Understanding Your Suppliers

Do you know what's happening below the surface?

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Contents

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Executive Summary

This briefing paper looks at how the importance of structured and effective supplier management has increased for major organisations over the years. It explains that managing both the risk and value generated by suppliers is more vital than ever and is a core requirement for procurement functions and indeed for organisations generally.

The paper suggests that there are three key types of supplier information; that related to “basic” business needs, performance information (usually gained from active suppliers during a contract) and risk related information. It then goes on to look at how the regulatory and compliance burden has increased in recent years in terms of organisations needing to understand much more about their suppliers and supply chain. Issues such as modern slavery, GDPR and conflict minerals have put a real focus on the need to manage appropriate information about suppliers. The implications and penalties in terms of fines, other government actions and reputational damage can be severe.

The final section of the paper looks at how organisations can segment their supply base for the purpose of considering these risks and points out that it is not just the“most strategic” suppliers that can be a source of issues in some of these regulated areas. Managing suppliers well requires the right systems, policies and processes for supplier data management to be in place, and while it is not the purpose of this briefing paper to go into detail on how to achieve that, it aims to highlight some of the key issues and draw readers’ attention to what is an important issue - one that many organisations still do not address in a professional and structured manner.

A Potted History of Supplier Management

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For many centuries, "procurement" was local and tactical (as we would define it now). Negotiation was no doubt important, and there would be some repeat business between buyers and sellers, particularly once a retail industry started to gain importance in the 17th century.

But the biggest historical change in procurement activity as we know it was linked to the growth of factories and mass production, as those manufacturing organisations started to require the same items consistently, again and again. That led to the development of longer-term supplier relationships, and a greater focus on issues such as quality, reliability, and delivery.

More recently, the growth of category management in procurement led to a more professional approach to planning supply chain activity. Buyers assessed suppliers, developing strategies in areas such as the type, number or location of suppliers, and generally taking a longer term view more linked to the wider needs of the business – "strategic sourcing" had emerged.

Through all of this, everyone no doubt appreciated in some sense that suppliers were important to the buyer. But it is only relatively recently that organisations and procurement professionals have started looking at suppliers in a way that goes well beyond the transaction itself or simple questions such as "can they supply the right goods at the right quality"?

Concepts like strategic supplier management and supplier relationship management were developed as organisations started thinking about how they might get more out of their key suppliers, above and beyond the basic terms of the contract. And buyers increasingly wanted more data and information from suppliers – not just their banking details so they could pay them, but more about how the supplier behaves, thinks and positions itself.

Even more recently, these issues started becoming important from a regulatory angle too. Governments introduced legislation in a host of areas to protect citizens or to drive policy agendas, and this led to greater information and data demands on supplier and buyer. Suddenly, organisations could be prosecuted and fined if they failed to understand their supply base. (We might argue that as governments struggle to raise more tax, they will both push compliance responsibilities back onto business, and be enthusiastic about fines and penalties!)

So, managing both the risk and value generated by suppliers is more vital than ever, and is a core purpose for procurement functions and people as well as for their organisations.

The purpose of supplier management therefore is to recognise that and manage the supply base to maximise value and minimise risk to the organisation.

> It is also worth defining supplier management, as opposed to contract management, as focusing on activities linked to suppliers that are not purely linked to a specific contract or contracts.

What Information do we Need?

Over the years, we can see that organisations have gradually needed more and more information about their suppliers. We can classify that in terms of the purpose behind the information.

Basic Business Information

If we look at the different stages of the procurement cycle, we can identify the basic information that is needed to enable us to transact business at each point. So, for instance, when we first go out and look for suppliers to meet a need, we need the basics about what they do and what they can supply.

Pretty soon, if we want to take it further, we need basic contact details; we need to know who to talk to in the organisation and understand their roles. And if we take it to the next level and want to engage more closely, perhaps get a quote or more information from them, we will start needing some validation that they are genuine, they are who they say they are, and so on. We might want to check they have certain accreditations, capabilities or experience.

At the point at which the decision is made to trade with them, we get into what is often called supplier onboarding. Now we need to know more, including the details that are required to pay them - their bank account details and so on. There may well be a contract to agree, of course.

Performance

Then once these firms are in place as suppliers, it is likely that information and data will be required to support performance management. That might be production and output information, or it could be information linked to KPIs, customer satisfaction or service-level information. If goods are supplied, there may well be delivery-related data, quality information from the supplier or our own checks that generate more data.

