

CSCMP hottopics

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Supplier Viability: Are Your Suppliers Prepared for a Downturn?

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With a potential economic downturn in 2023, taking a look at your supplier base to assess critical supplier long-term viability is imperative. Liberty has a framework to assess, measure, and identify options for mitigating these supplier viability risks.

Many companies today are bracing for an economic downturn. Current global events such as the China lockdown, the war in Ukraine, and the Fed's increasing interest rates have compounded the situation. These events have a direct effect on the supply chain. First, demand has overall lowered compared to last year. Secondly, an economic downturn would result in prices going down and moving toward a stable equilibrium point as they were pre-pandemic. Lower prices have a severe impact on the supply chain as they cut into the profitability of suppliers and all supply chain players. Here's where the importance of supplier viability comes in.

Your organization may already be feeling the heat. A report by Riskmethods revealed that 79% of businesses have lost 4% of revenue due to supply chain disruptions in the past 3 years. Amid thin margins, proper supplier chain management is key to business survival and profitability. One of these approaches to building supply resilience is assessing supplier viability.

CURRENT OPERATING ENVIRONMENT

Supplier viability is not new. The recent increase in supplier shutdowns caused by the pandemic, recession, as well as employment challenges has made supplier viability a top-of-mind supply chain issue. Many companies find it difficult to identify a supplier viability's greatest origin of risk hence, incurring costly supply chain disruptions.

As the country continues to brace for an economic downturn, supply chain executives are having a sobering time as they face lowering profits. You can [improve how you manage your supply chain](#) by having a professional supplier viability assessment.

DEFINING SUPPLIER VIABILITY: WHY IS SUPPLIER VIABILITY IMPORTANT?

Supplier viability is the risk level of a supplier. Assessing a supplier's viability involves looking into a supplier's financial and performance health to determine if they can commit to and fulfill contractual requirements. Your suppliers should show the ability to survive and grow in a volatile environment. Supplier viability assessment is a risk-mitigation strategy that helps you identify supplier red flags that indicate that a supplier is headed to financial trouble. The assessment aims to take mitigation measures and minimize knee-jerk reactions to sudden events and maintain a healthy supply chain. Asking the right questions and using the right tools can help you obtain information on the risk level of working with particular suppliers.

Checking supplier viability is also part of improving the entire supplier relationship management (SRM). SRM involves the entire supplier management process, from choosing the right suppliers to partner with to determining which suppliers are most important to a business in terms of performance and continuity and building mutually-beneficially supplier relationships to improve performance.

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HERE IS LIBERTY'S APPROACH TO ASSESS YOUR SUPPLIER'S HEALTH

1. Identify High-Priority Suppliers

Organize supplier profiles based on importance and financial capability using a data- and hypothesis-driven approach.

Classifying suppliers based on importance looks at how critical supplier functions are. You can start by identifying your own critical activities by looking at your business continuity plan or disaster recovery plan. Generally, critical suppliers are those who carry out activities whose breach would cause business disruption or major financial losses, are sole-sourced within the supply chain or are strategic partners for the long term.

You should also classify your suppliers based on their financial situation as either business-as-usual, financially distressed, or critical. Some of the financial factors to consider when deeming high-priority suppliers are:

- **Profitability** – The ability of a supplier to cover all their overhead
- **Liquidity ratios** – Whether a supplier has enough cash to meet short-term obligations such as paying debt and meeting higher demand
- **Activity ratios** – How effectively a supplier uses their resources, for instance, how they manage customer collections, stock inventory, and pay suppliers

When analyzing your critical suppliers, keep in mind that the large suppliers that may sell the most product are not the most critical. Companies tend to focus on their top-tier suppliers, but the real risks live in the smaller, critical suppliers that are more susceptible to financial, operational, and cybersecurity risks.

2. Assessing Supplier Viability

Conduct a multi-category assessment of key supplier risk components as part of Supplier Due Diligence. You can assess the financial viability of a supplier as well as other viability dimensions such as:

- **Operational** – Providing the required quality and quantity of supply
- **Technical infrastructure** – The major supporting technologies for conducting business
- **Supply chain** – The viability of your supplier's own supply chain

Some of the situations that threaten a supplier's viability include bankruptcy, litigation, merger or takeover, as well as a technology failure. Exceptional growth can also be a threat when a supplier cannot fund or recruit new staff quickly to meet increasing demands.

3. Evaluate the Risk

Once you assess suppliers and identify risks, the next step is to understand the type of risk and the level of exposure and urgency. The goal is to identify the priority risks based on probability and impact and address them first. Risks can be too many to handle with limited time and finances. Probability is the likelihood that these risks could take place while the impact is the brand and financial impact of such risks should they occur.

4. Mitigate Supplier Risk

Once you've identified the priority risks, the next step is to create a defined action plan to mitigate the risk and ensure proper and broad communication and accountability. Implement the mitigation program by investing in the right data and tools as well as ensure that you continually evaluate and monitor supplier risk levels to keep them on the low.

About CSCMP Hot Topics

Issues of *CSCMP Hot Topics* may include early results from ongoing research being conducted for CSCMP or other organizations; new supply chain practices, thought-provoking ideas, or emerging trends; discussions of changes in the broader business and regulatory environment that may impact the supply chain and logistics field.



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LIBERTY'S EXPERIENCE - A CASE STUDY

A global engine manufacturer's procurement tasked us to come up with 'early warning sign' indicators of supplier risks and a playbook to mitigate them for a global engine manufacturer. We aimed to establish mature supplier risk management capabilities and develop a repeatable process for assessing and mitigating critical and/or distressed suppliers. We achieved this through the following:

- Implementing new processes for risk identification, exposure evaluation, diligence standardization, and remediation
- Creating a balanced risk scorecard including external information and internal product/supplier data to assess the specific operational and financial risks
- Developing a standardized supplier risk assessment report focusing on financial, operational legal, organizational, technical, and external factors
- Documenting "risk & remediation" tactics to address specific scenarios
- Establishing a Risk Management Office (RMO) to manage the day-to-day ongoing identification, evaluation, management, mitigation, & monitoring activities
- Supporting clients with select distressed supplier evaluations and remediation execution

The project outcome positioned our client to identify and mitigate supply risks to prevent supply chain disruptions across their global presence.

IN SUMMARY

In the past year, the pandemic has continued to have a powerful impact on organizations and the economy. Your ability to adapt will determine whether your business continues to be sustainable in volatile times.

Now is the time to proactively prepare for the future by creating a robust supply chain. Identify your critical suppliers that are facing the highest risk by conducting a supplier viability assessment and be proactive—and do not just focus on your big suppliers but check your smaller suppliers as well.

Don't wait until it is too late and you are caught in the middle. [Call or hire Liberty Advisor Group](#) to assess your suppliers today.