White Paper

Why Sustainable Supply Risk Management Cannot Be Siloed: Lessons From Leaders Who Beat the Odds

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Supplier Risk Monitoring series

Sourcing Innovation
Next Generation Supply Management Defined

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SUPPLIER SUSTAINABILITY RATINGS

Many organizations are beginning to make efforts in supplier management and risk mitigation, but the fact remains that preventable risks are still materializing on a daily basis. In addition, many organizations are still losing millions, and in some Global 3000 cases, billions of dollars a year due to supply chain incidents that could have been caught or had their impact significantly reduced with proactive supplier management and monitoring. So why are organizations still losing millions, or billions, due to these supply chain risks?

Introduction

In our last paper on Playing With Fire – 4 Hidden Risks Lurking in Your Supply Chain, we noted that modern supply chains are fraught with risks that can result in increased operational costs, large and sometimes devastating losses from fines and/or disruptions, and long term damage to your corporate reputation. Risks that, in many cases, could be mitigated to prevent the organization from suffering, in some cases, 100 million dollar fines simply by way of thorough supplier reviews, ongoing supply chain monitoring, and mitigating actions should suppliers slip or efforts start to go off the rails.

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Lack of Resources. Most organizations do not have enough people with the right expertise, or money, to effectively manage and monitor supplier sustainability efforts. Why? When one considers the full gamut of regulations a multi-national organization is affected by, as highlighted in our last paper, keeping up with these regulations can often be an insurmountable task for even a core team without mentioning the third party audits, news sources, and internal systems that should be monitored for compliance, risk, and performance indicators.

Lack of Time. Most skilled resources in an organization barely have enough time to do their primary jobs, and since this is never anyone's primary job (as Procurement needs to focus on cost cutting and cost control, HR with filling empty seats, Engineering with insuring product quality and safety, etc.), it typically becomes a side issue that is only addressed when an issue arises (and has to be dealt with right away) or when the C-Suite becomes aware of a new regulation that might impact the organization and hands the regulation over to the perceived subject matter expert to investigate.

Lack of Immediacy. Despite the fact that there may have been hundreds of smaller incidents (like tremors before an earthquake) in the supply chain that resulted in small fines, unexpected cost increases, disruptions, and minor brand damage, which may have collectively done considerable damage over time, if no single incident has been severe enough to get the C-Suite's attention, something else will always be higher priority.

Lack of Cohesion. Most risk management and sustainability efforts grow organically over time as different functions encounter risks, regulations, or sustainability and social responsibility objectives that need to be addressed. This results in a fragmented approach to risk and sustainability management that is inefficient and ineffective.

Fragmented Risk Management

Often the biggest reason that many organizations are losing millions, if not billions, of dollars a year due to supply chain incidents that could have been caught or significantly reduced in impact with effective supplier management and monitoring is that risk management is fragmented. What do we mean by this?

There are many different departments within the organization tackling risk from different perspectives.

- **Finance**
  who are concerned about passing the scrutiny laid upon them by financial regulators screening for FCPA, Sarbox, and similar regulations

- **Human Resources**
  who are concerned about passing the scrutiny laid upon them by the IRS, OH&S, Worker's Rights Advocacy Groups, Anti-Human Trafficking laws, etc.

- **Operations**
  who are concerned about environmental compliance regulations, consumer safety acts, and other regulations that could open up the risk for a costly lawsuit

- **Procurement**
  who are concerned with keeping production lines going, trade lines flowing, and adhering to any requirements placed upon them by the internal customer

