

Supply Chain Risk Management: Current Models, Issues and Solutions



Report Contents:

- How do organisations approach risk management? What processes are used and how well do they work?
- How do people keep track of the results of their supply chain audits and are the various systems integrated and or centralised?
- Who is responsible for managing the process?
- What type of standards are suppliers audited against and where do these standards come from?

Introduction

There is an ever increasing pressure on companies to ensure that they fully understand their supply chains. It is necessary for companies to be able to understand and limit the operational risks they face with regards to management of quality, health and safety, environmental, business continuity and corporate social responsibility. In the modern business world protecting the brand is essential. Therefore supply chains must be run both efficiently, effectively and ethically.

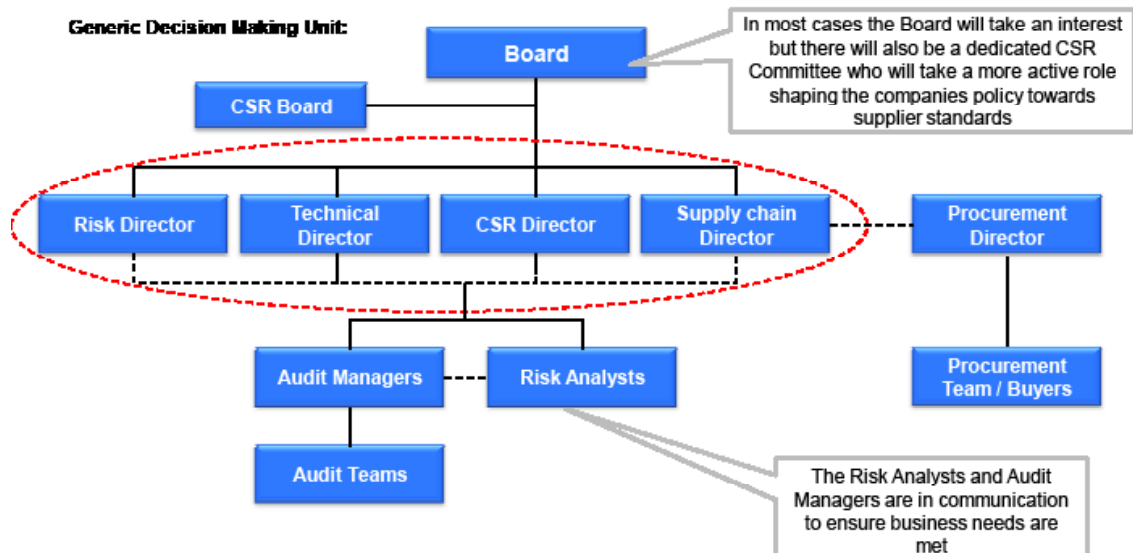
Set against a backdrop of global economic downturn, rising commodity prices, increasing competition for limited resource, greater global instability and larger more complex global supply chains; is everyone really keeping up?

The recent series of media stories relating to the supply chain practices of UK retailers clearly demonstrates the dangers of a poorly audited supply chain when it comes to corporate social responsibility (CSR) and ethics. However, Directors are equally as concerned about business continuity when reliant on critical suppliers. This problem has been put into sharp focus by two recent events in China: the halt on all manufacturing in the Beijing region for 2 weeks prior to the Olympics and the devastation caused by the earthquake in the Sichuan province. Though these two events have not had as large an impact as the clothing retail problem they have made Supply Chain and Risk Directors sit up and take note. All of these examples stem from the ever increasing global nature of supply chains. So how are different organisations addressing these issues?

In order to find out, White Space Insight has interviewed decision makers at 25 different retail, manufacturing and services companies, based in the UK, but with global supply chains. Our discussions have focused on how organisations are auditing their supply chains, and where the key challenges lie.

Who's responsibility is Supply Chain risk management?

The importance of supplier auditing is clearly recognised by retail and manufacturing organisations, but who's responsibility is it within an organisation to oversee and manage the system? The level of importance given to the issue is highlighted in the generic representation of the supplier risk management decision making unit below. There are four key job roles who may take the lead role in the process, each with a direct line of reporting



to the Board.

