Evaluating Vendor Risk . . . An Emerging Best Practice

Procurement challenges run rampant in our business environment. From the federal government's signature procurement policy changes under President Obama to private sector issues, organizations continue to seek new approaches to managing this very sophisticated and volatile function. Finding the right balance between procurement risks and the resources allocated to each phase of procurement (from front end to back end) is critical to any effective procurement function.

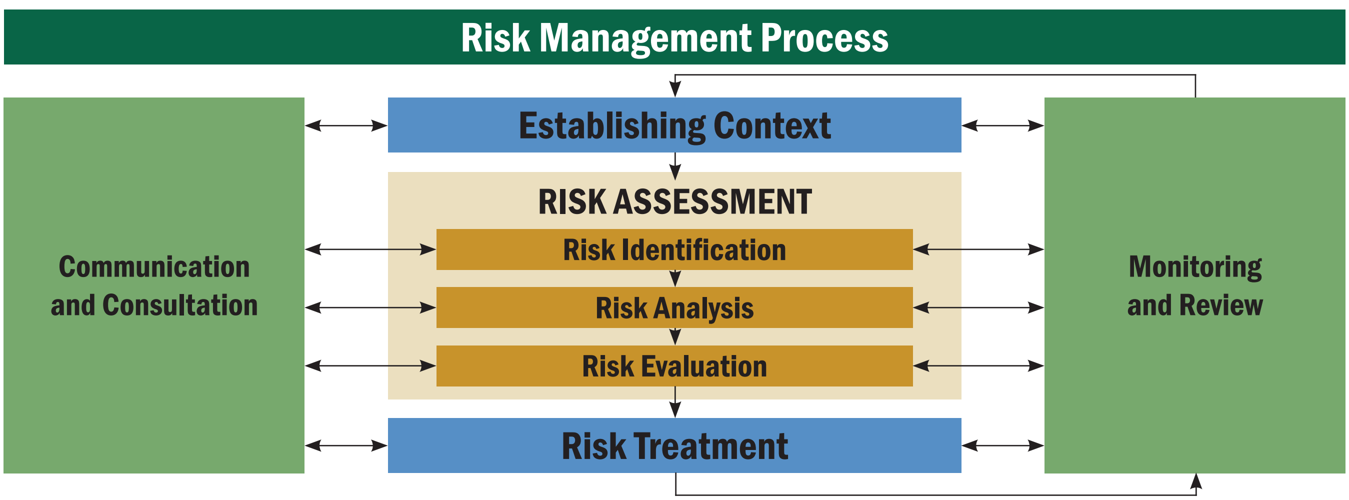
Why Is This a Problem?

Modern companies routinely fulfill specialized operational functions with third-party vendor products and/or services. Outsourced payroll and IT support, for example, offer businesses both savings and efficiencies upon which the business model relies.

However, each key vendor relationship has the potential to damage your business. The warehouse that holds your major supplier's product burns to the ground or the distribution company that ships your product goes under. If you anticipate those potential risks, you can survive their impact. Yet most companies do not have an effective tool to identify and evaluate vendor risk, much less one that establishes monitoring mechanisms to mitigate risk and take advantage of the related opportunities.

Companies that manage vendor risk by anticipating and managing exposures and opportunities have been able to leverage the vendor management process to gain significant business benefit during the most challenging business environment.

For example, Company A (a mortgage banking organization) identified through its risk assessment model a growing market risk that several of its mortgage servicers were going-concern risks due to market pressures. Company A implemented a plan to protect its assets held with these servicers and minimized its loss exposure from more than one month of cash flows to less than one day. The mortgage banking organization was also able to put in place transition plans for transferring servicers in a timely manner. These actions saved the company millions of dollars that would have been lost had the company not been proactive.



From ISO 31000, the New International Standard for Risk Management

Identifying & Managing the Risks

Vendor risk occurs at every stage of the procurement cycle. The risk assessment approach incorporates the following steps: Identification, Analysis, Evaluation and Treatment.

In the world of risk assessment, each business is considered unique with respect to business strategy and objectives. Accordingly, the organizational risk profile must be specifically tailored for each business model. The risk assessment will identify, weigh and prioritize all risks across the procurement life cycle and allow the organization to channel resources to the most significant areas of risk. For example, the risk that a critical vendor (one required to perform a core business function) creates to a business would be weighted higher than a vendor providing standard office supplies, and the former would require more monitoring than the latter. Employing this top-down, risk-based approach to the procurement process ensures that the right level of attention is provided to important vendor risks and controls.

If you would like to discuss in more detail how your organization can benefit from a formal vendor risk assessment process, please contact the author or your local CBIZ advisor.

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