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Simplifying Supplier Management with ISG GovernX®

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INTRODUCTION

The outsourcing market today presents a fragmented landscape. We've come a long way from the single, billion-dollar sourcing deals of 20 years ago. Today, organizations of all sizes are choosing to work with greater numbers of smaller suppliers, taking advantage of niche players with specialist expertise either for operational benefits or to access better value for money.

This approach brings with it a new set of issues. Managing multiple suppliers can be a serious headache. Tracking the potential for risk, ensuring compliance and staying on top of the financial and contractual details for dozens, hundreds or even thousands of suppliers takes serious organizational skills and teams of people.

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Most organizations are naturally more comfortable outsourcing work that's closer to their core business. They have a deeper understanding of their requirements and are more confident in their abilities to evaluate the supplier. But delve into more niche areas, and it becomes harder to understand the health of your suppliers, or the potential risk they pose to the business. Can you be confident that you have the information and skills you need to effectively manage the relationship – and related risk?

Now, more than ever, organizations must understand what their total sourcing landscape looks like, how healthy relationships are with each supplier and the potential risk they bring to the enterprise. What parts of your business might be put at risk by a third-party supplier, and what issues pose the greatest risk? How important are these areas to your business function? What is an acceptable level of risk when compared to the benefit the supplier brings and how do you routinely re-assess that risk-benefit analysis? Organizations need a way to answer these questions to confidently manage third-party risk.

Organizations also must consider the cost efficiency of their supplier management processes. What do you need to know to reduce the cost of each contract? Is there value leakage or duplication across contracts?

In this paper, we'll look at how **ISG GovernX®** makes third-party management more efficient, less resource-intensive and less risky.

Maintaining Healthy and Sustainable Supplier Relationships

Ask a random sample of organizations how they manage their suppliers, and you will get a diverse set of answers. Some will have teams dedicated to the task. Some may use databases, while others rely on spreadsheets and a few key employees. Managing suppliers well is different than periodically checking on the health and sustainability of supplier relationships. Good management doesn't necessarily equate to a sustainable relationship.

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Organizations should follow these steps to check that supplier relationships are healthy and sustainable.

Firstly, assess whether the organization needs everything on which it's spending money. Waste can come from several areas. There may be a niche supplier that is no longer needed, but the person who worked with the supplier has moved on, and no one is aware of its existence. There could be two suppliers providing – or able to provide – the same service. Rolling contracts may be renewed unnoticed, bringing with them hefty increases in fees.

Since a supplier is not likely to let you know you don't need it any longer, the onus is on the organization to track usage and value and to control and manage the relationship. Organizations must have the ability to review, track and evaluate the supplier's performance against the service level agreement (SLA) and other more qualitative factors, such as how the partnership helps an organization take advantage of its suppliers' innovation.

How is this tracked in your organization? How do you tackle the outcomes of these evaluations? And can you track what happens if the SLA is breached?

Of course, when you have hundreds or thousands of suppliers, it can be a nightmare trying to keep track of all the deliverables and obligations they've committed to. You might also find commonalities across different third-party relationships that you could handle more efficiently. Organizations need a way to get an overview of these factors and ensure that suppliers are working properly and efficiently.

The more third parties an organization works with, the greater the potential for risk.

Best practices to maintain healthy supplier relationships

1. Maintain governance structures and processes. Hold minuted meetings and follow up on actions, tracking deadlines for completion and escalating issues swiftly.
2. Hold suppliers accountable for contractual terms and compliance by tracking deliverables and outcomes.
3. Focus on the overall relationship with the supplier. There may be many contracts over the lifetime of the supplier relationship, so it's far better to look at the relationship as a whole. Keep active communication between teams.
4. Evaluate the relationship regularly. It doesn't have to be labor intensive; even a light touch health check such as asking the supplier contact "how are we doing?" is a good start. Actively look for ways to make the relationship better; great ideas can come from both sides.
5. Use a system that lets you see all your contractual commitments in one place, providing you with a single, shared version of the truth.

ISG GovernX® ensures that organizations follow best practice in supplier management by providing a central hub to track, manage and evaluate suppliers easily.