Most companies see supply chain auditing as very separate to commercial discussions or service level agreements (SLA's):

“Supply chain and procurement are both of course heavily involved in choosing a new supplier but the auditing is my responsibility. The Procurement team arranges processes and SLAs and the like, the more operational aspects”

CSR Director, Retailer

However, there are also a number of subtle differences across different industries. The role of Technical Director generally only appears in the food manufacturing industry. Where this role exists they have overall responsibility for supplier auditing. This is because the single most important aspect of supplier auditing in these organisations is the assessment of food safety procedures and all other areas for audit, for the sake of efficiency, then fall under their remit.

In most cases the role of CSR Director is only found at the more consumer focused companies, as would be expected, though their role is more practical than solely being PR focused, *“ensuring that high safety, quality and ethics standards are upheld throughout all operations”* (Manufacturer). A major driver for these actions is brand protection.

In the PFI and construction industries the responsibility for supplier auditing lies with the Supply Chain Director. Traditionally construction companies have not faced the same degree of public scrutiny as other industries and have been primarily concerned with results and timely delivery of projects. This however is changing with the interest being shown in high profile government projects and this may see the development of new roles in the future.

“We are responsible first and foremost for food safety along with any other ethical concerns being checked to confirm that business can be done with the supplier”

Food Manufacturer

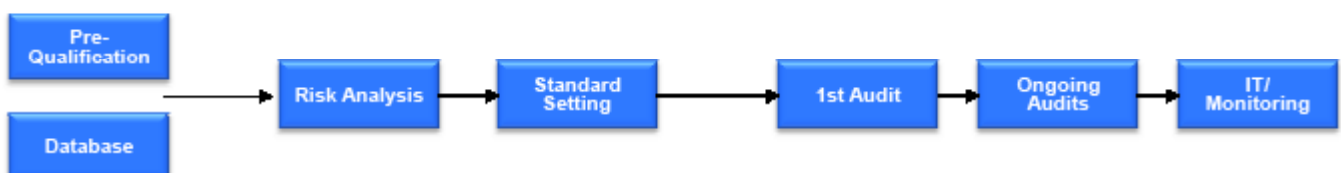
Supplier Management Process Overview

There is a common process followed by most firms in auditing their supply chains. The most simple way of representing this is through understanding the process by which new suppliers are identified, risk assessed, audited and monitored.

The initial stage when engaging a new supplier is to either send out a pre-qualification questionnaire (PQQ) or to check their entry on an industry database such as Sedex. If a supplier passes minimum requirements of quality and reliability at this stage, companies undertake a risk analysis. After this

How do different organisations approach supply chain auditing and where are the biggest issues?

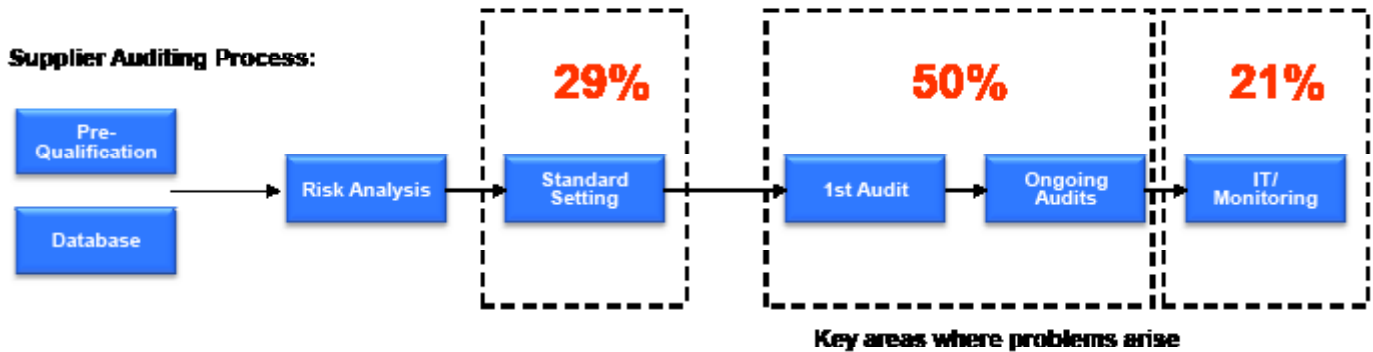
Supplier Auditing Process:



