MANAGING VENDOR RISK

WHAT IS THE ROLE OF PROCUREMENT?

THE SHELBY GROUP™
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Vendor Risks Defined:

Operational Risk: The risk that your organization will experience a major disruption of some segment of your business if a vendor's processes, people or systems fail

Financial Risk: The risk that your organization is negatively impacted financially due to a vendor relationship

Regulatory Risk: The risk that a third-party vendor will violate a law or regulation placed on them as a requirement for doing business with your organization

Reputational Risk: The risk that the actions or negligence of a third-party vendor will cause unfavorable public perception or brand damage to your organization

Recent examples of losses caused by vendor risks:

March 24, 2020
General Electric (GE) revealed that a third-party vendor exposed the personally identifiable information of over 280,000 current and former employees.

February 28, 2020
Cardinal Health paid $8.8M to the SEC and $2.09B in criminal penalties to the DOJ for FCPA offenses related to a Chinese subsidiary that provided marketing services.

February 14, 2020
Nedbank, one of the largest banks in South Africa, reported that a breach at its vendor, Computer Facilities Ltd., impacted the personal details of 1.7M current and former customers.

Introduction: What is the role of procurement in managing vendor risks?

Supply chain disruptions, increasingly sophisticated cybersecurity attacks and more aggressive regulatory controls over the past decade have brought increased attention to the role of procurement in facilitating vendor risk management. For most organizations, there is an implicit understanding that procurement has a responsibility for helping to manage vendor risk. However, from an operational perspective, the nature and purpose of this role is often either poorly defined or misunderstood.

At the most fundamental level, procurement departments create business value by helping to obtain goods and services in response to internal needs at the right price, from the right source, at the right specifications, in the right quantity for delivery at the right time. The intelligent management of risk is essential for optimizing each of these value drivers in today's business environment. This report provides a framework consisting of eight key topics that will help you define the role your procurement department can play in proactively managing vendor risk to enhance the strategic value that procurement creates for the enterprise.

Why is proactive risk management vital in today's business environment?

Traditionally, the role that procurement has played in managing vendor risk has focused on vendor selection and finalizing vendor contracts. However, three factors are driving the need for a more proactive level of involvement:

> **Moving from Supply Chains to Value Chains:** Increasingly complex vendor networks, greater dependency on third parties for value creation and rapidly changing business and technical environments have resulted in the need for procurement to be more proactive in facilitating vendor risk management.
>
> **Increased Operational Risk:** A greater dependence on third parties for delivering value cost-effectively to customers creates increased operational risk. The ability to anticipate, monitor and respond to disruptions caused by vendors reduces operational risk and increases resiliency, which strengthens competitive advantage.
>
> **Increased Financial, Technical, Regulatory and Reputational Risk:** When your organization outsources business activities, this does not include the outsourcing of responsibility for compliance. Understanding vendor risks and managing them effectively to ensure compliance with internal policies and evolving regulations are needed to mitigate vendor risks and avoid disruption, penalties and negative impacts on customer relationships and your company's brand.

Key Challenges: How can your procurement organization play a more proactive role in mitigating today's complex supply chain risks and liabilities? How can you anticipate inherent risks to avoid or minimize the costly consequences of simply reacting to adverse circumstances after they occur? This report provides a framework for answering these questions. But first, it is important to know how a more proactive role in vendor risk management fits within current enterprise procurement functions.

