/outourcing, including reduced costs and freeing up internal resources to focus on core business tasks.

Our findings also demonstrated that organisations are keeping tabs on their suppliers via KPI monitoring, and working to build mutually beneficial relationships.

However, we identified some concerning gaps in the way organisations managed suppliers. Many respondents were simply not gaining some of the basic yet vital benefits they had hoped to achieve from their sourcing arrangements, including greater efficiency and risk mitigation.

Perhaps the most worrying finding was the lack of robust governance structures for managing the growing webs of supplier relationships. In our view, some organisations’ attempts to reduce costs had in fact created the potential for greater financial, operational and reputational damage.

We believe our study can play a valuable role in helping organisations reassess and revamp their SRM approaches to achieve greater business benefits.

We would like to thank all the participants for taking part and generously giving their time. We hope you enjoy reading this report, and we look forward to hearing your thoughts on the key findings.

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Supply chain management has always been a key tool in moderating the impact of changing business conditions, driving down costs and lifting efficiency. However, the reality for many Australian organisations is that their supply chains are increasingly complex and unknown beasts, encompassing multiple partners who in turn manage sourcing in a variety of ways across varied international jurisdictions – often to their own standards, not yours.

This increased complexity is creating a pressing need for organisations to get a better handle on their supplier arrangements. For instance, unpredictable economic conditions have played havoc with supply and demand planning, and natural disasters have elevated supply chain volatility. Furthermore, customers often want more products delivered faster and cheaper.

At the same time, local and international regulators have stepped up their scrutiny of sourcing arrangements with external partners – particularly in the area of outsourcing. We have witnessed very public cases of supplier risks manifesting in unfortunate ways, including Europe’s horse-meat substitution scandal and the Bangladesh factory fires. It is important to remember that the less-than-ethical practices of your supplier’s supplier can quickly become your problem.

In this environment, supplier risk management (SRM) is more important than ever. To assess how Australian organisations are meeting their supply chain challenges and explore potential strategies for improvement, PwC surveyed 68 organisations across all industry sectors. We surveyed respondents from the C-suite (CEOs, chief financial officers, chief risk officers, chief information officers and chief operating officers); heads of corporate services and logistics, risk, procurement, supply chain; and commercial and general managers.
Five key findings from PwC’s Supplier Risk Management Study 2013

Finding 1
Supply chain risks and relationships are often poorly understood.

While most organisations maintain an inventory of suppliers, only 51% have categorised them based on risk to their organisation. In addition, only half of the organisations surveyed are comfortable with how their suppliers are managing fourth- and fifth-party relationships.

Finding 2
Spending on SRM is minimal and many organisations do not know the true costs of working with suppliers.

Despite spending substantial funds on procurement – in some cases upwards of A$50 million per year – 80% of respondents believe they have or may have been over-billed by their suppliers. In addition, organisations are not clear on the ‘invisible’ costs, such as increased costs as a result of supply chain disruptions caused by suppliers.

Finding 3
There are gaps between the expected benefits and the reality of sourcing.

Six out of 10 organisations say they are not getting the benefits they want from their sourcing arrangements. We found that organisations are not securing the outcomes they seek in areas such as risk mitigation, higher-quality service delivery and enhanced tax outcomes.

Finding 4
Strong relationships do not always equal strong performance.

We found a recent shift to improved supplier relationships with most respondents viewing their relationships as mutually beneficial. But in reality, supplier performance does not match the perceived strength of supplier relationships and organisations are therefore not maximising benefits.

Finding 5
Organisations’ governance frameworks do not always adequately address risks.

While the majority of organisations have SRM governance frameworks in place, only half of those respondents said these arrangements were effective. The findings point to capability gaps within organisations when it comes to SRM. To help resolve these gaps, in our view organisations should consider the risks posed by their supplier base and develop comprehensive governance frameworks to mitigate key risks.
Detailed study findings
**Finding 1**  
Supply chain risks and relationships are often poorly understood

Today, it is easier than ever to engage external suppliers. Employees can sign up providers with the swipe of a credit card, without having to negotiate with procurement departments. This can lead to a tangled web of supplier relationships that can complicate business processes and increase risks (including regulatory and financial issues).