has been performed, the standards against which the supplier is to be audited are decided upon. Once standards are agreed, suppliers are audited in depth initially and then on an ongoing basis to ensure compliance and continual improvement. Monitoring and processing of audit results are handled by designated IT systems and produce relevant management information.

Where do the biggest issues arise?

The most common problem being faced by the companies interviewed is lack of auditing capacity. 50% of the companies interviewed felt that they often did not have enough internal auditing resource to be able to carry out the process to the correct level of quality.



“We could do with extra resource at times, we are not always able to audit against all the issues as we would like to” Retailer

The next most common area of concern is at the ‘Standard Setting’ stage, where companies often find it difficult to keep on top of the vast array of international and industry standards published on a regular basis. 21% of companies also felt that their IT systems did not provide a central repository for supply chain audit management or generate the correct real-time management information for reporting processes. So what are the main differences and similarities at each stage of the model?

Pre-Qualification

The first stage of the process varies from company to company. Some rely heavily on databases such as Sedex for their initial supplier information and others rely solely on an initial PQQ which must be signed off by senior management at the suppliers firm.

All of the companies interviewed within the food industry used Sedex but this did not preclude the use of a PQQ. Companies believe that using Sedex is advantageous to both the supplier and the purchaser. The supplier’s credentials are “pre-proven” by their Sedex listing, limiting the auditing pressure on the supplier. The purchaser also benefits from the ready, easy, instant access to up to date information on their suppliers and potential suppliers.

The main criticisms of the database system are that audits can be too generic and that certain points in which the purchaser might be interested are not addressed.

Risk Assessment & Standard Setting

The information now available is used to determine the risk associated with the supplier or product category in which they sit to decide if further auditing is required and then against which standards they should be audited.

“The risk analysis depends on factors such as commercial activity, severity of

potential risk and the incident history

Construction Firm

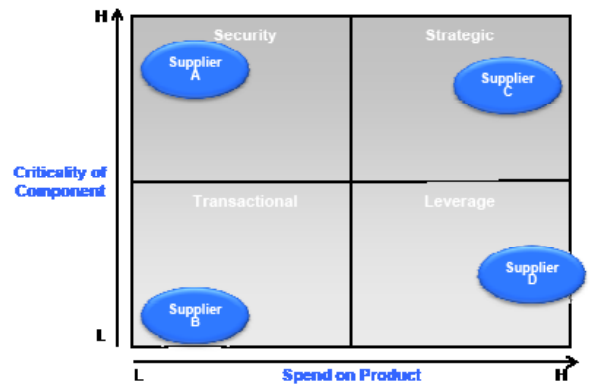
Factors such as volume of business and criticality of supplier are also considered at this stage.

The more important a standard is to a company the more likely they are to tailor it to their own specific needs. The table below compares and contrasts the different areas of focus within each industry sector.

Key Variations by Industry Sector:

<p>Construction and PFI</p> <ul style="list-style-type: none"> - The most serious area of concern for the construction companies is health & safety (H&S) especially when auditing a contractor - A close second to this is environmental, due to the obvious public environmental impact of large scale construction work 	<p>Food Manufacture</p> <ul style="list-style-type: none"> - These companies are most interested in food H&S and ensuring that their suppliers have good systems in place to ensure their ingredients are not harmful to the end user - These companies are also concerned with ethical sourcing 	<p>Food Retail</p> <ul style="list-style-type: none"> - Because these companies are more directly customer facing and not so involved with the food manufacture themselves, both environment and food safety are of great importance
<p>Business Process Outsourcing</p> <ul style="list-style-type: none"> - The main concern for these organisations is information security - (Information security is of course a concern in other industries – but it would appear to a lesser extent) 	<p>Technology / Aerospace</p> <ul style="list-style-type: none"> - The single most important area is consistent high quality - The environment is also becoming an ever more important issue and ISO14001 is being given increased recognition 	<p>Electrical / Mixed Retail</p> <ul style="list-style-type: none"> - This sector has the least specific and focused concerns - Companies are concerned with their suppliers being up to statutory standards in all areas

