

Strategies for managing customer and supplier risks



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Strategies for managing customer and supplier risks

A growing number of organisations are developing enterprise risk-management (ERM) frameworks and other holistic risk-management approaches in response to an increasingly unpredictable global business environment. Doing so facilitates a focus on root causes rather than on the symptoms of shocks to their businesses. It also allows companies to take corporate risk management to a new level as they actively seek to anticipate, track and manage customer and supplier risks. Given the complexity of managing third-party risks across different corporate departments, many companies are turning to predictive analytics to gain a better and more complete view of long, complex supply chain and distribution networks.

A survey, sponsored by D&B, of nearly 400

business executives around the world conducted in August 2013 by The Economist Intelligence Unit (EIU) sheds light on the extent to which companies are protecting themselves against risks posed by their customers and suppliers. The majority of companies represented in the survey actively manage financial risks, but many follow a less structured approach for the more specific risks that are encountered outside their organisations. The survey also found that organisations with structured risk-management styles—both integrated ERM and collaboration among specialised risk managers—are more likely to systematically address the full range of threats confronting them, including those associated with customers and suppliers. ■

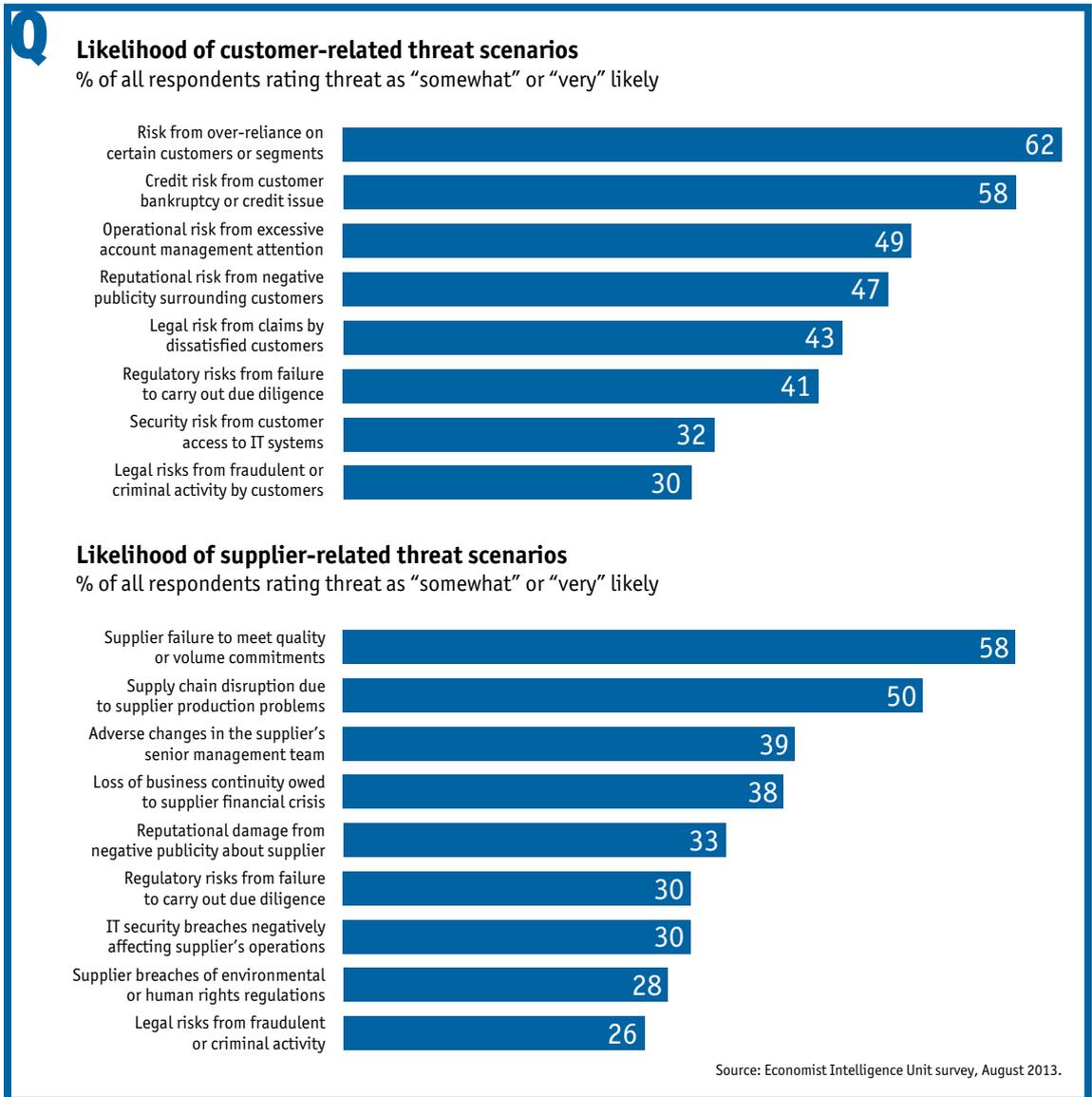
About our survey?

Strategies for managing customer and supplier risks draws on an Economist Intelligence Unit survey of senior managers conducted in August 2013. The 395 respondents are from 67 countries across six continents and represent 19 different industries. The sample is evenly split between large firms, those with annual global revenue of more than US\$500m and small and mid-sized firms. More than half of respondents are board or C-level, while the remainder describe themselves as senior vice-presidents, vice-presidents or directors. ■

The rise of uncertainty

As companies tap into world markets, increase outsourcing and tie into more complex supply chains, the links between customer risks and supplier risks have become more apparent. “Risk at any point on the supply chain is risk at every point, so it’s not enough just to focus on the internal

threats facing your own enterprise,” says Alasdair Ross, global product director for the EIU. “It’s equally critical that you have a handle on vulnerabilities among your suppliers and your distributors—and also in the markets where you find your consumers.” As supply chains get longer and more complex, he adds, “protecting them from disruption is that much harder.”



These challenges are compounded by the risks of doing business with customers and suppliers in unfamiliar markets, each with its own unique array of threats. Steven Leslie, lead analyst, financial services for the EIU, mentions this and points to “a host of risks that are intrinsic to cross-border transactions and doing business in places that may be riskier than your own domestic market.” He adds that most organisations are less equipped to manage foreign disruptions: “Look, for example, at how many firms were blindsided by floods in Thailand, which cut off their suppliers from crucial manufactured parts.”

Companies that choose to focus on their own domestic markets don’t escape the forces of globalisation. Many are adapting to slower growth and more intense international competition with strategies designed to build loyalty among existing customers. While this may insulate them from foreign competition to some extent, it exposes them to “concentration risks” stemming from over-reliance on certain customers or segments. In fact, executives who participated in our survey indicate that this is the number one customer risk scenario. Concentration risks related to suppliers

are just as important since they magnify the consequences of other threats such as failure to meet quality or volume commitments.

