Spend Matters / MetalMiner Perspective

Supply Risk Management and Supplier Performance Management – Managing Your Supply Base in Real Time

From Batch to Reality

Outside of procurement, no one seems to talk about supply risk and supplier performance failures in so many words. But the evidence of organizational inability to adequately manage vendor risk and performance is never too far from the headlines. In fact, in recent quarters, it has been possible to see an accelerating trend of product recall issues, other quality challenges, tainted / counterfeit parts and ingredients, use of “conflict minerals”, labor strikes and demands and perhaps the form of supply risk that gets the most attention, supplier financial failures. In fact, the number of US business bankruptcies continued to increase on a yearly basis in 2009, despite an upswing in GDP by year-end. *Figure 1*, below, highlights information from the Administrative Offices of the US Courts showing that domestic business bankruptcy reached an all-time high in 2009 of 60,837. And many more businesses simply closed their doors without filing for liquidation or restructuring.

Spend Matters analysis based on information and citations from D&B, the Turnaround Management Association and Dow Jones suggests “The number of businesses filing for bankruptcy in 2009 increased 38% over the prior year, providing a measuring stick of the widespread economic crisis that likely will continue to put pressure on companies in 2010.” And as “As long as there are certain economic conditions, there is a substantial risk of business insolvency and bankruptcy for many companies.” Moreover, some sectors have been harder hit recently than others. One estimate suggests the 2009 year-over-year change in manufacturing bankruptcies hit 62% domestically.

Figure 1: US Business Bankruptcies – US Court Data

Year	Q1	Q2	Q3	Q4	**Total**
2007	6,280	6,705	7,167	7,985	**28,322**
2008	8,713	9,743	11,504	12,901	**43,546**
2009	14,319	16,014	15,177	15,020	**60,837**

Participation in global markets has not proven any easier. Companies often find themselves working with suppliers in low cost countries who often appear to be in a strong cash position and willing to take new orders on one day, only to find themselves subjected to sudden demands for early payment or help with financing just to fulfill obligations the next. Central to the continued supplier financial risk challenge, is what we see as a bifurcated credit market situation where large organizations on strong financial footing can borrow at low interest rates while smaller and medium sized organizations without the same track record – or with red flags on their credit – find themselves paying double-digit APRs to borrow in a range of markets. The recent debt crises in Greece, Spain and Portugal has made borrowing more challenging and costly throughout the troubled EU region and has also increased the price of imports and raw materials for suppliers as the Euro has plunged to recent all time lows.

Within this environment, finance, procurement and supply chain organizations must react far more quickly than ever before to detect changes in the financial and operating condition of their suppliers. Waiting an extra quarter or month to intervene can easily make the difference between having enough time to identify new suppliers or develop existing, troubled ones versus having to shut down a production line or service center. But the problem for many organizations is that traditional systems and process approaches (e.g., manual or infrequent batch-based analyses) to ameliorate supply risk just aren’t cutting it.

Unlike periodic – say quarterly – spend analysis updates or staff or supplier performance reviews which often serve as a more than adequate means to deliver the desired procurement ends, companies must learn to react far more quickly, on a real-time basis, to financial and operating changes in their supply base. The existing paradigm that many companies are operating in when it comes to supply risk is the equivalent of putting on an old fashioned lap safety belt and lapping a car racing track at 150 MPH. Sure, it may give the average driver some sense of safety and security. But in most accidents, such preparations will prove wildly insufficient.

Is Supplier Performance Management the Antidote to the Poisonous Supply Risk Environment?

One of the challenges of managing supply risk, especially in global market environments and with small and middle market suppliers, is that the sources of publically available credit and financial information often leave quite a bit to be desired. The accuracy of D&B and their competitive rating organizations is most accurate for suppliers that exceed $100mm in revenue (some even argue that at <$200mm in revenue, credit and risk rating information can be quite inaccurate). The quality of global information, especially in emerging supply markets like China and India, often remains a challenge, even at the middle-market supplier level. Because of these challenges, many organizations have opted instead to base intervention metrics driving their supply risk and development programs on performance-based information as much as they do on credit or financial data. Supplier performance management (SPM) approaches that track a variety of qualitative and quantitative metrics (e.g., SLA adherence, PPM, escapes, on-time performance, responsiveness, stakeholder satisfaction, invoice accuracy, etc.) can be telling indeed when it comes to not just how good a supplier is overall and how they are trending over time, but if there are also underlying financial or other operational issues that should raise overall risk red flags.