Contract compliance data may also come into the picture, or progress reports in the case of a major IT or construction project. For more strategic suppliers, engaged in supplier relationship management (SRM) schemes perhaps, we may want information about the progress of joint projects or innovation initiatives.

Risk Management

Risk issues today run through the whole procurement and supply chain process, as risk links to every step of the journey with suppliers. Some are regulation-driven, as explained in the following section.

Some might centre on getting hard factual intelligence about the supplier’s financial situation, to assess whether there is risk of bankruptcy or similar. Issues might be related to whether their factory in Thailand is likely to be subject to flooding. But increasingly we want to know more about their business approach and beliefs as well as the hard facts. Buyers want to understand how suppliers operate, their philosophy, if you like. Are they the sort of company we want to deal with? Do they have any skeletons in their closet? Might they be involved in modern slavery, abuse of environmental good practice, breaches of health and safety or human rights issues?

Exploring Regulation & Reputation

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That last risk heading overlaps with information linked to regulation. This focus has been the major change in supplier information management in recent years, as rather than the buying organisation wanting information purely for its own benefit, now governments and related third parties are insisting (with regulatory backing) that buyers must have certain information, data, and understanding related to their supply base. That is backed up with severe penalties, ranging from fines which can run into millions of pounds, to exclusion from bidding for government contracts, as well as the reputational damage that can follow.

So, what was once seen as "nice to have" information has become defined by law. Other requirements are enshrined in public procurement legislation. For instance, in the EU, asking questions about whether company directors have convictions, or the firm has been investigated over tax matters, is now a routine part of public sector supplier qualification processes. There is regulation for everybody – not just public bodies - in terms of environmental issues, employment practices in the supply chain, data protection and so on.

Another example: go back to the 1990s, and the banking regulators were totally disinterested in the precise supply arrangements of the big UK high street banks. But from the late 1990s onwards, and with accelerating interest through the last financial crisis, regulators decided that they would check more diligently that banks understood their suppliers better.

Why did this change come about? Because understanding key suppliers was seen as an important element in understanding how secure and well-managed the funds of the banks' own customers might be.

Today, there is considerable regulation across many aspects of banking, including supplier management. As the European Central Bank said, announcing a new framework for cyber-resilience: "We also anticipate that the TIBER-EU framework will have an important interplay in the on-going supervision of key financial market infrastructure providers, given the framework's overriding emphasis on "critical functions" – which firms will want to delineate with a view to the official definition used by the framework: ... the people, processes and technologies required by the entity to deliver a core service which, if disrupted, could have a detrimental impact on financial stability, the entity's safety and soundness, the entity's customer base or the entity's market conduct."

> "We also anticipate that the TIBER-EU framework will have an important interplay in the on-going supervision of key financial market infrastructure providers."

Those "people, processes and technologies required by the entity" includes suppliers and suppliers' activities, hence the need for much tighter management and better knowledge about key suppliers than existed 20 years ago. That is an example of a specific industry, but there are other regulatory developments that apply to all firms, and it is vital that firms understand their responsibilities and take action. Having effective visibility of the supply base and the appropriate level of knowledge around specific suppliers is an absolutely fundamental element of this essential regulatory compliance. Of course, every industry, not just financial services, is affected; here are just some of the general provisions that must be considered.

Bribery Act/Foreign Corrupt Practices Act

In many countries, legislation defines how firms must act in terms of bribery and corruption. For instance, The Bribery Act 2010 was introduced in the UK to enhance UK law and to address better the requirements of the 1997 OECD anti-bribery Convention. While some might think this is mainly of relevance on the sales side of the business, it can also be linked to the supply side. For instance, there have been cases where payments apparently for purchase of consulting services turned out to support and facilitate payment of bribes to political or other leaders in return for buying the firm's products. The presence of individuals who receive large sums of money as "suppliers" of vague services,in countries known for corruption, is a potential indicator of illegal behaviour.

GDPR

The General Data Protection Regulation came into force in the EU in 2018. It covers the processing of personal data relating to individuals by enterprises operating within the EU (whether or not they are EU domiciled organisations). For buyers, it means that any supplier who handles personal data, which can range from marketing providers to payroll processors or even travel agents, must follow certain rules and operational principles. If they don't, both the supplier and the buying organisation can be fined.