Executives overwhelmingly say that planning for both customer risk and supplier risk has become increasingly challenging. Survey respondents who say that adverse supplier-related events are becoming more frequent and more severe outnumber those who disagree by 2-to-1, and their views are nearly as pessimistic for adverse customer-related events. That executives see supplier risk as more challenging than customer risk reflects the inherent difficulty of achieving supply-chain visibility in a setting where suppliers are arranged in multiple tiers. “When it comes to supply-chain risk management, businesses don’t know what they don’t know,” says Joseph Robinson, director of crisis management and business continuity with Abbott Laboratories. “Many companies don’t have the ability—or the will—to map even their first-tier suppliers. This leaves them blind to the risk that is embedded in their supply chain and extremely vulnerable to a failure of a tier-two or tier-three supplier.” ■

Different strokes

There is no one-size-fits-all solution for managing customer and supplier risks. Our survey found that while about 26% of respondents' companies have adopted comprehensive ERM, nearly as many (21%) have no structured approach to addressing business risks. Others assign risk management to specialists or to business unit managers. The risk-management style of an organisation depends on several factors, including risk appetite, economies of scale, corporate structure, industry-specific challenges, stakeholder pressures and its overall risk-management philosophy.

Our survey reveals that these different approaches have sharply different success rates. Respondents were asked to rate their organisations' risk-management effectiveness relative to their peers. A company's approach to risk management has a big effect on its chance of being rated successful. Success here is defined as the likelihood of delivering above-average performance:

- Fully integrated ERM: rated 78% successful by survey respondents
- Enterprise-level collaboration among specialised risk managers: 68% successful
- Risk management by business unit managers: 56% successful
- No structured approach to risk management: 46% successful

These overall success rates, however, conceal significant differences among individual companies. Although enterprise-level approaches are clearly more effective in general, a significant proportion of respondents say they are succeeding even with unstructured styles. Analysis of the successful firms in each group ("top performers") provides insights into the most effective risk-management tools.

Successful strategies of top performers

Four classifications of distinct risk-management styles emerged from the survey results. Top performers among and within these categories tend to have elaborate risk-management frameworks, many of which use advanced data analytics:

ERM practitioners

Successful ERM practitioners, according to our survey, are mainly large companies—30% reported annual revenue more than \$10bn. The vast majority of these say that their companies systematically manage customer and supplier risks. Since ERM stresses a balanced risk profile for the organisation, it is not surprising that an overwhelming majority also say that risk exposure to both customer risk and supplier risks consistently aligned with broader corporate strategies. Successful ERM practitioners are relatively heavy users of data-driven risk analysis; close to 70% say they use third-party databases or predictive analytics or both. In these companies, data analysis augments rather than substitutes for managerial judgement. More than half of respondents in this category point to personal judgement of managers and 82% cite customer-engagement assessment as top elements of their customer risk-management strategy. For supplier risk, more than one-third continue to rely on managers' personal judgement, while 62% make assessments based on direct engagement.

Specialised collaborators

Specialised collaborators tend to be smaller companies with more than half reporting annual global revenue of less than \$1bn (although about one-quarter have revenue of more than \$10bn).

These companies achieve above-average performance by assigning risk-management responsibilities to specialists who collaborate to develop a comprehensive risk profile of the organisation—some view this approach as a step towards ERM. More than two-thirds of specialised collaborators say they systematically manage customer risk and three-quarters say the same for supplier risk, although a greater proportion claim they are more successful at managing customer risk than supplier risk. Moreover, they are less likely than ERM practitioners to report alignment of customer and supplier risk with broader corporate strategies, but the proportion is still more than 80%. Specialised collaborators are more likely to use subscription databases than are ERM practitioners but less likely to use predictive analytics.

Business unit generalists

Companies in this group successfully manage risk without the benefit of enterprise-level coordination. They are distinctly smaller than ERM practitioners and specialised collaborators, with 68% reporting annual global revenue of less than \$1bn and only 13% more than \$5bn. This reflects the broader trend of the largest companies shifting to ERM while those in transition to ERM typically begin with enterprise-level specialists. Only about

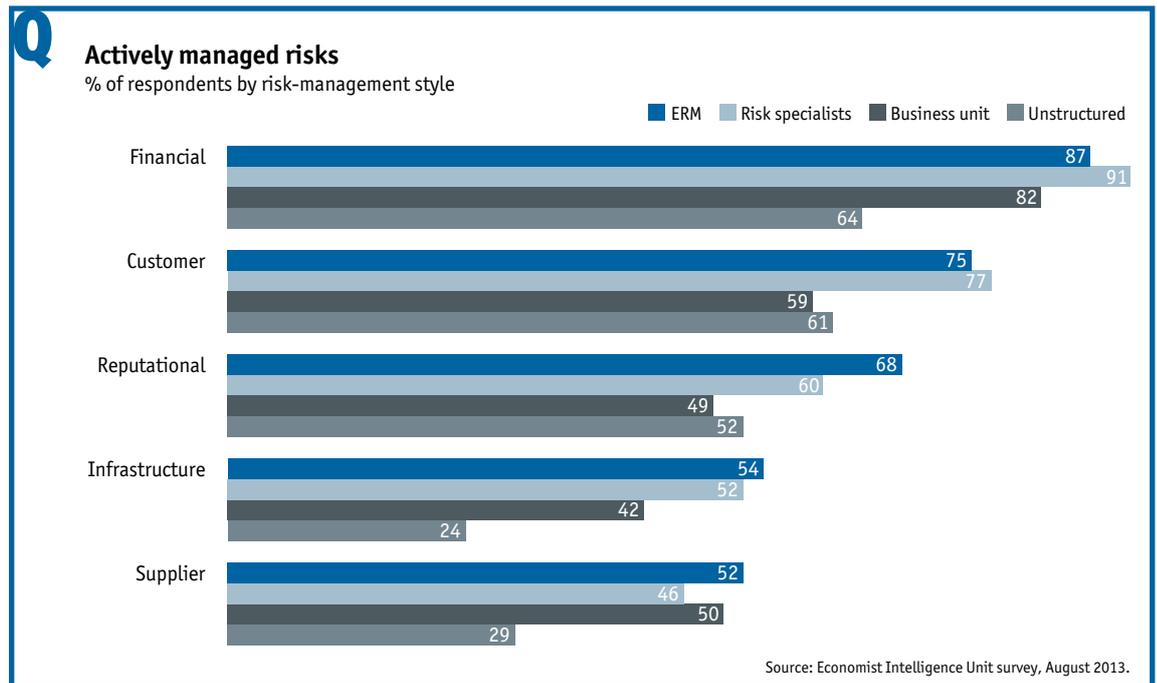
half of business unit generalists say they systematically manage either customer or supplier risk. They have lower uptake of data-driven analytical tools, perhaps because they lack economies of scale. These companies rely on the personal judgement of managers to a larger extent than other groups: 77% say this is true for customer risk and 61% for supplier risk.