According to our study, 81% of respondents said they maintained an up-to-date inventory of suppliers, but only 51% of these organisations had examined their supplier base and evaluated the risk each provider poses to their supply chain.

In our view, the evaluation and understanding of supplier risk is critical as not all suppliers are created equal. For example, an organisation’s largest supplier may be its lowest-risk provider, while the bankruptcy of a small player could substantially disrupt operations. In our experience, leading organisations are profiling their suppliers on key risk metrics such as the materiality of the arrangement, the potential impact of a breakdown in controls or a supplier disruption and the likelihood of such an event occurring.

In addition, when organisations outsource key functions to a provider, they may be entering into multiple supplier relationships whereby their providers outsource to fourth and even fifth parties. We found that nearly four out of five respondents were aware that their suppliers used offshore operations or multiple providers. Despite this knowledge, only half of those respondents were comfortable with the controls their providers had in place to manage those relationships. Furthermore, only 30% of respondents felt they had robust assurance and compliance activities over key supply chain risks.

This is an important finding because the actions of providers further along the supply chain can cause lasting financial and reputational damage to the organisations that initiated the outsourcing arrangement. In recent times, we have seen fourth-party data-centre outages halt vital airline systems such as check-ins and reservations, and unethical and inadequate practices by offshore suppliers that have led to regulatory and criminal investigations.

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**Figure 1.1 Has your organisation categorised its suppliers according to risk?**

<table>
<thead>
<tr>
<th>51%</th>
<th>49%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

**Overview**

According to our study:

- 81% of respondents have an inventory of suppliers; but only 51% of these organisations have evaluated the relative risks each supplier poses to the organisation.

- While 79% of respondents are aware that their suppliers use offshore operations or fourth party providers, only half of these organisations are comfortable with the controls their suppliers have in place to manage these relationships.
Finding 2

Spending on SRM is minimal and many organisations do not know the true costs of working with suppliers

Figure 2.1: “The invisible” costs of sourcing

Many organisations use sourcing arrangements to reduce expenses by securing better deals and ensuring costs – such as energy, labour and raw materials – are more predictable. Our study found that 53% of respondents spend more than A$50 million each year on sourcing from and with suppliers, and 64% have a dedicated manager to oversee the cost structure of sourcing arrangements.

However, given the substantial funds spent on sourcing, many organisations are underestimating the true costs of sourcing. According to our study, organisations do not always take into account the costs of compliance, supplier disruptions or supplier billing errors.

For instance, contractually agreed costs are only part of total sourcing costs; there is a danger of ‘invisible’ costs escalating and outweighing the benefits of supplier arrangements. By not estimating the true impact of these costs, organisations can incur unexpected losses.

In addition, some respondents do not supplement their sourcing investment with spending on risk management initiatives. The study results imply that many organisations are investing limited funds into supplier compliance (including auditing supplier costs). For example, 61% of participants spend up to A$250,000 per year on supplier risk management, which represents only 0.05% of the A$50 million more than half of organisations spent on sourcing. This is a particularly concerning finding for organisations in closely regulated industries.

The results of this relatively poor quality control are evidenced by our finding that nearly 80% of respondents believe they have or may have been over-billed by their suppliers.

Overview

According to our study:

- 53% of respondents spend more than A$50 million per year on sourcing, with 80% of organisations believing they have or may have been overbilled by their suppliers.
- More than half of the participants had experienced a significant supply chain disruption in the last three years, which increased costs for 42% of respondents and affected customer service levels for 39% of respondents.
- 40% of organisations said they could not respond to supply chain disruptions without incurring substantial losses.
We found that 60% of respondents say they can respond to supply chain disruptions without substantial financial losses. This was a positive finding given how frequently these disruptions can occur.