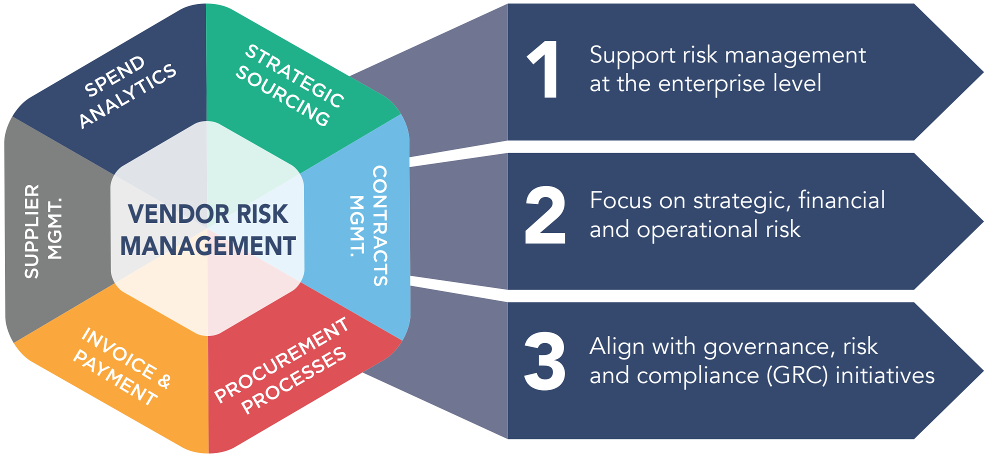
Vendor risk management is the process of ensuring that third-party suppliers do not create business disruption or a negative impact on company performance.

What can procurement organizations do to help mitigate supply chain risks?

Boards of directors and senior leadership teams are realizing just how little risk information they have about third-party relationships. The failure to effectively manage the risks resulting from these relationships can have a significant financial impact, including fines, criminal convictions, customer reparations, revenue losses, a reduction in share value and reputational damage.

The diagram below shows six areas of responsibility that are associated with modern procurement operations. Every one of these functions, from sourcing, contract management and procurement processes to invoice and payment, supplier management and spend analytics, is vital for proactively managing vendor risk. Whereas most procurement departments focus on the sourcing and due diligence stages, extending vendor risk management across the entire supplier lifecycle enables procurement to more comprehensively support risk management at the enterprise level. This enables procurement to help address strategic, financial and operational risks and provide audit-level support for governance, risk and compliance (GRC) initiatives.

Effective vendor risk management, which leverages each of the core functions of procurement, is essential in today's business environment for minimizing disruptions and negative impacts from third-party supply chain partners.



Traditional vendor risk management practices—which are focused on the selection and contracting phases—are inadequate for mitigating today's complex supply chain risks and liabilities.

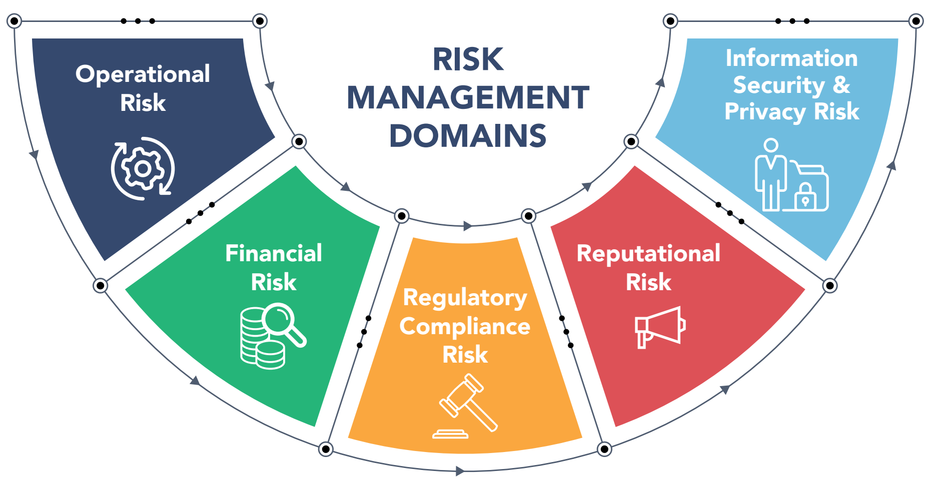
Use risk domains to proactively manage 100% of your suppliers

Risk domains are categories of risk posed to your organization as a result of third-party relationships. Risk domains can be broadly defined, as shown in the table below, and granularly defined based on the regulatory and compliance requirements of your business.

These can include regulations such as GDPR, HIPAA, FCPA, OFAC, CFPB, Gramm-Leach-Bliley, FISMA, anti-bribery and anti-corruption requirements, and compliance with guidelines such as OCC 2013-29, FDIC, FFIEC. In addition, performance-driven or production-related requirements can be established as risk domains.