Nimble improvisers

Some small firms are nimble enough to manage risk successfully even in the absence of a structured approach. That said, the majority of firms with no structured approach to risk management assess themselves as below-average performers. Three quarters of companies in this group have annual revenue of less than \$500m. Notably, about one-third of nimble improvisers say they systematically manage customer risk and supplier risk even though they don't manage all risks to the same extent. Moreover, about 31% say they use data-driven tools for customer and/or supplier risk management, even though personal judgement of managers and internal assessments based on customer or supplier engagement are still the dominant tools. A surprising 69% say they manage customer risk successfully, with 61% saying they successfully manage supplier risk. ■

Characteristics of successful risk-management styles

	Size	Risk-management success		Use of data-driven tools	
	>\$500m	Customer	Supplier	3rd-party data	Predictive analytics
ERM practitioners	74%	88%	80%	37%	40%
Specialised collaborators	71%	84%	75%	38%	24%
Business unit generalists	43%	71%	74%	21%	15%
Nimble improvisers	25%	69%	61%	25%	6%



The promise of big data

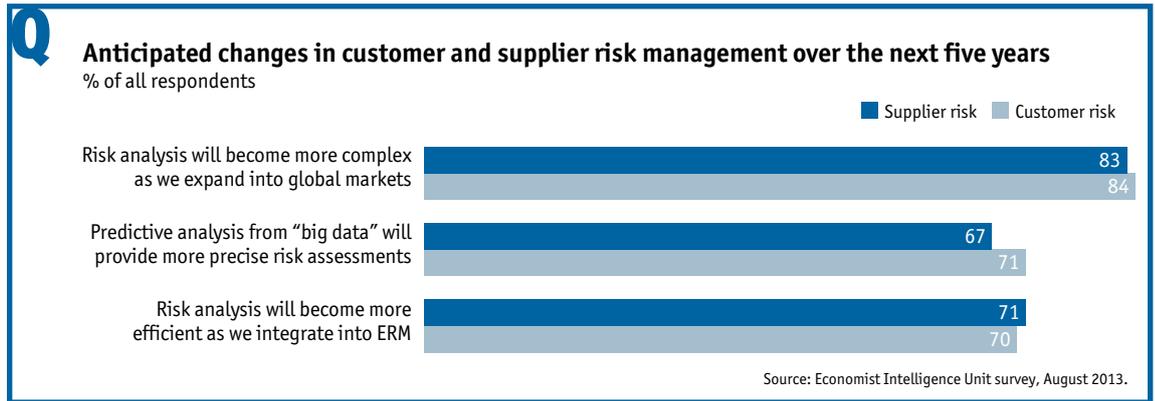
Companies with successful risk-management strategies use a variety of tools to manage specific threats related to adverse customer and supplier events. Those that use data-driven tools are significantly more likely than those that do not to say they successfully manage both types of risk. Larger firms are far more likely to use advanced analytics to generate predictive risk-management information. Nonetheless, all four groups identified in this report make relatively extensive use of third-party databases, typically in combination with other tools.

Many organisations represented in the survey are on the verge of implementing more advanced analytics. The majority say that they are using some analytical tools now to navigate through risk data and that they recognise the need for more sophisticated tools to obtain actionable or predictive analytics. Managing “big data”,

however, requires integration of diverse data types from multiple sources; the challenges can be daunting. About 60% of executives say they want to extract greater business value from risk data but are uncertain about how advanced analytics can help.

A cautious approach is natural with any new technology, but the situation is changing rapidly as analytical tools become simpler to use and as prospective users begin to understand how they will employ the resulting business intelligence. “Data analytics, like most emerging digital tools, are moving quickly from being an expensive option for the few to an off-the-shelf solution for anyone who wants to have a go,” says the EIU’s Alasdair Ross. “Then, what you need to worry about is the quality of your data and your ability to interpret what it tells you.”

This need to interpret and apply information and insights obtained from advanced analytics means that data tools enhance rather than displace



management judgement, even though new tools tend to reduce the overall management effort through improvements in efficiency. Our survey reveals that "judgement of managers" and "heavy monitoring of relationships" are the most widely used strategies for identifying and controlling customer and supplier risks even among firms using advanced analytics. This is not really surprising, says Mr Ross: "Models are necessarily simplifications of the real world, so data analytics need to be sense checked and interpreted by humans to make the most of them." ■

Measure what you manage

Findings from our survey add credence to the old management adage that "you can't manage what you don't measure". Only about half of survey respondents say their companies track the outcomes of their strategies for managing either customer risk or supplier risk. Respondents who do track outcomes report substantially better performance. Nearly 90% of respondents who track outcomes of their customer-risk strategy say they manage those risks successfully, compared with only 54% of other firms. The results are similar for supplier risk management: 85% of those who track outcomes are successful, compared with 51% of those that don't.

Mr Robinson says that performance assessment must be integrated into any successful risk-management programme, but many organisations don't know where to start. "I don't think that enough companies have matured their programmes sufficiently to rely on external benchmarks because they're still not sure what aspects should be measured. External providers can help, but to manage costs you need to understand where the gaps are." ■

Conclusion

Advanced analytics and “big data” are set to play as big a role in risk management as they have in other aspects of business management, such as marketing. Increasingly sophisticated data-driven techniques will make risk management more efficient, freeing managers and executives to focus more on the task of aligning risk across the enterprise. “No matter what the data says, we as human beings tend to make risk-based decisions based on our gut instinct,” says David Jacoby, president of Boston Strategies International. “Data is a supporting element of a high-performing cross-functional organisation and key business processes. Managers must integrate what the data is saying into their workflow and culture

for it to be effective.”