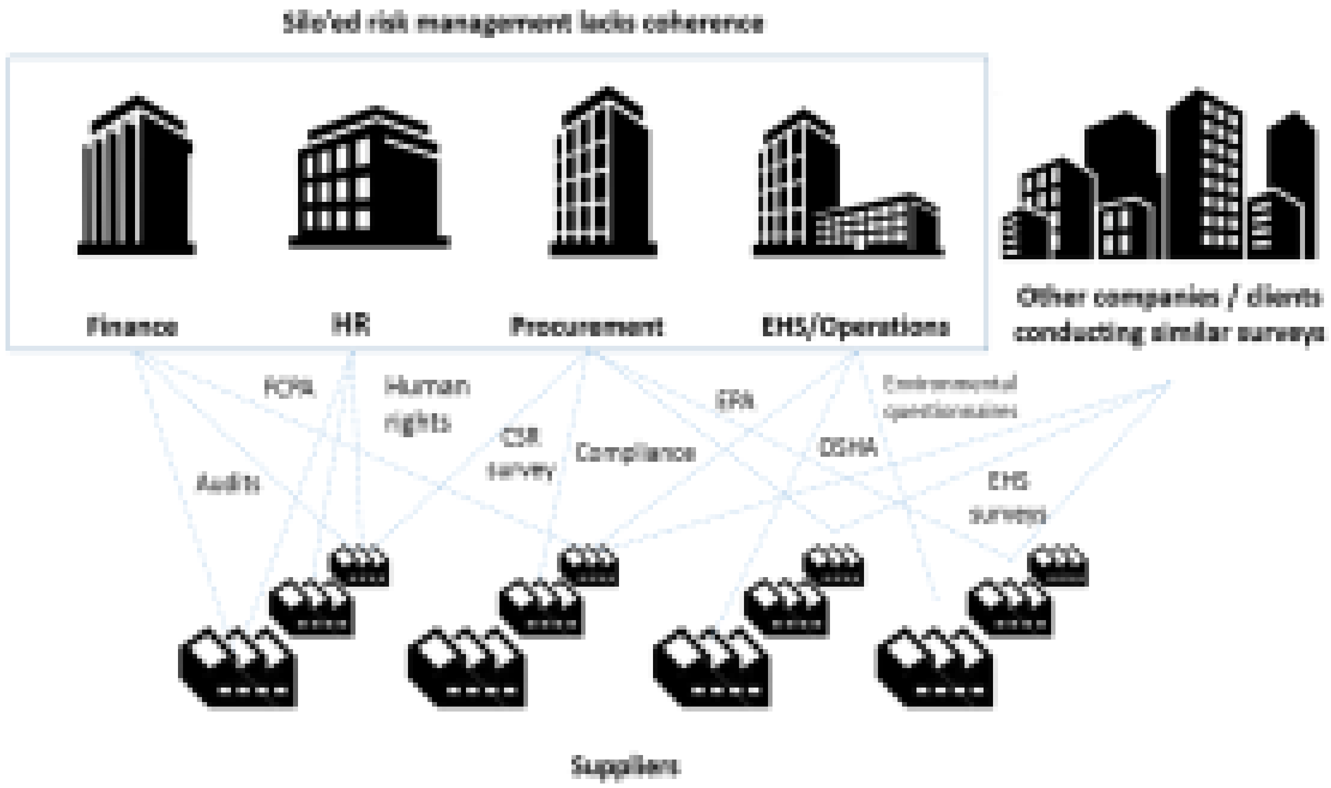

Figure 1: Silo'ed risk management can be complex and inefficient

Each of these departments, following their own processes, will conduct their own supply chain and supplier reviews that will consist of zero or more of the following:

- **internal surveys,**
- **supplier questionnaires, and**
- **third party data source reviews.**

While this sounds good in theory, since it seems likely that all suppliers will be assessed given that, between the various departments, all major categories of risk will be scrutinized to some degree, it is bad in practice. Why? This decentralized, silo approach usually results in:

• a duplication of effort
as multiple departments will be tackling risk but

• some suppliers will be assessed on the same dimensions twice,
as they will receive multiple surveys from different departments on overlapping issues, including environmental responsibility (between Operations and Procurement), child labour and human trafficking (between HR and Procurement), financial and employee earnings reporting (between Finance and Operations), etc. while

• other dimensions for the same suppliers will go unassessed
as Operations might think Procurement will be checking against all restricted, hazardous, and banned substances regulations, and not just the expected target marketplaces or HR might think that Procurement is ensuring its workers' rights requirements are being enforced by the supply chain, etc. and