Managing Third-party Risk

The more third parties an organization works with, the greater the potential for risk. Those risks might include:

- **Data breaches.** Even global businesses aren't immune to data breaches affecting their third-party suppliers. Organizations that use external partners to store corporate or customer data, for example, should demand evidence of the supplier's security certificate and be confident in the security processes and procedures the supplier has in place.
- **Logistic and delivery problems.** When KFC started working with a new delivery provider, it found it couldn't fulfil its obligations to deliver chicken and other items essential to the operation of its franchise branches. The failure of the new supplier resulted in shops running out of food and having to close temporarily.

- **Supply chain issues.** Businesses that are still operating have experienced supply chain issues during the coronavirus pandemic. An increased reliance on supermarkets now that we're no longer eating at schools and restaurants has placed a **strain on supply chains.** While this specific threat may have seemed far-fetched in 2019, supply chain disruption is always a risk.
- **Compliance.** Does your third-party have the right certification to prove compliance? And do they have the necessary internal processes to maintain certifications?
- **Macro trends.** Is the third-party supplier particularly exposed to macro-economic, political or environmental trends? These may well have an indirect impact on the contracting organization.

Other issues might include financial and contractual risks, such as automatic renewals from rolling contracts, a default on an obligation within the contract or the reputational risks of a third-party supplier getting caught up in a corporate scandal.

We advise organizations consider the following seven key categories of risk when they assess suppliers:

- **Reputational risk** is the impact to an organization's reputation based on a failure or risk event caused by the services or products of the third party.
- **Operational risk** is the impact to an organization's operations based on the supplier's ability to deliver services or products, manage its subcontractors and rely on its technology.
- **Business continuity and resiliency risk** is the impact of a third party's ability to perform in the event of a process failure or catastrophic event.
- **Information security and privacy risk** is the potential impact to an organization in terms of its suppliers' requirements for availability and confidentiality of information and data privacy.
- **Strategic risk** is the geopolitical, regulatory, legal and economic risk of sourcing with a third party in a different location and with a different strategic direction.
- **Regulatory risk** is the impact to an organization based on the third party's ability to comply with regulations.
- **Financial risk** is the risk associated with the supplier's financial stability and viability.

Figure 1: Third-Party Risk Categories

It's common for organizations to focus on the risks posed by larger third parties that tend to require more attention from the customer business. That can mean smaller suppliers fly under the radar, and they can pose significant risk that goes undetected. **By bringing all your suppliers under one process,** you can assess the risk levels across your supplier organizations, not just the biggest ones. We recommend doing this on an ongoing basis. Just because a third party had all its certification up to date a year ago when you started the contract doesn't mean it still does today.

Best practices for managing third-party risk

We recommend the following steps to assess and manage third-party risk:

1. Implement a risk compliance management framework that identifies risk during supplier selection and at the contract stage. It should then go on to manage risk throughout the delivery of work.
2. Use risk-tiering. Assess what sort of risks the supplier relationship poses and what impact an event would have on the organization. Then allocate the resources needed to manage that risk.
3. Use the contract to establish compliance and regulatory requirements.

4. Don’t settle for the supplier’s assurance that it is compliant. Ask for proof, such as certification documents – and keep track of whether that proof has been provided. Maintain a list of expiry dates so you know when the certification expires. Keep track of the stages of each requirement: which have been completed and which are outstanding.
5. Include trackable deliverables in third-party supplier contracts. Track metadata from suppliers to ensure they are delivering on compliance obligations.
6. Conduct regular compliance assessments for high-risk third and fourth-party suppliers.
7. Monitor suppliers’ ability to deliver on contractual obligations and keep an eye on changes to their partner ecosystems, as these could affect your relationship.
8. Note and track any macroeconomic and geopolitical changes in your supplier’s region. Monitor for infrastructure changes and major people-related changes the supplier is going through. For example, if a supplier suddenly makes a significant proportion of its workforce redundant, what would this mean for the delivery of the agreed work?

Prioritize and focus resources on actions that can provide the most benefit in managing third-party risk.

Prioritize and focus resources on actions that can provide the most benefit in managing third-party risk:

1. Capture and consolidate contract information so all decisions regarding third-party risk are based in data.
2. Determine the provider relationships that pose the most risk to the organization and allocate resources accordingly.
3. Review and score the business continuity planning controls of your suppliers based on their adequacy and identify deficiencies that require remediation.
4. Develop remediation actions that are required to mitigate risk exposure.
5. Assign stakeholder responsibility and track remediation resolution through closure.