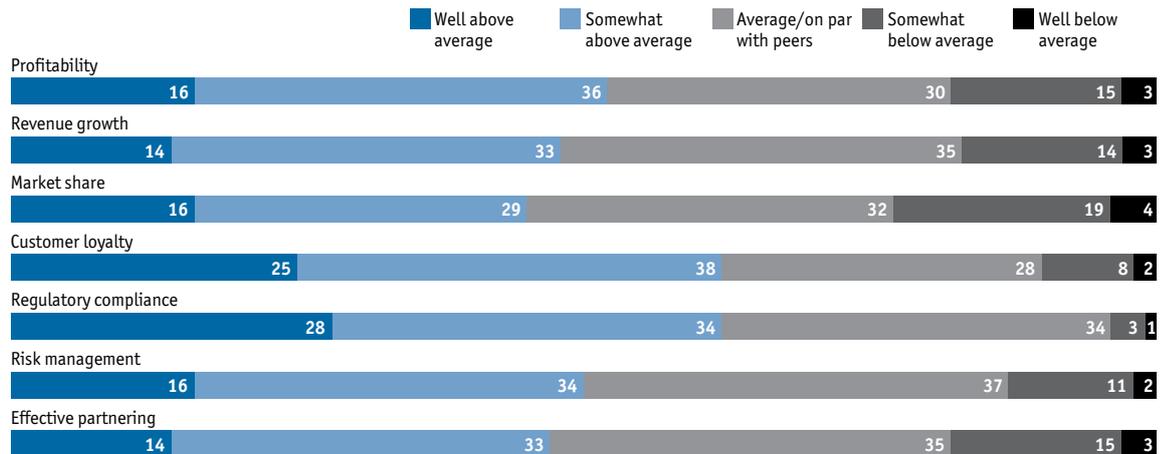
While executives express concern about the complexities of advanced analytics, this is not their biggest challenge in managing customer and supplier risk. In the case of customers, the biggest hurdle is associated with conducting effective assessments while avoiding offending prospective buyers and respecting their privacy and confidentiality. For suppliers, the biggest obstacle is related to integrating and consolidating risk management throughout complex global supply chains and assessing individual suppliers in a complicated logistical environment. Advanced analytics are promising solutions in both cases because they allow a wide range of data from different sources to be accessed and interpreted using sophisticated risk models. ■

Appendix: survey results

Percentages may not add to 100% owing to rounding or the ability of respondents to choose multiple responses.

In your opinion, how effective is your organisation in each of the following performance indicators compared with its peers?

Please rate on a scale from "Well above average" to "Well below average".
(% respondents)



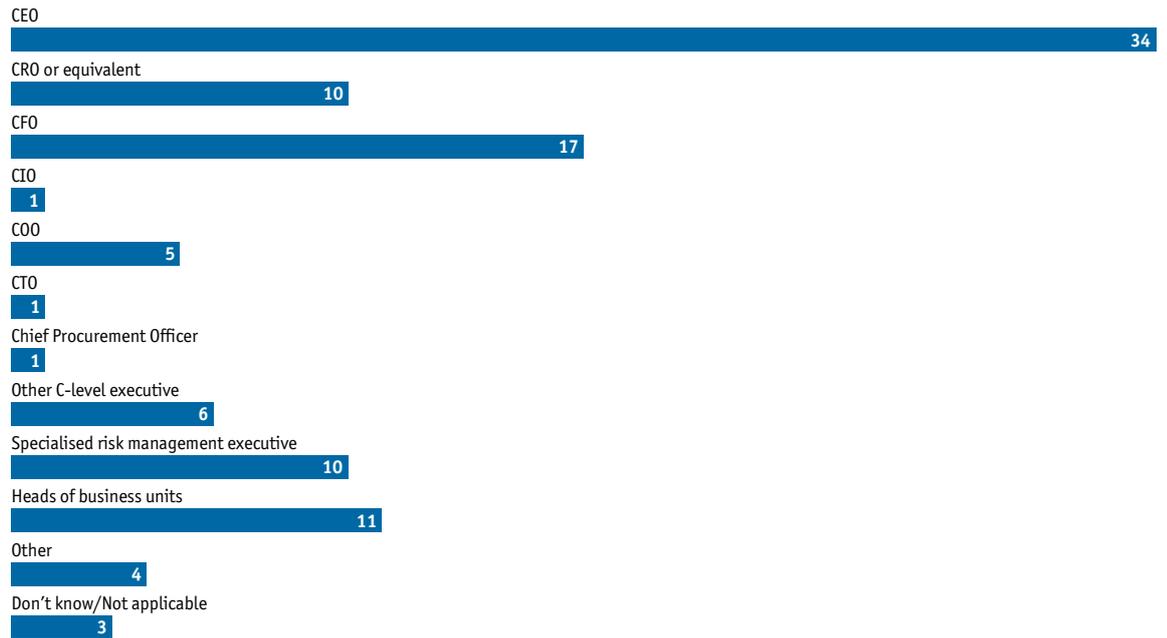
Which of the following statements best describes your organisation's overall approach to risk management?

(% respondents)



Which role in your organisation is primarily accountable for ensuring that risks to the business are identified and managed properly?

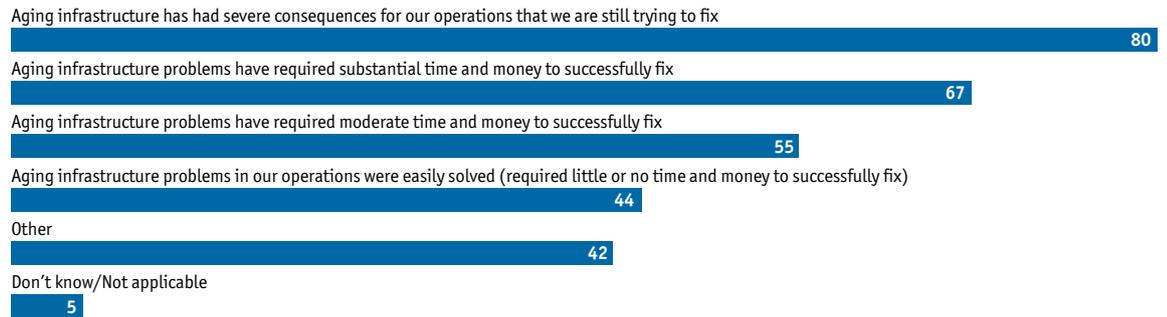
(% respondents)



What risk areas does your organisation actively manage?

Please select all that apply.

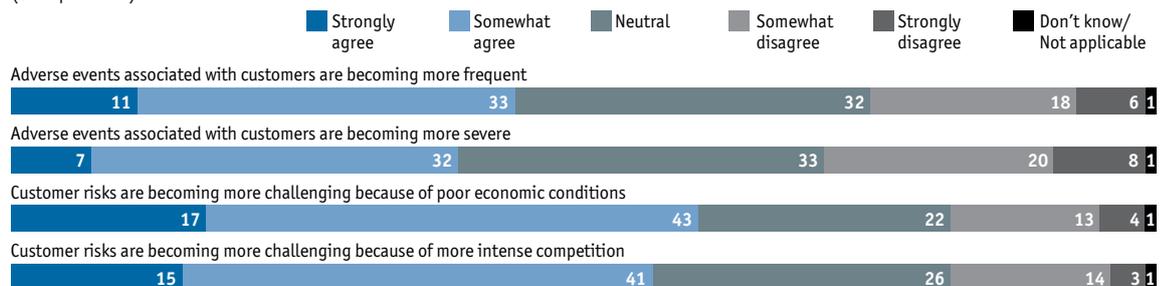
(% respondents)



Please rate your level of agreement on the following statements about the frequency and severity of customer risks.