• some suppliers will not be assessed at all
as their products / services and / or locale means that they need to be assessed only against a few dimensions, and each department thinks the other department is checking them due to the overlaps described above, and this does not address the fact that

• there will be false positives
as some suppliers will be flagged for potential environmental non-compliance even though they are only non-compliant at some locations and Procurement is being sure to not use those locations until the supplier completes the necessary factory upgrades and

• there will be false negatives
as a supplier may pass the HR review and have a supply chain (apparently) free of child labour and human trafficking but would not pass an environmental and sustainability review and does not adhere to European REACH and RoHS restrictions; also, if the organization is IT, Finance might not flag a 5K payment for a server as suspicious, but it could be to an organization connected with a denied party.

At the end of the day, a lot of data will be collected by this fragmented approach, and some decisions will be made independently on specific topics, but no one department (including Procurement) will have a view of what suppliers are covered by which criteria, even for strategic suppliers. Furthermore, there is no authoritative single version of the truth and no authoritative answer on how compliant a supplier is or how risky they are.

Moreover, this cannot be solved by buying a Supplier Information Management (SIM) system and forming a supplier management (survey) team that simply assembles all questions from all departments into one mega-survey, implemented and delivered through a SIM system, in an effort to avoid duplication of effort and make sure all departments have access to all of the data. Why? First of all, not all questions are relevant to all suppliers. A services provider does not need to be asked questions about restricted materials in its manufactured products, for example. Secondly, there is no guarantee that the assembled surveys will cover everything important. As above, each department is typically only interested in preventing against certain risks and may assume that a certain risk is being assessed by another department. Thirdly, and most importantly, this doesn't address the fact that risk management efforts are localized.

Not only are most risk management efforts localized, but companies tend to (over)focus on an aspect of sustainability and risk that is of the highest perceived importance to their industry sector and ignore others. For example:

- **Utilities** tend to start by focusing on environmental regulations. A case in point, the Electric Utility Sustainable Supply Chain Alliance mission still states that it was "formed to promote environmental stewardship".

- **Apparel** organizations tend to start by focusing on human rights.

- **Consumer Packaged Goods** (CPG) companies start with chemical and material restrictions. For example, the Consumer Speciality Products association is highly focused on helping its members adhere to chemical regulations.

- **Pharmaceutical** companies start by focusing on health & safety.

- **Financial** companies start by focusing on health & safety. For example, the American Bankers Association is very focused on Dodd-Frank.

Moreover, these companies tend to start with a compliance focus, instead of a holistic loss prevention and value creation mindset. This is partially due to the dominant analytic approach that most organizations tend to apply when beginning a risk and compliance effort and partially due to to a lack of benchmarks and industry data. Either way, as per our last paper and our introduction, preventable losses are mounting.

"Correlated Risks" are Often Overlooked

There is a strong case forming for addressing risks holistically. For example, as Alison Taylor of BSR (Business for Social Responsibility) points out in her blog post[1] on the relationship between corruption and human rights risks:

> *The correlation between complex supply chains, corruption, and human rights abuses is not unique to the Gulf. In the 2008 earthquakes in Sichuan, China, thousands of school classrooms collapsed, and as many as 70,000 people died. The cause of these deaths was not the earthquakes themselves, but corruption—the schools had been built in a rush, on fault lines, and with shoddy materials that likely weren't up to code.*

This approach not only brings a more holistic stakeholder view, but is quite simply more practically efficient for the companies or governments attempting to monitor the issues. Taylor goes on to state:

> *Anticorruption assessments … could easily be extended to consider human rights issues across the same risk categories—something that would require little extra budget and time while providing extensive additional insight*

A Holistic Approach: The Whole Far Exceeds Value of the Parts

The most effective approach to consistently minimizing preventable losses and to mitigate compliance, disruption, and sometimes even volatility risk is a holistic sustainability and compliance initiative that engages the buyer and supplier communities in a common framework against a common set of goals.