Reducing Cost

Through proper third-party supplier management, organizations can assess how much cost is wasted in contracts that are not managed efficiently and reviewed regularly. It’s not just a matter of major issues – like unnoticed auto-renewed contracts hiking up the supplier fee – but smaller, everyday issues that fly under the radar. We call this "value erosion" or "value leakage," and it can amount to as much as 30 percent of the contract value. Figure 2 below shows the discrepancy in anticipated business value and realized business value that can happen when contracts are not managed effectively.

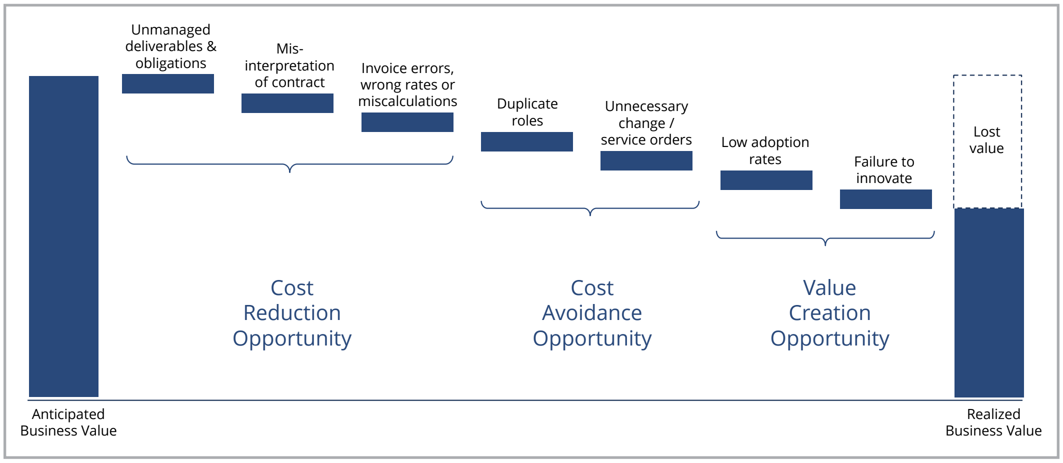

Figure 2: Value Erosion

Seeing and tracking discrepancies in cost such as expectation versus delivery is another area where a platform like ISG GovernX® helps organizations regain control of their supplier management process.

Best practices for reducing cost

To effectively manage contract costs and guard against value leakage, we recommend organizations:

1. Validate invoices against the rate cards agreed in the contract and take other documents into consideration, such as timesheets, discount structures, rebates and service credit expectations
2. Manage new work orders centrally
3. Optimize spend by avoiding overlap and duplication
4. Invest in the right areas and ensure adoption of technologies and services.

Conclusion

There's a tremendous amount of information organizations must consider when they enter into a supplier relationship; this work is increased dramatically when those suppliers run into the hundreds or even thousands.

Every supplier relationship poses a different sort of risk and requires a different level of management. Each has SLAs to meet and unique issues to face, which can have a significant impact on your organization if not managed properly and strategically.

It is almost impossible to do this manually. Even the best and most efficient teams will need the right tools to help them avoid making errors in contract management, stay on top of regulation and compliance requirements, and extract the greatest value from the relationships. This is why we created ISG GovernX®: to give organizations the tools they need to assess the overall health of their third-party relationships, reduce costs and mitigate risk.

ABOUT THE AUTHOR

Simplifying Supplier Management with ISG GovernX®

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Eleanor is a director with responsibility for digital sourcing in ISG across EMEA. She is responsible for shaping the sourcing offering and proposition across EMEA; ensuring that we understand our customers' evolving needs and continue to address them with best-in-class capabilities. In the past she has led a number of successful European advisory organizations, including Quantum Plus, Source, Alsbridge and SIG. Eleanor has led teams to success in the Global Sourcing Association awards for innovation and achievements in sourcing. She is a advocate for adoption of emerging technologies and ways of working and has extensive knowledge of RPA, AI, IoT and Blockchain.

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