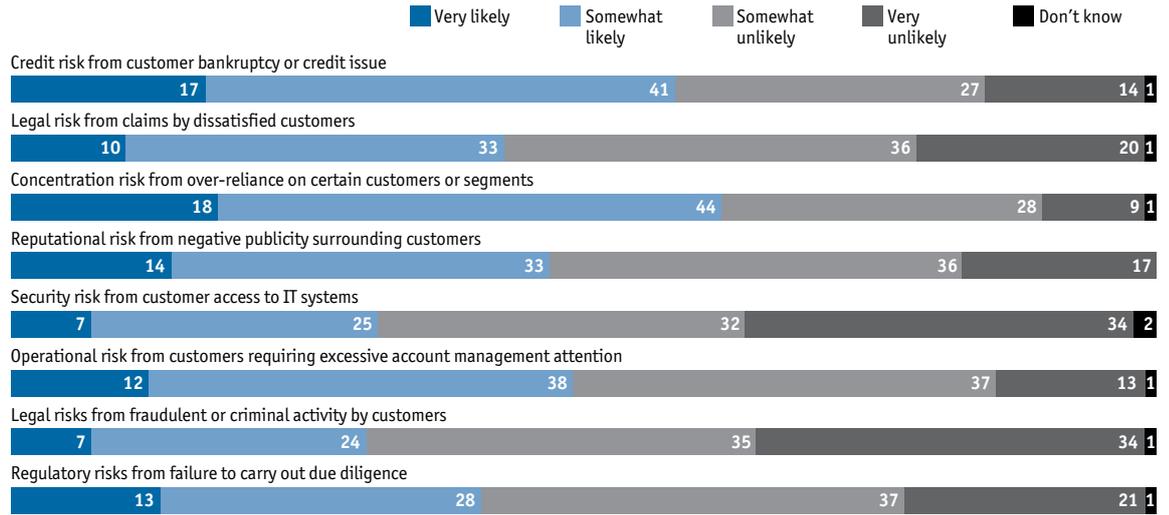
Please rate on a scale from "Strongly agree" to "Strongly disagree".

(% respondents)



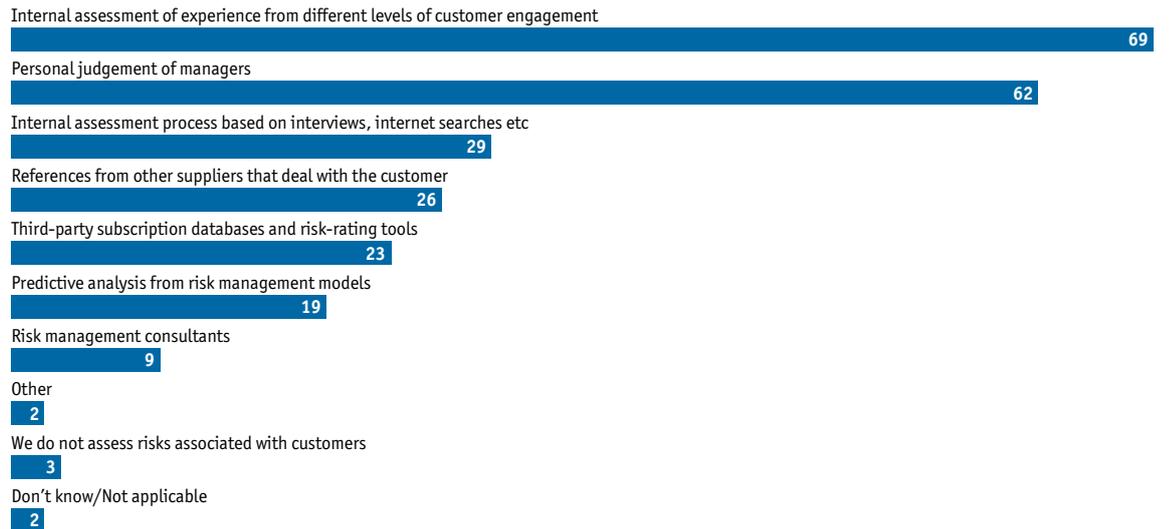
What is the likelihood of the following threat scenarios occurring related to customer risk?

Please rate on a scale from "Very likely" to "Very unlikely".
(% respondents)



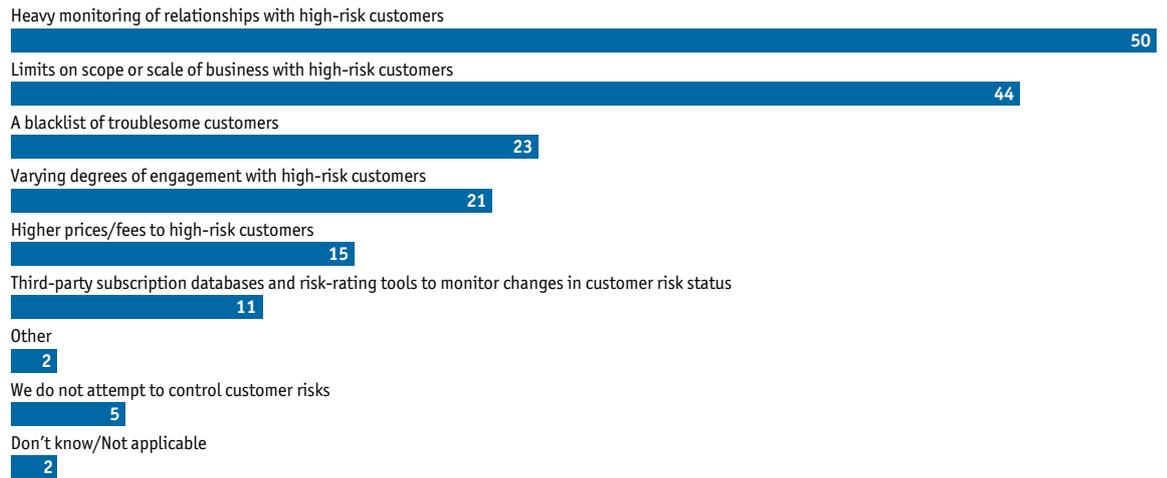
Which strategies and/or tools does your organisation most rely on to identify and assess customer risks?