Sherry Gordon and Spend Matters Jason Busch gave a talk at the 2010 ISM conference highlighting supply risk and performance management approaches. In their presentation, they suggested an overall rationale for investing in the performance management area, offering a range of reasons why companies pull the SPM lever. These include: a better understanding of who suppliers are, building better insights into actual supplier performance, building closer working relationships, identifying risks using early warning signs, preventing and mitigating supply risk, setting criteria for new supplier on-boarding and approved supplier lists, rationalization of a supply base, disengaging with low performers and high-risk suppliers, giving more business to high performers, identifying supplier continuous improvement opportunities, gaining insights that help suppliers improve their performance and reduce costs and risks, working on development projects with suppliers and creating a certification program.

While many of the reasons that companies invest in SRM can bring substantial benefit in their own right, a surprising number tie back to the broader opportunity of tackling supply risk. There are three reasons, according to Gordon and Busch, that supplier performance is valuable in analyzing supplier risk:

1. Less risk data is available for small to middle market suppliers
2. Internal supplier performance data provides more timely insights with perhaps greater quality. Examples include: late deliveries, lengthening cycle times, reduced responsiveness
3. Relationships provide valuable insights and a mutual opportunity to take action

What components should companies look for in a supplier performance management automation solution? Busch and Gordon suggest the following key areas and capabilities:

- Supplier survey and assessment development and deployment
- Systematic collection of assessment results
- Stakeholder satisfaction surveys
- 360° evaluations
- Creation of KPI formulas
- Ability to import KPIs and performance data from other systems
- Rolling up KPIs to scorecards
- Sharing scores and results with suppliers
- Trend analysis
- Alerts regarding performance issues

- Measuring against contracts and SLAs
- Tracking corrective actions and improvement plans
- Site visit or audit support

With these specific automated capabilities, procurement organizations will find themselves able to survey and monitor a much broader percentage of their supply base, as well as to zero in on performance monitoring and development activities focused on a subset of more strategic suppliers (or for those that raise a red flag at any point in time during a performance monitoring program). But perhaps most important, SPM tools can enable companies to monitor their suppliers on a consistent basis (e.g., systems data pulled on a weekly or monthly schedule) as well as potentially pull in third-party information on a dynamic basis. This not only allows companies to more accurately monitor both SMB and large suppliers from a supply risk standpoint, but can afford the early warning of potential issues that only performance data is capable of providing, either independently or in conjunction with financial profiling and monitoring.

Rising to the Risk and Performance Challenge

In developing supply risk programs, it is important for organizations to consider a range of criteria for evaluating and forecasting different risk elements in their supply base. Supplier performance management is most certainly one critical component of a broader supply risk monitoring program, but other elements are often essential as well, especially those based upon industry and region. For example, a retailer may place extra emphasis on insuring compliance to certain labor standards across all of its supplier facilities, even in developing economies, lest a single violation from accepted protocol translate into front-page grabbing negative headlines. Or in the industrial or construction sector, an organization may opt to monitor tractability within its metals supply chain for government-related work to make sure raw and semi-finished materials meet specific standards (e.g., Buy American Provisions of stimulus packages).

Our research suggests the following areas are those that companies often prioritize to monitor in broader supply risk management programs outside of performance data:

- CSR and social responsibility (including labor, Co2, hazardous substance compliance/certification and related information)
- Financial/credit/banking supply risk
- Import/export compliance

Organizations most frequently use this information when they're able to either collect survey and compliance information directly from suppliers and/or when information is available from third-party content providers (e.g., D&B, Equifax, EcoVadis, Bureau van Dijk, Coface, etc.)

Consider ArcelorMittal, the world's largest steel producer, with operations in more than 60 countries and thousands of global suppliers, heterogeneous IT systems, mixes of business cultures, reporting structures and change management challenges.

The company sought to harmonize supplier information world-wide across all sites, identify and reduce supplier risks particularly around safety, product availability, continuity of supply and quality as well as financial and credit risks. The company also wanted to increase negotiation leverage with documented supplier performance data, particularly in sharing that data across all business units and geographies as well as complying with new European ISO requirements (particularly ISO 9001, around supply chain and supplier information).

The company implemented a Supplier Performance Management system (SPM). Despite several challenges, ArcelorMittal received numerous benefits, including: global visibility to supplier performance, traceability and historical analysis of supplier performance, improvement plans and better insight into supplier decision-making. The company also received several financial benefits and in particular, specifically increased negotiation leverage and cost reduction via contract renewals (this last benefit had become an unintended [positive] consequence of implementing the system). From a productivity standpoint, the company saved huge amounts of time with the harmonization and consolidation of performance evaluation practices, and team members felt a greater sense of accomplishment for having the ability to deploy more objective supplier assessments and evaluations.