Sanctions

Trade sanctions are introduced by governments to act against other countries with which thy are in dispute in some way. Trade sanctions prohibit organisations from participating in trade in certain goods from affected countries, usually arms or commodities such as oil, timber, gold and diamonds, or equipment for use in the nuclear, oil and gas or related industries. The consequences of being found guilty of breaching sanctions are serious; for instance, major financial institutions have been subject to multi-million-dollar fines and settlements with US and UK regulators for sanctions breaches. Thomson Reuters showed over 30 examples in a very clear chart, with examples from Credit Agricole to PayPal!

Modern Slavery

In the UK, the Modern Slavery Act contains various provisions aimed to combat offences around people trafficking, slavery and human rights abuse. In terms of the supply chain, businesses of a certain size must produce a statement laying out the steps taken to ensure that slavery and human trafficking are not taking place in the business or in any supply chain - or declare that they consciously don't take such steps. In the UK earlier this year, 25 of the top 100 firms were formally asked by the anti-slavery commissioner why they were not complying with the Act.

> Exeter-based airline Flybe "deliberately sent more than 3.3 million emails to people who had told them they didn't want to receive marketing emails from the firm". Those emails ironically were asking customers to update their marketing preferences, including whether they wanted to receive emails like the ones Flybe had just sent … Flybe ostensibly sent to ensure that its data on customers was held in compliance with the GDPR but landed a £70,000 monetary penalty notice from the ICO for breaking the Privacy and Electronic Communication Regulations (PECR) while attempting to do so".
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> **(The Register, March 2017)**

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Conflict Minerals

Conflict minerals (and metals) are produced in countries that are involved in wars or conflicts and can be traded to support and finance these conflicts. Developed countries have introduced legislation to attempt to reduce the damage this can cause and make firms more aware of the source of key raw materials. In the US, the 2010 Dodd–Frank Wall Street Reform and Consumer Protection Act required manufacturers to audit their supply chains and report use of conflict minerals. On 1 January 2021 a new law will come into full force across the EU – the Conflict Minerals Regulation.

Exploring Reputational Risk

As well as these "hard" regulatory issues that require buyers to have proper oversight of their supplier base, there are other cases and issues that are less regulated, but where suppliers can nonetheless cause reputational damage to the buying organisation. Often that is driven by increased consumer and citizen awareness of issues such as sustainably and environmental issues.

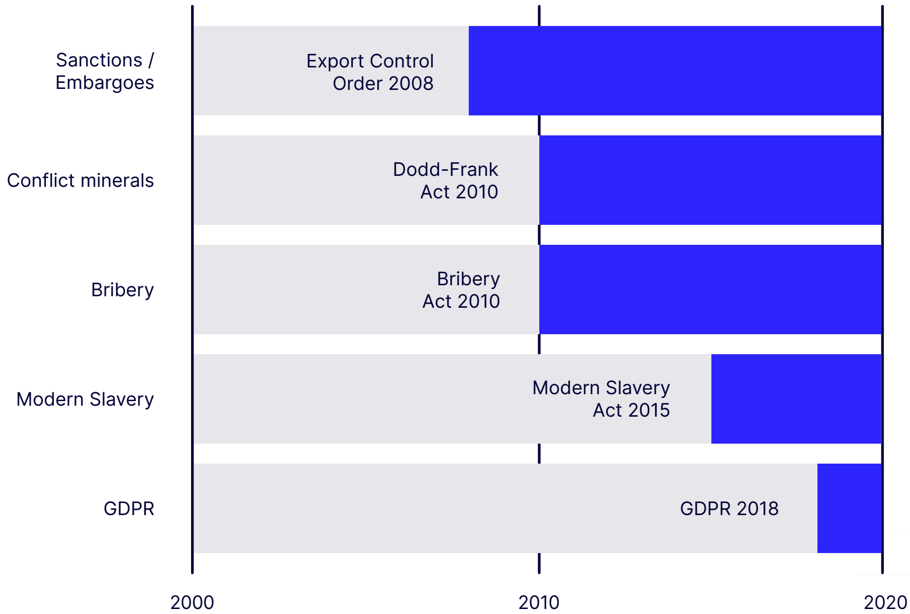
Corporate social responsibility is usually looked at in terms of environmental, social and economic responsibility. Just as any of these can be positives for an organisation that supports relevant initiatives, they can be risks for businesses either through their own behaviour or that of their suppliers.