Please select up to three.
(% respondents)



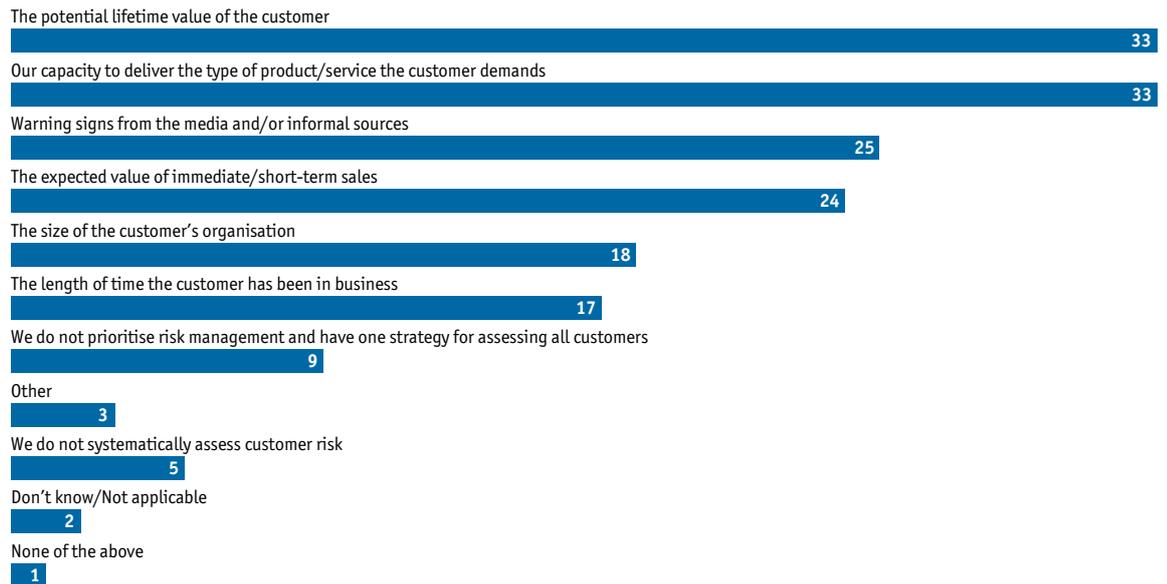
Which strategies and/or tools does your organisation most rely on to control customer risks?

Please select up to two.
(% respondents)



What does your organisation consider most important when deciding if a customer requires risk management attention?

Please select up to two.
(% respondents)



Do you agree or disagree with the following statements about the outcomes of your organisation's strategies for managing customer risk?

Please select one in each row.
(% respondents)



What is the single most important challenge that your organisation faces in effectively managing customer risks?

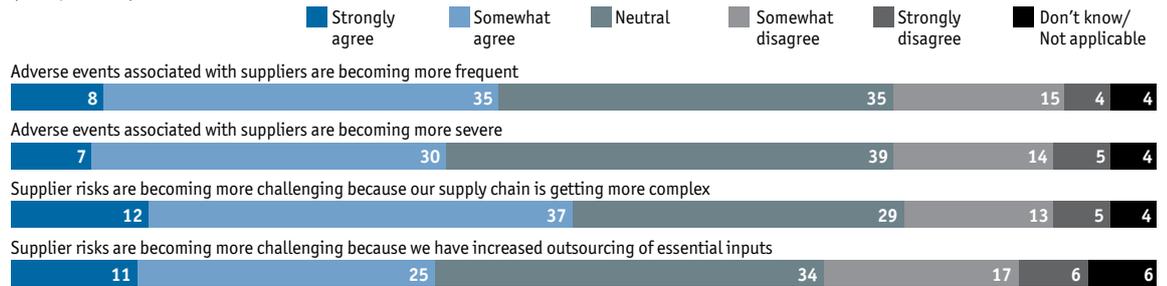
(% respondents)



Please rate your level of agreement on the following statements about the frequency and severity of supplier risks.

Please rate on a scale from "Strongly agree" to "Strongly disagree".

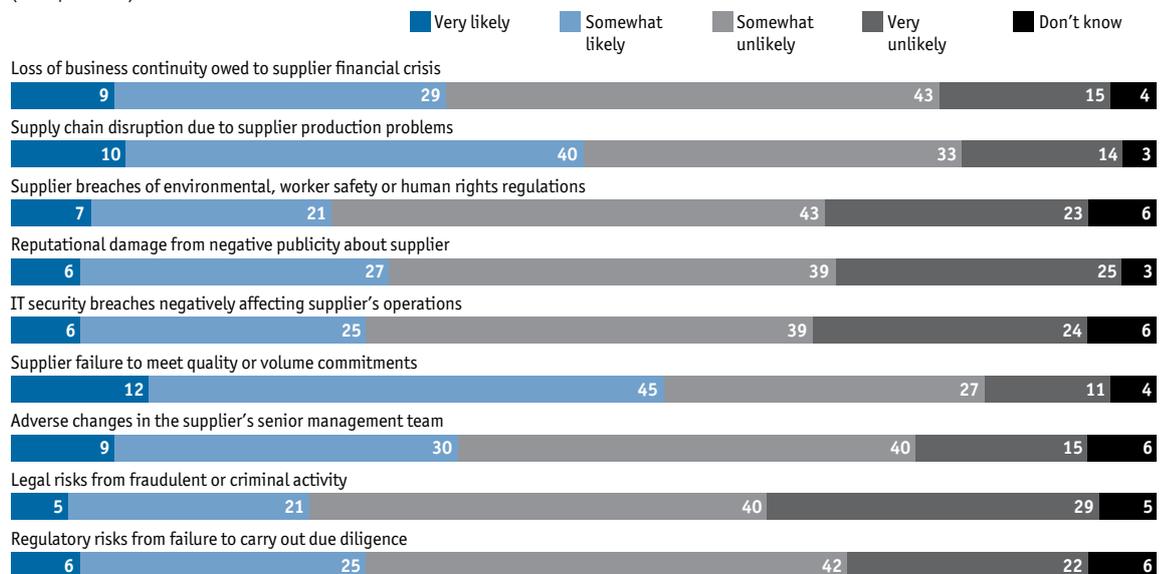
(% respondents)



What is the likelihood of the following threat scenarios occurring related to supplier risk?

Please rate on a scale from "Very likely" to "Very unlikely".