Supplier Risk Management Matrix



One of the major challenges in this area is that there are a multitude of standards and ascertaining the most appropriate can be difficult.

“One of my biggest problems is the large number of standards available across the globe”

Retailer

When the issue is of particular importance a company might want to tweak an industry or international standard and in extreme cases if a company feels none of the available standards are applicable they will design their own bespoke standard. This is more expensive and requires high levels of internal expertise.

“Our typical model would be to take the appropriate industry standard and then bolt on an internal standard to complete the criteria for auditing”

Retailer

“In an ideal world, we will look for ISO’s, but in areas such as sustainability these are quite immature”

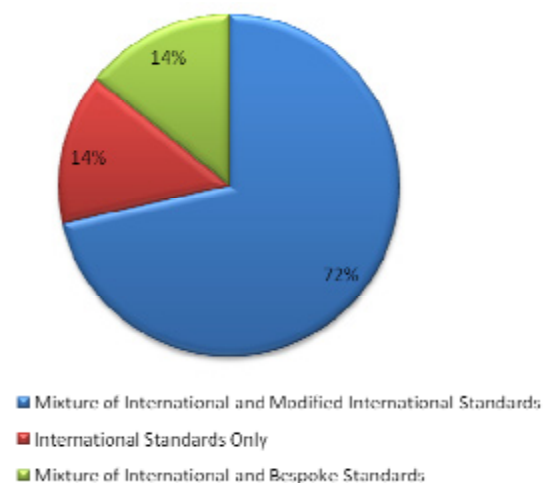
Construction Firm

“We have developed our own internal protocol that goes into much more depth than ETI”

Retailer

This internal expertise is not always available, for instance when the company is either entering a new market or when the area of concern is very specific: this results in this part of the process being outsourced.

Types of Standards Used



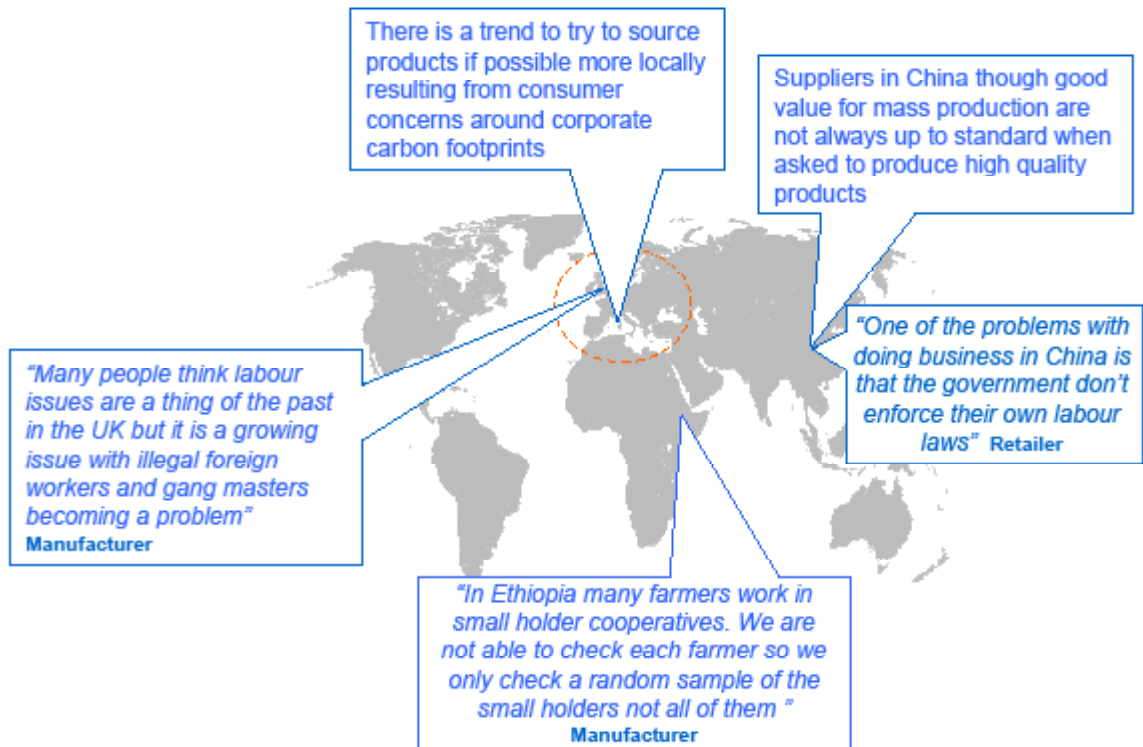
“When deciding on changes to policy or new requirements in terms of standards we will get external auditing advisors and the category managers to work it out. We sometimes lack specialist knowledge in new areas”