ArcelorMittal has put more than 1,300 suppliers thorugh the system, each evaluated against more than 30 criteria. ■

Aggregating, analyzing and obtaining the right set of risk and performance data is just the ante toward building a foundation for supply risk and supplier performance management success. Top performing companies not only collect and present this information to stakeholders, they also do so by extracting and sharing the data in a powerful way. For example, they expose this information not just in a separate application or Excel file as part of a monthly reporting cycle; rather, they provide it in the context of a broader suite of sourcing and procurement capabilities (e.g., e-sourcing technology, supplier management tools, spend visibility, requisitional buying/purchasing, contract management, etc.) In this integrated context, companies can begin to share, roll-up and analyze information across functions and sites, avoiding information silos, while also being able to analyze detailed performance information at all points in the sourcing and procurement lifecycle in a common environment within the application itself.

Yet not all companies are this sophisticated when it comes to managing performance and risk – not to mention implementing a broader suite of enablement and automation solutions. Many know they must target risk and performance opportunities to reduce and avoid unnecessary costs – not to mention other qualitative dangers, e.g., brand/reputational risk – yet are not at the level of overall procurement functional maturation that they can do so in a truly world class manner. For these organizations – not to mention even more sophisticated companies – it is an invaluable exercise to understand where your organization lies on an overall capability/maturity model. This can help you gauge the best solutions to help you move to the next level of performance given the organizational, process, team and technology constraints. *Figure 2*, below provides a simple maturity model that can help organizations understand what typical risk programs look like based on overall procurement sophistication in the context of other sourcing and supply management functional and technology areas.

Figure 2: Understanding Organizational Sophistication and Maturity in Procurement

Area	Level 1	Level 2	Level 3
Spend Under Management	Targeted category-based approaches to bringing spend under management (e.g., office supplies, IT hardware, etc.)	Spend under management looked upon from a % standpoint—% spend managed, % suppliers e-enabled, etc.	Achieving > 50% spend under management across a broad range of categories; focus on compliance and visibility across the entire process
Services Procurement	Low-hanging categories and areas targeted as one-off efforts (often through hosted applications); often driven by MSP relationships	Enabling tools and information on a category basis available outside of purchasing; significant savings and traction	80+% of services spend under active management (even spend controlled by front-line employees); rigorous processes and systems
Technology Environment	Mix of hosted and installed applications; point-based efforts with batch integration; IT detached from efforts	Business needs and architecture drive investments; integration points understood; possible platform standardization	A standardized—or virtual—platform with tight process, category, and functional integration; "early adopter" perspective
eProcurement Environment	Roll-out limited across the broader organization (or in process); limited focus on supplier enablement, content management ,etc.	Focus on adoption and translating implementations into hard-dollar returns; starting to embrace a broader enablement ecosystem	eProcurement is procurement—for all non-direct spend categories; significant focus on SIM, closed-loop compliance, etc.
Invoicing / EIPP Environment	Invoicing as an extension of eProcurement—not as a stand-alone initiative; limited coordination of A/P procurement efforts	Automation of function and integration of invoicing with overall procurement workflow; analytics/functional coordination a part of effort	Invoicing foundation allows new initiatives (e.g., supply chain finance); often shared service or outsourcing in larger organizations
Risk Management	Reactive approach to risk management. Either ad hoc or coordinated response to supply risk events. No formal process or contingency plans in place.	Proactive approach. Anticipates risks and has developed formal processes and contingency plans. Purchasing responsible.	Cross functional and well-developed formal approach across organization. Specific risk expertise and resources. Top execs and key suppliers involved.

The first step in the process involves an assessment of the organization's maturity with regard to supplier performance management and supplier risk management. The KPIs, variables and metrics may all differ among industries but every industry can benefit from having real-time access to key performance indicators. Companies like Honda have long known that performance management metrics precede financial difficulties. Two late shipments for example, from a supplier with a yearly history of no late shipments can sound a warning sign well before the company files for bankruptcy or reorganization.

Having the means to identify these signals quickly can make all the difference between shutting an automotive line down or quickly switching to the pre-qualified alternative supplier. Supplier development teams can deploy quickly and in advance of supplier failure when companies monitor risk in real time. Leading industrial organizations know that current supplier operational performance metrics precede changes in financial stability. Just as the price of a recall always exceeds the cost of identifying a problem earlier in the product development life cycle, the earlier a procurement organization can spot changes in performance and risk criteria with suppliers, the more likely it is to avoid costs – both direct and indirect – that exponentially exceed the small price of monitoring and early intervention. And it certainly pays to stay out of those nasty front-page headlines now too, doesn't it?

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