Modern risk assessment platforms enable you to extend the reach of vendor risk management to 100% of your supplier base, automating periodic or continuous monitoring and assessment. This is critical because lower-tier vendors can significantly impact your business in areas such as bribery and data breaches. Domain-specific templates help you gather the information you need from vendors for risk mitigation and compliance.

Managing multiple risk domains is essential for protecting your business from disruption, compliance liabilities and other negative impacts resulting from third-party relationships.



Risk domains enable you to collect the right information from vendors and model risk to ensure compliance and identify problems for remediation.

Segment your supply base to prioritize risk management activities

Positive relationships with vendors are essential to the success of your business. Effectively managing the day-to-day aspects of these relationships is essential for maintaining your company's competitive advantage. Procurement organizations are uniquely positioned to provide business decision makers with information and reporting to manage risks introduced by suppliers that they might otherwise not be aware of to prevent disruption or costly consequences.

After categorizing suppliers based on the relevant risk domains discussed on page 6, many leading organizations segment their supplier portfolios based on transactional value. As illustrated in the table below, top-tier vendors (A), representing 80% of spend, receive strategic attention including performance-based risk management. Vendors in the B and C categories, representing 20% of spend, can be supported with automated monitoring and score carding.

RISK MANAGEMENT APPROACH	VENDOR CATEGORY	% OF SUPPLY BASE	% OF TRANSACTION $ VALUE
Technology-Enabled Strategic Risk Management	A	15%	80%
	B	25%	15%
Automated Risk Monitoring & Score Carding	C	60%	5%

Segmenting your supplier portfolio based on transactional value enables greater focus on strategic and performance-based risk management for top-tier suppliers.

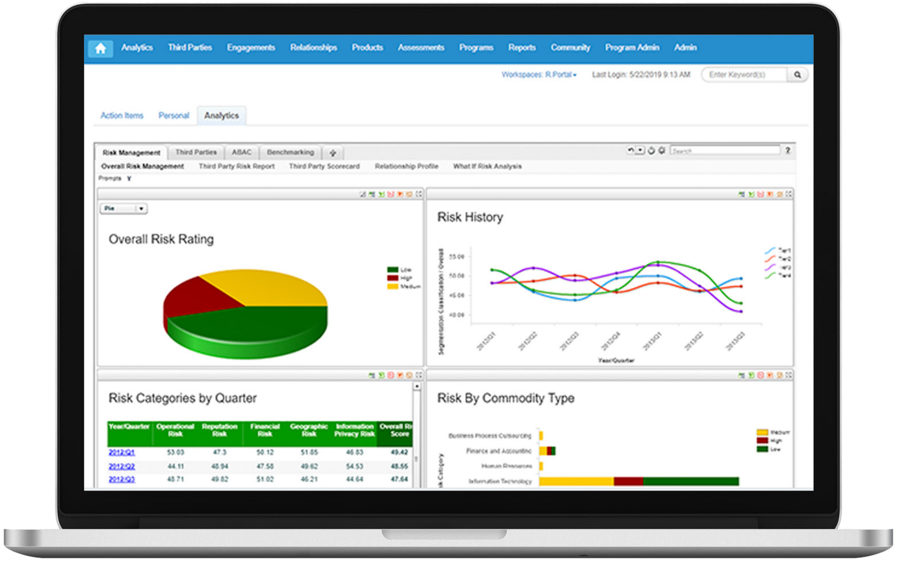
Establish risk ratings for suppliers enables increased span of control

The decision makers who oversee supplier relationships have a first-hand view of performance-related activities that affect your business. From a risk management perspective, however, much more information is needed to proactively manage risks resulting from third-party relationships.

Risk ratings enable you to continuously monitor supplier health and stay on top of emerging trends to help business decision makers plan and take corrective actions—when needed—to prevent adverse impacts. Digital platforms with risk management technology compile risk ratings from multiple external sources, such as financial reports, judicial filings and news reports, as well as internally generated transaction data. In addition, risk scores can incorporate performance data regarding SLAs, production targets, quality assurance goals and contractually obligated commitments.

Risk ratings help you stay on top of emerging risks to continuously monitor supplier health—at scale— for every vendor in your supply base.