Best practices show that leaders in this area share these attributes:

- *Strong executive leadership and support*
- *Clear statement of values, usually codified in a code of conduct, that covers as many of the core issues that can practically be addressed*
- *Tools for monitoring the full spectrum of CSR risks across sectors, geographies and demographics of the entire supply base*
- *A comprehensive change management program for ensuring adoption of risk monitoring, including communications, training, and integration of the monitoring indicators and results into procurement processes and decisions,*
- *Goals and measurable targets, both for the company and for its suppliers*

In addition, leaders will centralize sustainability, social responsibility, and risk management oversight, often through a center of excellence (COE). This COE, which will identify and implement a holistic approach around compliance, will identify and implement solutions that will be used to assess and monitor suppliers on an ongoing basis.

These solutions will integrate data from internal surveys, supplier reports, third party databases, and third party audits (from respected Non-Governmental Organizations) that can be used to paint a comprehensive supplier compliance, risk and sustainability profile and monitor this picture on an ongoing basis as third party sources provide updates.

The comprehensive assessment and monitoring solution implemented by the organization will allow the organization to address systemic problems that lead to repeated, preventable, losses instead of just reacting to problems identified when government or activist organization inquiries identify violations that result in fines, seizures, and considerable supply chain disruptions. Furthermore, the need for this comprehensive assessment and monitoring is growing by the day, even in industries that are not (yet) well regulated.

As James Cascone, partner, Deloitte & Touche LLP, and leader of the Deloitte Center for Global Food Value Chain said in the CFO Journal[2], *monitoring is becoming more of an issue in less regulated industries.*

For example, the apparel industry has enhanced its risk-monitoring efforts due to risks related to labor and human rights issues. That industry is not necessarily dealing with dangerous or regulated goods, but it needs strong monitoring because many companies in the industry are sourcing from developing countries where the treatment of employees might be in question, unbeknownst to them. The traditional way of monitoring through physical verification—for example audits and inspections—is still important, but there's a growing need for using advanced analytics or risk-sensing tools to better understand where companies are most vulnerable and to take proactive measures to manage risks.

A fragmented approach is no longer sufficient because, as Mr. Cascone pointed out in his article, *supply chain breakdowns often occur between those who execute an operational function and those who have responsibility for managing compliance.* That's why Procurement needs to own the supplier relationship and why sustainability and compliance needs to be the responsibility of a COE under Procurement's control. Furthermore, it needs to use a solution that is capable of assessing, monitoring, and predicting risk. What does this solution look like? Let's look at the Heineken Success story.

Heineken: A Holistic Success Story

Heineken[3], one of the world's largest international brewers, is one of the few companies that has adopted a holistic, centralized approach to sustainable sourcing and risk management. As part of this approach, all of their suppliers (and potential suppliers) are included in their supplier code program that keeps all (potential) supplier sustainability and CSR codes and assessments on file, analyzes them for acceptability, pushes approved suppliers into their sustainable supplier monitoring platform (a 3rd party system that monitors over 24 thousand suppliers across 150 different industry sectors), and audits critical or at-risk suppliers on a regular basis.

This program has allowed Heineken to, among other things:

- Guide suppliers to maturity in their CSR efforts
- Assist suppliers in their use of CSR as a competitive advantage
- Reduce supplier audit fatigue (as suppliers get assessed once)
- Facilitate supplier capability building and innovation (through joint programs)
- Develop industry wide standards for sustainable agriculture
- Initiate or support local sourcing agriculture projects in 11 African countries
- Drastically change the supply of cans in Nigeria, going from the extreme of 100% imported in 2010 to 100% locally produced by 2014

It has essentially transformed entire supply chains simply through better assessment and monitoring. Over time, the benefits it has realized compared to point-based sourcing projects are staggering.

For more information on how a holistic approach can breed success, see our next paper on 5 Questions to Ask When Selecting a Multi-Criteria Supplier Sustainability Monitoring Solution.