However, we also found that some organisations had experienced financial impacts from supply chain disruptions. For instance, 55% of participants have experienced a significant supply chain disruption in the last three years, and 42% say this has increased costs. Part of the issue is that some organisations simply don’t have the visibility they need across their supply chain to manage the risks effectively.
Finding 3
There are gaps between the expected benefits and the reality of sourcing

Many organisations’ business strategies call for more outsourcing and offshoring to deliver higher-quality services and greater efficiency at a lower cost. According to our study, respondents’ sourcing outcomes were in line with our expectations in a range of areas, including:

- access to subject-matter experts
- agility and the ability to focus on core business areas
- collaboration on ideas and solutions
- competitive differentiation in service delivery
- freeing up existing internal resources
- innovation in specialised services, tools and technology
- reducing costs.

However, in many cases expectations are not being met and organisations are failing to gain important benefits from their outsourcing and offshoring. In particular, there was a mismatch between expectations and results when it comes to achieving:

- an improved focus on business and controls
- improved operational efficiency
- improved service quality
- risk mitigation
- reduced complexity
- enhanced tax outcomes.

Overview

According to our study:

- 58% of respondents said realising the intended benefits was a key issue in sourcing.

- Organisations said they were achieving some benefits in line with expectations – in areas such as reducing costs, freeing up internal resources and accessing innovative tools and approaches.

- Some organisations are not achieving the desired benefits in crucial areas such as risk mitigation, higher-quality services and enhanced tax outcomes.
Why are organisations struggling to achieve some of the key desired benefits from their sourcing arrangements?

In looking at the results and drawing on PwC’s global experience, we believe that organisations are largely skilled at gaining quick wins when working with suppliers, such as getting access to specialists, freeing-up internal resources and lowering cost bases. But the real challenge is fully optimising benefits. This may require greater leadership, direction and organisational oversight over – and more effective partnerships with – their sourcing partners.

To develop these more advanced benefits, organisations may need to overhaul their current ‘set and forget’ approach to sourcing. The problem with this current approach is that organisations do not continually evaluate whether they are achieving the desired benefits, nor do they revise the supplier relationship where relevant. The end result, as we’ve seen in the study, can be a sourcing strategy with an impact that bears little resemblance to its intention, and that does not effectively manage the risks.

Furthermore, while organisations are achieving benefits from sourcing, the benefits they are missing out on often create new pain points. For instance, we found that 58% of respondents said realising intended benefits was a key challenge when sourcing from external suppliers.
Finding 4

Strong relationships do not always equal strong performance

Many respondents claimed to be pleased with the work of their suppliers. According to our study, 75% of organisations rate the performance of their sourcing partners as good or excellent. However, 55% of respondents overall said that their suppliers were responsible for at least one significant supply chain disruption in the past three years that resulted in the organisation suffering financial loss or reputational damage.

How do we reconcile these findings? How can our participants be satisfied on the one hand, but also still be nursing the wounds from a supplier-sparked disruption? We believe the issue is that organisations do not always have the right processes in place to accurately evaluate their supplier relationships and to consider and manage the risks.

We found 28% of respondents do not have clearly defined roles and responsibilities in designing and executing processes, systems and controls for their key suppliers. Furthermore, only 39% of organisations we surveyed have communicated their required controls and operating principles with their key suppliers.

In our experience, this gap in setting clear expectations and understanding what is required from a supplier can often lead to increased costs, supply chain inefficiencies, regulatory challenges and ultimately the breakdown of sourcing partnerships.

There is also some unease among respondents in terms of their supplier relationships and the potential risks they face. In looking at the activities of sourcing partners, our study found that organisations are concerned with the risks surrounding:

- a lack of control and governance
- IT and data security
- non-compliance with legislation and regulations
- business resilience
- political and economic risk exposure.

Figure 4.1: Risks where organisations are most concerned
In essence, some organisations are flying blind when it comes to truly understanding their supplier relationships. Only 30% of respondents feel they have robust assurance that all key risks are being managed in their supply chain.

The majority of respondents are keeping tabs on supplier performance by holding regular meetings, evaluating key performance indicators and managing contracts (see Figure 4.3). The least used performance measure is compliance monitoring (employed by 52% of respondents).

This is a potentially worrying finding given the growing issue of supplier compliance, particularly when trying to manage fourth- and fifth-party relationships where the intermediate relationships may not be transparent.