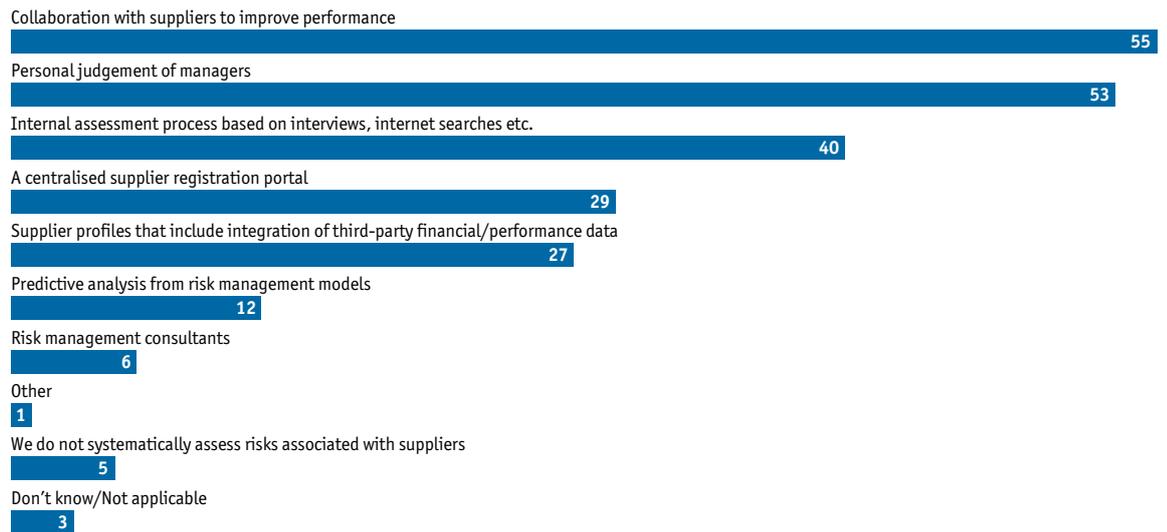
(% respondents)



Which strategies and/or tools does your organisation most rely on to identify and assess supplier risks?

Please select up to three.

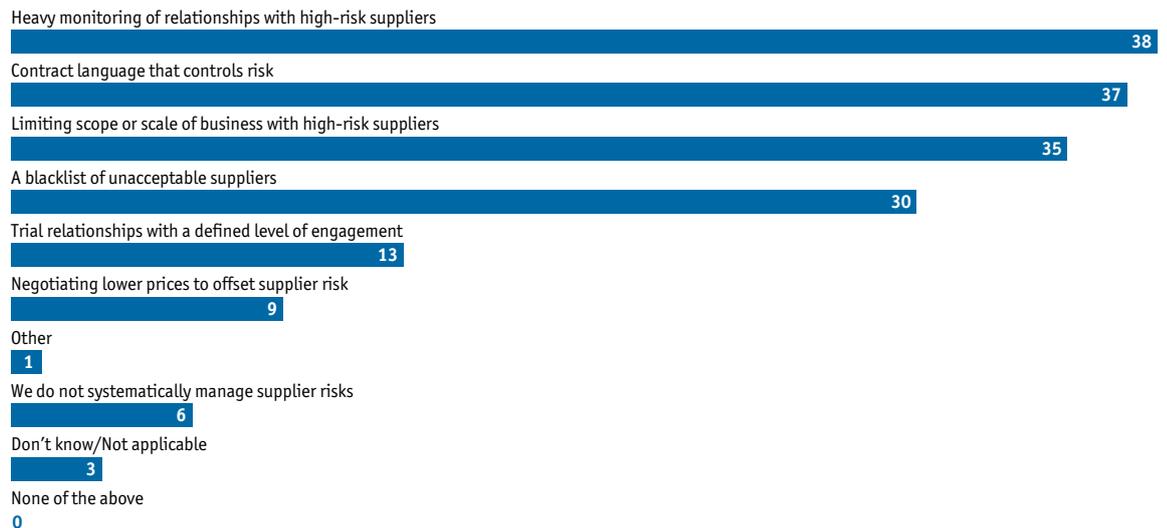
(% respondents)



Which strategies and/or tools does your organisation most rely on to control supplier risks?

Please select up to two.

(% respondents)



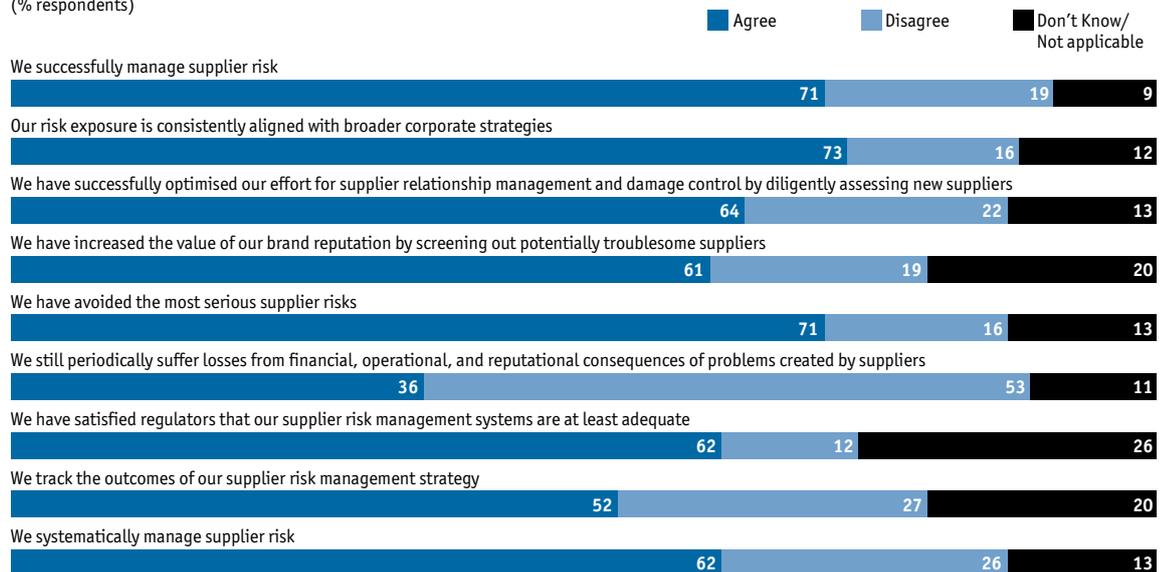
What does your organisation consider most important when deciding if a supplier requires risk management attention?

Please select up to two.
(% respondents)



Do you agree or disagree with the following statements about the outcomes of your organisation's strategies for managing supplier risk?

Please select one in each row.
(% respondents)



What is the single most important challenge that your organisation faces in effectively managing supplier risks?
(% respondents)



How will your organisation's customer risk management strategy change over the next five years?

Please select one in each row.
(% respondents)



How will your organisation's supplier risk management strategy change over the next five years?