Construction Firm

What are the pros and cons of current auditing models?

Auditing

With supply chains often being truly global, audits have to be performed in diverse locations; and each region has its own specific challenges.



Cost of travel, difficulties in resource utilisation, expertise gaps and lack of local understanding are all common problems where companies use exclusively in-house auditing staff.

“Having full-time in-house auditors is problematic as often they are only working a 20 hour week, but being paid a full wage”

Construction Firm

“We could do with extra resource, it is not always possible to do all desirable auditing”

Manufacturer

“Sometimes we lack internal expertise in specific areas, either as a result of it being a new area or being very specialist”

Construction Firm

“Too much of our own auditor time is spent checking on new auditors”

Retailer

“The problem is that we don't always have local people and that can cause communication problems”

Retailer

Those undertaking the audits need to have a thorough understanding of the product the supplier is producing. This means that many of the auditors also have other product specific roles and they are not auditing full time.

“We are presently in the process of replacing our internal generalist auditors with product category specialist auditors, who have product specific knowledge and can perform other roles beyond auditing”

Construction Firm

Often in-house teams simply cannot react to critical supply chain events quickly enough. Recent examples would include spikes in commodity prices, fears of global pandemics, global warming, failed harvests and natural disasters. Auditing resource inflexibility then either impacts upon the efficiency of the supply chain or the level of risk associated with it.

“It can be difficult getting our own people out to various places... We’ve had trouble getting X [existing auditing supplier] into Y [country] quickly under similar criteria”

Retailer

“For us having the flexibility to get someone into a factory anywhere in the world quickly would be something we would be interested in”

Retailer

So would holistic outsourcing of supply chain auditing and risk management to a trusted partner help solve these issues?

Quite possibly - though this is extremely difficult to test as there does not seem to be a holistic service offering operating within the market at the moment. Indeed our research identified no instances of holistic supply chain risk management outsourcing within companies headquartered in the UK.

Instead, around 50% of organisations interviewed had sought to reduce the impact of some of these internal resource issues by outsourcing a modest proportion of their audits to 3rd parties. However even in these cases, only 15-20% of audits were outsourced, with organisations preferring to keep as much control over the process as possible. General views on existing ‘2nd party auditing’ suppliers were neutral or dissatisfied, with companies seeing outsourcing as more of a ‘necessary evil’ than a strategic improvement tool.

Companies who did outsource auditing days primarily used the additional resource for non-critical auditing in ‘out of the way’ locations, and for repeat auditing of ‘safe’ suppliers.