To ensure effective supplier risk management, leading companies implement a range of measures including setting clear expectations and operating principles, and aligning key metrics and reporting to these agreed principles.

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**Overview**

According to our study:

- 73% of respondents view their relationships with suppliers as mutually beneficial.
- Nearly one-third of respondents do not have clearly defined roles and responsibilities in designing and executing processes, systems and controls for their key suppliers.
- Only 39% of organisations have communicated their required controls and operating principles with their key suppliers.
- More than half of respondents have had a significant supply chain disruption triggered by the actions of a supplier.
Finding 5
Organisations’ governance frameworks do not always adequately address risks

Until recently, most organisations managed supplier risk through governance frameworks that are underpinned by centralised procurement and decentralised supplier relationship management systems. Under this approach, a centralised contract management office undertakes the initial risk assessment process, and then hands the day-to-day management of supplier relationships to individual business units.

However, as business conditions have become more complex, this governance approach is increasingly risky. Traditional contract management offices typically lose sight of the breadth and nature of the services provided by suppliers, and struggle to co-ordinate personnel, processes and technology to effectively manage risks.

Our study results show that organisations are not responding and adapting their more traditional model in a timely manner. We found that while 61% of participants have a formal governance framework in place to manage suppliers, only half of those respondents said the framework was effective. Furthermore, less than half of the organisations surveyed have a dedicated team to manage their SRM.

Supplier monitoring is a critical component of SRM and our study results show that only 30% of respondents state they have robust assurance that all key supply chain risks are being managed. A quarter of participants said they were uncomfortable with their suppliers’ ethical practices (including child labour and fair living/minimum wage arrangements).

Perhaps this demonstrates why more than half of respondents have suffered a significant supply chain disruption, financial loss or reputational damage as a result of a supplier in the past three years (see Finding 4).

According to PwC’s global research, leading organisations are investing substantial resources in refining their SRM governance frameworks. This includes securing buy-in from senior leadership teams within the organisation and from sourcing partners, as well as equipping internal SRM teams with the appropriate resources and support to handle short and long-term challenges across the enterprise.

Overview

According to our study:

- 61% of participants say they have a formal methodology or framework in place for sourcing partners – but only half of those respondents said this was effective.
- Less than half of organisations surveyed have a dedicated team for ensuring the control posture is being effectively managed.
- Only 30% of respondents feel they have robust assurance that all key supply chain risks are managed by their sourcing partners.
Taken as a whole, these findings show that many organisations are not using the right governance frameworks to establish, implement and maintain successful SRM functions.
Towards more effective supplier risk management

Supplier relationships are under more scrutiny than ever before. Within organisations, decision makers are seeking greater benefits from their providers; externally, stakeholders and regulators are asking more questions about how suppliers operate, particularly around the operations of suppliers’ suppliers. At the same time, our study reveals many Australian organisations are not managing supplier risk effectively and therefore could be exposed to business disruptions, reputational damage or other issues.

To help organisations enhance their SRM arrangements, we recommend they focus on two strategies:

1. Developing a greater understanding of their suppliers,
2. Establishing a comprehensive governance framework.

1. Developing a greater understanding of suppliers

Supplier stratification process (Example A)

Supplier stratification is the foundation from which effective SRM processes flow. Organisations have limited resources, so they need to prioritise their supplier activities based on the relative risks posed by each provider.

The stratification process requires organisations to:

• identify relative risk levels, by listing their full range of suppliers and assessing the risks posed by each provider and the overall exposure risk
• develop an exposure perspective at the enterprise level, focusing SRM efforts on the highest-risk providers
• build a customised framework, creating SRM strategies that are targeted to the challenges presented by an organisation’s unique supplier base.

Illustrative stratification criteria:

• Unique service offerings
• Active/inactive status
• Presence of compensating controls (for example, through finance, monitoring, legal or insurance)
• Level of inherent risk.