EcoVadis has sponsored this paper from Sourcing Innovation, as part of a series. This is Paper 2 of a 3-part series from Sourcing Innovation. Get the other two papers here:

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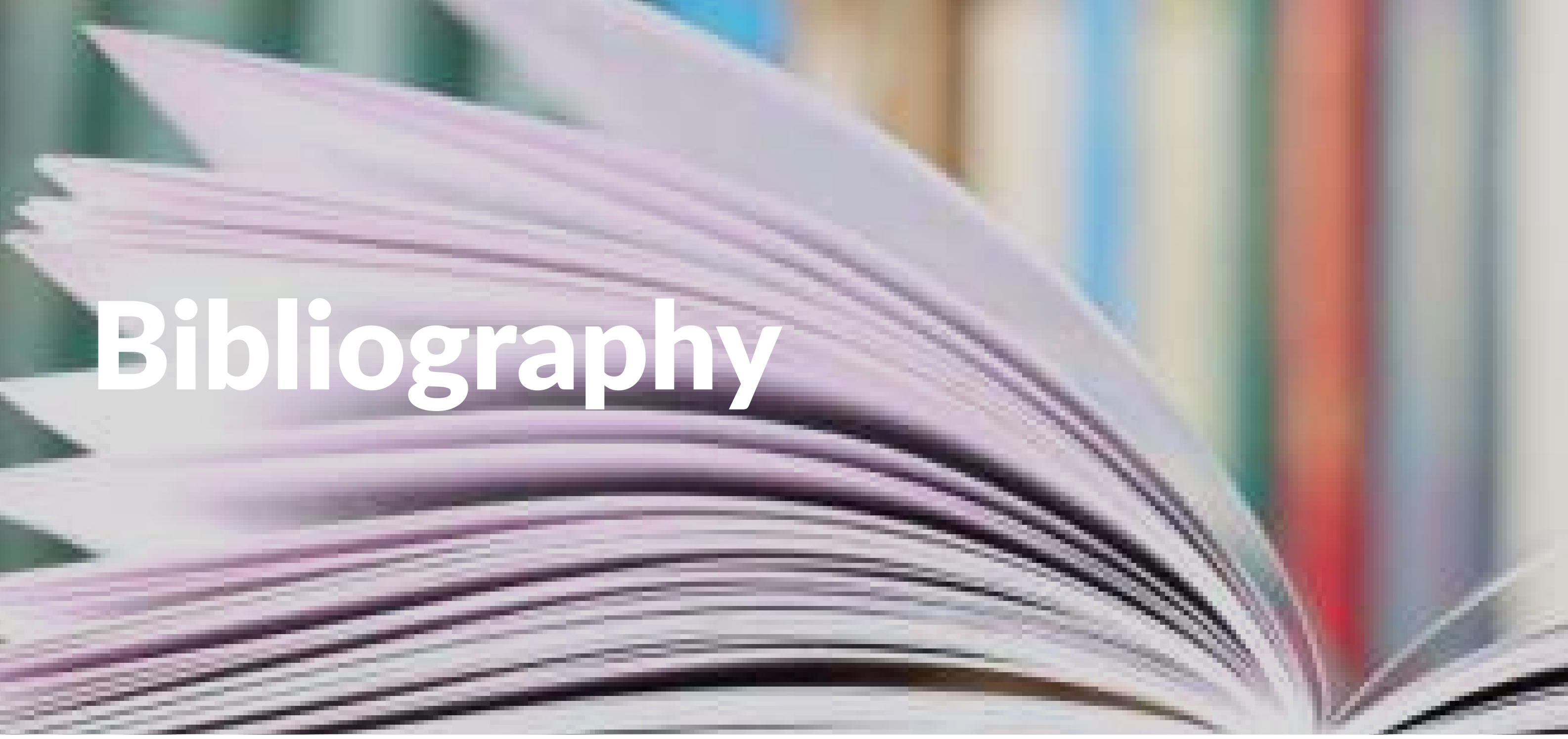

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