Organisations see auditing as a critical touch-point with suppliers. Getting the relationship off to the right start is seen as something that only an in-house auditing team are capable of:

“The initial audits are always done by an in house auditor to create a relationship and then the re audits in most cases are done by external auditors”

Retailer

There is also a great deal of scepticism as to whether 2nd party auditors can demonstrate enough of an understanding of not only the industry, but the specific needs and drivers of the company themselves. Outsourced auditing is also seen as not flexible enough to add value to audits and too focused on pass/ fail rather than on improvement:

“There is a stigma attached to 3rd party auditors – in the past there have been a number of times when they didn’t drill down in areas they should have done”

Retailer

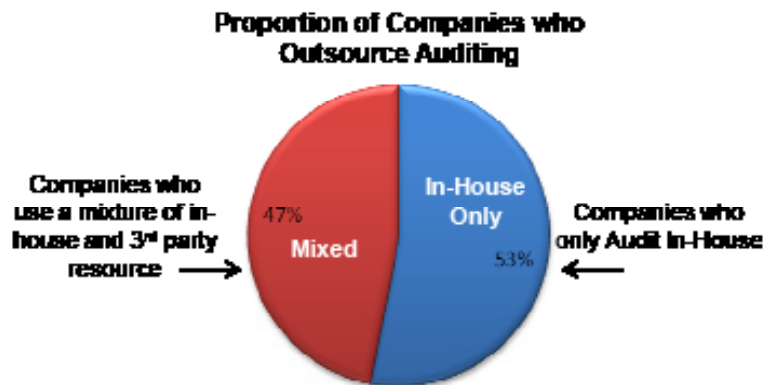
“3rd parties won’t understand what is important to us”

Construction Firm

“Auditing is an opportunity to build relationships and improve performance – a 3rd party would not enable this”

Manufacturer

These concerns over outsourcing seem to be in part a manifestation of the



“Accredited auditors only spot faults and don’t help to fix them. I won’t have non value-add audits”

Retailer

“What would be great would be an end to end system that gives total visibility”

Construction Firm

general dissatisfaction with the current providers of outsourced auditing within the marketplace.

Monitoring and IT

The final part of the process as shown in the earlier diagram is the monitoring stage, underpinned by an IT system. It is a microcosm of the audit process as a whole- all parts must “connect”. The best IT systems all had similar properties; the most notable of these being that they were designed with the supplier in mind, the system was centralised and gave automated prompts when any action was required.

The main problems with the IT systems include the fact that they *“can be difficult to navigate around”* (Manufacturer) and that they are not centralised meaning that information is disparate. In both instances this results in the information being difficult to access and therefore hard to use to its full potential. Often this is a legacy of merger and acquisition activity, where IT systems were not intended to work together and the new conglomerate has yet to undertake a full enterprise software implementation such as SAP.

In the most extreme case, one organisation was forced to manage their auditing programme manually through a series of Word documents, having a huge impact on the amount of time and resource spent on maintaining the system.

Conclusions

UK companies are constantly working to improve their supply chain risk management processes and procedures. Some are just beginning the journey of process improvement, but others feel they have the matter well in hand. However, even those organisations who have highly developed supplier auditing processes still struggle to get the right auditing resource to the right location across the globe at an efficient cost and effective lead time. Other organisations spend a great deal of internal resource on getting to grips with constantly updated international standards, whilst others are unsure of whether they may become the next ‘public relations casualty’ because their IT systems do not give them the right management information.

Despite all of these issues, very few companies seek external help through strategic partners, perhaps because at this point in time there are no credible organisations offering a holistic solution to support the entire process. Companies currently offering component services are not well respected and seen as little more than ‘box-tickers’ or ‘a necessary evil’.

Many companies admit their own supplier auditing procedures are not perfect but have not been able to find a partner who they believe can do a better job. There is clear white space within the market for an organisation offering a partnership approach to the issue, with the provision of an end to end service, encompassing aspects of Standards Consultancy, Auditing and IT Monitoring Systems. The optimal model will need to deliver not only a service which increases the level of confidence, quality and control within the supply chain, but yield additional cost saving benefits.



Authors

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