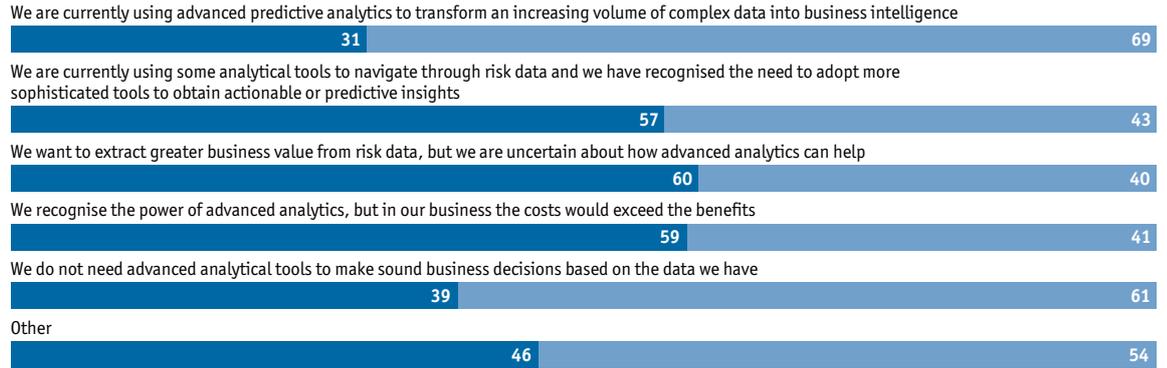
Please select one in each row.
(% respondents)



Please indicate whether you agree or disagree with each of the following statements about your company's current needs for advanced analytical tools to manage supplier and customer risk.

Please select one in each row.
(% respondents)

Agree Disagree



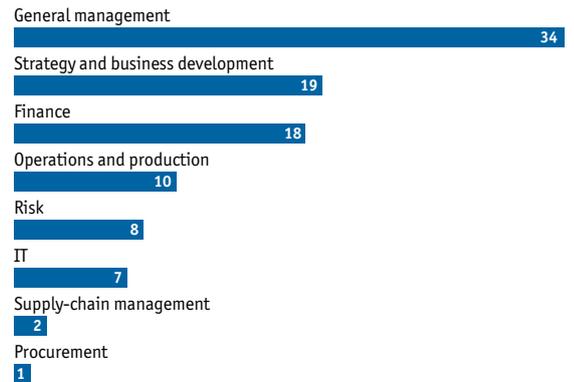
Which type of customer does your organisation primarily cater to?
(% respondents)



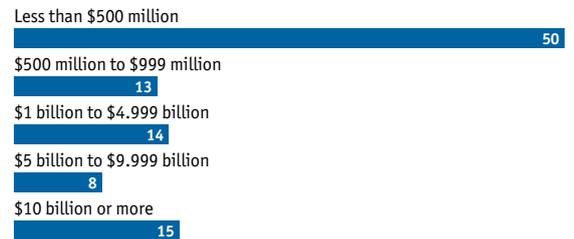
Which of the following best describes your job title?
(% respondents)



What is your main functional role?
(% respondents)

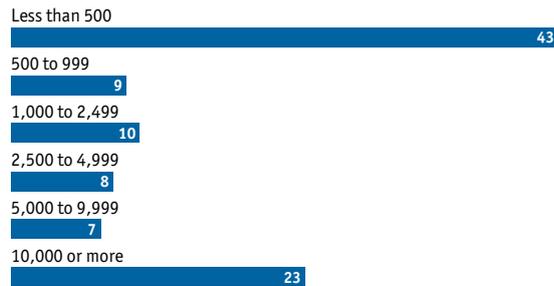


What are your company's global annual revenues in US dollars?
(% respondents)



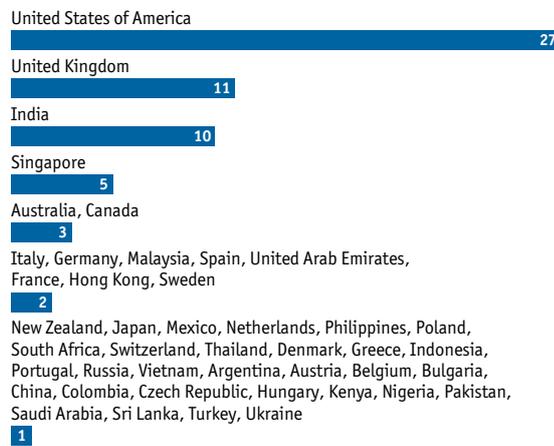
How many people does your company employ in its global operations?

(% respondents)



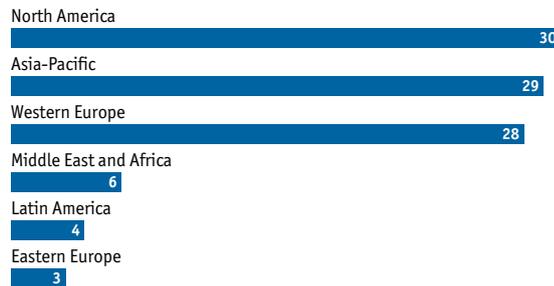
In which country are you personally located?

(% respondents)



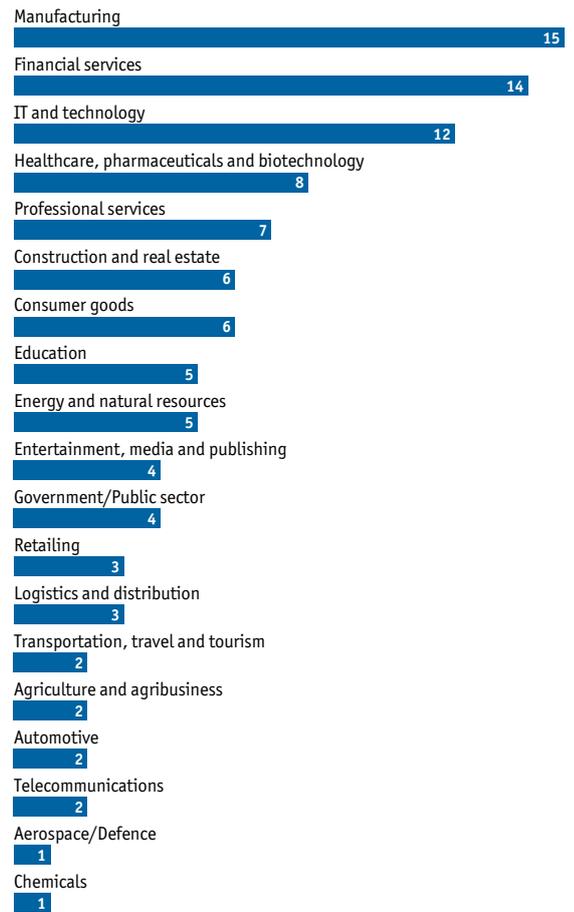
In which region are you personally located?

(% respondents)



What is your primary industry?

(% respondents)



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