Even if the activities are not covered by regulation as such, firms whose suppliers are found to have employed children in the developing world, or whose suppliers are found to be polluting rivers or oceans, can suffer in consequence. On the positive side, firms that are employing apprentices or disabled workers, which contribute to local communities, take care of the environment, and act responsibly, will be perceived well themselves and reflect well on those firms that choose them as suppliers.

Segmenting Supplier Information Needs

Going through these regulatory and reputational areas, each one may require a somewhat different approach from organisations, but there is at least one important point that all have in common. That is the need to have robust, accurate and extensive supplier information. To know that the appropriate suppliers have been briefed on your GDPR expectations, or to be as certain as you can be that you don't have sanctions-busting or bribery in your supply chain, it is essential to understand your supply base.

The chart below shows how the regulatory imperative has grown over recent years. What might be added next? It is impossible to say; but what seems certain is that the requirement for firms to understand, manage and report on their supply chain is likely to increase further in coming years – and the consequences for failure can be significant.



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That leads to the issue of segmentation. In terms of supplier management linked to performance, the usual approach is some sort of segmentation along the lines of the pyramid shown below. The strategic suppliers are those with whom we pursue deep "partnership", perhaps even joint ventures and similar activities. For most organisations, no more than a handful of suppliers – literally – will fall into this layer.

Then there is a segment we might call "collaborative" layer – where we may well be looking to capture additional value, encourage innovation, and have strong and trusting relationships. Large organisations may have between 10 and 50 suppliers at this level. Then perhaps several hundred or even more suppliers sit at what we have called operational level – these are suppliers that are less critical but still need careful monitoring and risk management because they do important work – providing goods or services – for the organisation.

Finally, there are those "transactional" suppliers, which aren't that important in performance terms other than in the short term. In these cases, managing the transaction properly and ensuring a fair price for a decent product is important, but there is little real chance of gaining competitive advantage from their actions.

However, the problem when we consider the regulatory issues around supplier information, is that they do not correlate to where the supplier sits in the "pyramid".

So generally, the further up the pyramid, the more generally critical we might consider the supplier, and the more performance information we will probably want about that supplier.

But just because a supplier is in the "partnership" bracket, it does not mean you necessarily have the most complex or detailed requirement in terms of regulatory related information. So, it can be suppliers that appear to be relatively tactical in general terms who can nonetheless generate the greatest issues lie in terms of GDPR, sanctions, or modern slavery.

So mapping supplier information needs must be looked at independently from that standard segmentation - you can't just rely on your pyramid. When it comes to regulatory supplier information, you must (perhaps unfortunately) look at every supplier, to some extent at least. And as the regulatory imperatives for supplier management increase, that is undoubtedly leading organisations to be more professional in terms of how they manage suppliers, and more aware of what is needed in terms of supplier information.

Supplier segmentation by general "importance"

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CONCLUSIONS

The requirement for buyers to have better, more complete and robust supplier information has grown gradually over a long period but has become more critical in recent years. That acceleration in the need has been driven by several trends. The regulatory environment is a major cause; governments have become increasingly enthusiastic about demanding that buyers know more about their suppliers and supply chains, in areas as different as data handling, bribery or human rights abuse.

This is unlikely to go away, and along with the reputational and operational risks that suppliers can generate for buyers, it all adds up to a need for organisations to make sure their supplier information processes, systems and policies are - at the very least - adequate, and preferably much better than that. Much of this starts with management of supplier master data; the foundation on which all supplier-related information can be built. Ensuring that the right information is gathered at the beginning of the relationship, then further relevant information is added where necessary, all in a structured, controlled manner (including where updating is required), is the goal for organisations.

That requires the right systems, policies and processes for supplier data management to be in place. It is not the purpose of this briefing paper to go into the detail on achieving that, but as we have seen, understanding suppliers and managing the information that is required, for both regulatory and performance reasons, is increasingly vital in today's business environment.

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HICX is the Low Code Platform for Supplier Management.
We enable business to find, maintain, and re-use trusted Supplier Data and Information across their Enterprise, across any spreadsheet, app or system. Our solutions enable your businesses to be more reliable, flexible, and scalable. Building from a rock solid platform of good quality data, we help businesses become digital in supplier management, third party management, compliance and risk, master data and finance management.

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