Risk monitoring processes and controls include:

• SRM operational processes
• Metrics, scorecards and reporting
• Technology, systems and data.
Supplier stratification process (Example B)

We also recommend that organisations faced with significant and numerous suppliers develop integrated, enterprise-wide approaches to supplier governance. While there will likely be different risks posed by individual suppliers, organisations still need an overall framework to manage supplier risk throughout the sourcing lifecycle.

The goal here is to encourage cost-effective sourcing while ensuring the risks and accountability for end-to-end sourcing and service delivery are clearly defined, managed, monitored and understood by the organisation and its suppliers.

Figure 6.2: Supplier stratification process (Example B)

An SRM framework can help organisations achieve substantial benefits including:

- minimising operational, financial and reputational risk
- greater control over supplier activities through reliable and consistent processes for managing supplier risk
- competitive differentiation through a transparent purchasing policy that supports corporate social responsibility as a differentiator
- increased operational efficiency and reduced costs through centralised contract management
- an enhanced ability to outsource non-core activities and partner with strategic suppliers on key activities while protecting your data and process
- greater consumer confidence in the operating practices of the organisation and its suppliers
- a reduced need to replace failed suppliers.
2. Establishing a comprehensive governance framework

Figure 6.3 sets out a framework and a range of activities organisations can undertake at each stage to develop an effective SRM governance framework. The SRM strategy provides an overall direction for the SRM function and its supporting roles. The governance model lays out the organisational framework, policies and procedures under which SRM activities are conducted. This includes:

- SRM reporting structure, roles and responsibilities
- SRM policies, procedures and guidelines, such as risk assessment methodology
- Risk tolerance levels.

In addition, the governance model should consider how SRM activities integrate with other supplier and risk management functions to promote consistency and quality in program activities.

Conclusion

By following the strategies listed above, organisations can take the next steps to improve their SRM arrangements and develop effective supplier relationships that deliver business benefits and improve performance now and in the future.
**Best practice in supplier risk management**

Based on PwC’s global experience, we’ve identified SRM best practices being undertaken by leading organisations in the following key areas.

1. **Due diligence assessments**
   To ensure effective risk management, organisations conduct such assessments prior to commencing new supplier relationships. The assessments include country, financial and reputational risk; business continuity planning and disaster recovery; the security and privacy of information; and legal and compliance analysis.

2. **Contracts**
   Leading organisations manage supplier relationships through standardised master service agreements and contracts. Further, contract data is thoroughly checked to ensure it is accurate, complete and up to date.

3. **Monitoring**
   In this area, suppliers are comprehensively monitored using a defined, documented and technology-driven approach. This includes the use of monitoring plans, scorecards and quality assurance reviews.

4. **Accurate and complete inventory of third parties**
   In addition, leading organisations maintain a complete list of suppliers through data analysis of accounts payable, contract and risk-related information. They do not solely keep track of their suppliers based on the largest contracts. Also, organisations use supplier risk management systems to ensure key data is kept up to date.
About the study

PwC’s Supplier Risk Management Study analyses the views of 68 organisations across all industry sectors.

How the report was produced

- The survey was open to PwC clients and non-PwC clients.
- The survey comprised numerical data questions as well as non-numerical questions.
- Throughout the process, each client’s identity was kept confidential.

- Data was collected over an eight-week period from August to October 2013.
- Respondents were able to complete the survey online.

- Once the data collection ended, PwC analysed the data over a three-week period.
- Subject-matter experts from across PwC within the Assurance, Advisory and Tax practices provided commentary on the spread of our survey results as well as insights from the local market and the global PwC network.

- The survey results reflect the data collected from 68 organisations across various industries.
- The results and publication are presented in a non-identifiable way.
- The Supplier Risk Management Study should be seen as a starting point for further discussions rather than a conclusive assessment in any one particular area.

Disclaimer:
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Related reading

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Audit and Risk Committee Matters:
Is your supplier risk management keeping pace with your strategic imperatives?

Are you sure that’s beef in your burger?
Giving you confidence in the performance of your supply chain

Global Supply Chain Survey 2013
Next-generation supply chains: Efficient, fast and tailored

APEC’s evolving supply chain:
2012 APEC CEO Summit PwC Issues Spotlight
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