Digital risk management platforms leverage external and internal data sources to provide multi-dimensional risk ratings that are essential for mitigating supply chain risk.



What to look for in a vendor risk management technology platform

Technology plays a vital role in enabling your proactive risk management initiative. Today, businesses are investing heavily in third-party risk platforms and programs to better identify and manage risks before they can affect their businesses. For procurement departments seeking to expand their role in managing vendor risk, an important criterion is selecting a platform that can be easily integrated with their Procure2Pay (P2P) system. The ability to integrate risk management into your company's automated procurement processes is essential for scalability, extensibility and real-time transactional insight. Listed below are some of the factors to consider when evaluating platforms.

Vendor Risk Management Technology Requirements

- Integrates with your P2P platform
- Adaptable for your industry
- Includes evolving compliance and regulatory requirements for your industry
- Incorporates robust data sources for risk scoring
- Automated workflows
- Intuitive user interface
- Scannable reporting
- Customizable risk domains and assessment forms
- Intuitive scoring methodology
- Shareable dashboards
- Full vendor lifecycle support

Selecting a vendor risk management platform that can be easily integrated with your P2P system is essential for scalability, extensibility and real-time transactional insight.

Manage risk throughout the supplier relationship lifecycle

As previously stated, most procurement departments focus vendor risk management activities during the selection and contracting phases. In today's business environment, minimizing exposure from financial, operational, reputational and security risks requires a proactive risk management initiative that spans the entire supplier lifecycle.

Companies that have implemented a best-in-class P2P platform are uniquely positioned to accomplish this. Once you have segmented your supply base, established risk domains and selected a vendor risk technology platform that can be integrated with your P2P platform, then you will have the infrastructure in place to automate the entire lifecycle of third-party risk management.

- Take actions based on risk scores
- Identify issues for corrective action
- Initiate performance improvement and mitigation plans
- Put high-risk suppliers on hold
- Develop contingency plans
- Realign supply chain as needed

Minimizing exposure from financial, operational, reputational and security risk requires a proactive risk management initiative that spans the entire supplier lifecycle.

Why add proactive risk management to your procurement charter?

Manual processes and tools are ineffective for managing the complex and ever-changing range of risks, vulnerabilities and liabilities that can result from third-party relationships. In building your business case for implementing a proactive risk management program, it is important to recognize that effective management of vendor risk does more than help your company prevent adverse business impacts. A properly designed program helps you create a more resilient supply chain that increases your company's competitive advantage.

Reduce Adverse Business Impacts

- **Reduce Reputational Risk:** The impact of data breaches and compliance violations caused by third-party relationships damages your company's brand, customer relationships and shareholder value.
- **Avoid Regulatory Penalties:** Fines for non-compliance can add up to millions of dollars or more. Proactive risk management automates compliance with current and evolving standards and regulations.
- **Prevent Business Disruption:** Failure to anticipate and mitigate business disruption resulting from third-party relationships reduces profits and drives customers to do business elsewhere.

Increase Competitive Advantages

- **Increase Span of Control:** Proactively address more risk with less resources.
- **Improve Supply Chain Resiliency:** Prepare for unexpected risk events and improve the organization's ability to respond and recover.
- **Strengthen Supplier Relationships:** A properly designed system provides continuous reporting and enables action planning that strengthens relationships with key suppliers.
- **Increase Supply Chain Visibility:** Increased transparency from continuous monitoring of risk enables faster decisions that strengthen your company's value chain.

Expanding your company's vendor risk management program to include automated risk management processes that are integrated with P2P operations enables you to reduce adverse business impacts and increase competitive advantage.

Accelerate procurement success with platform-enabled solutions from Shelby

Procurement departments everywhere face a common challenge. How can you increase transparency, control and compliance in order to deliver measurable business benefits to your organization? Today's cloud-based procurement platforms offer powerful and flexible tools to integrate best practices into daily operations. However, a low utilization of features and misalignment with business processes can negatively impact your success.

The Shelby Group is the global leader in platform-enabled procurement optimization. With hundreds of platform implementation and support engagements to our credit, Shelby can help accelerate your success through each step of your journey with support for Platform Implementation, Program Optimization, Procurement Operations and Digital Solutions.

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