Managing risk in global supply chains
Managing risk in global supply chains – getting to grips with the ‘unknown unknowns’

A report in November 2016¹ highlighted that global supply chain risk has climbed to its highest level since 2013. In Western Europe supply chain risk notably increased in response to uncertainty around the post-Brexit relationship between the UK and the EU.

Changing consumer expectations are massively affecting the supply chain. Consumers have a strong thirst for ‘new’ – whether that’s in terms of technological devices or the latest fashion brands. Thanks to the internet, they are also travelling much farther to shop. In 1955, people travelled less than 15 miles on average. Now they are travelling over 6,000 – mostly virtual – miles².

As global supply chains become more complex, managing them can be a due-diligence headache. Organisations including Barclays and Thomson Reuters are exploring the risks associated with supply chains and considering how corporates can protect their reputations and drive profitability while ensuring the effective delivery of goods and services.

“The main risks to the supply chain can be categorised into three areas: price risk, supply risk and supplier risk.”

Doug Pollock, F&R Industry Lead, Energy Practice Group
Thomson Reuters

In 2015, Thomson Reuters surveyed companies in 16 different industries to find out the biggest threats to their supply chain over the prior year. Raw material price volatility came top of the list, ranked by 43% of respondents, followed by currency exchange rate volatility (38%)³.

Major threats to the supply chain

Overall, the main risks to the supply chain can be broadly categorised into three areas. These are:

1. Price risk – exposure to fluctuating costs relating to raw materials, currencies, transport, labour and an increasing amount of components;

2. Supply risk – exposure to events that disrupt supply such as political unrest/conflict, economic turbulences, natural disasters, infrastructure failures, supply shortages and regulatory changes; and

3. Supplier risk – exposure to a diverse and less visible range of counterparties, leading to compliance or regulatory violations, supplier default, reputational risks and sanctions.

¹ Chartered Institute of Procurement and Supply, Dun & Bradstreet, November 2016
² ‘Chain reaction: Forces shaping the retail supply chain today’, Barclays, August 2016
³ Thomson Reuters Supply Chain Survey 2015

Efficiency through technology

Fortunately, various tools exist to support companies with managing their supply chain – for example, digital maps that enable the tracking of individual ships in real time while highlighting potential risks to the vessel such as congestion and piracy zones.

In time, companies will also be able to overlay third-party information with their own information, potentially creating a global database. This is a crucial capability to have in an age when a major incident affecting supply chains is likely to be broadcast first on social media and then reported by the local and global press. Through technology and efficient management of risk and, therefore cost, supply chain management can ultimately become a source of competitive advantage.
Third-party risks in the supply chain

Serious compliance risks are hidden deep within today’s supply chains. As a result of today’s ‘regulatory tsunami’, it is challenging for businesses to ensure that they are on top of the guidelines, legislation, frameworks and standards that will inform their decisions on third-party risk management.

These seven risks, in particular, threaten the reputation of companies and potentially expose them to large fines from regulators:

- [Politically Exposed Persons (PEPs)]
  PEPs are people entrusted with a prominent public function. As such, they are recognised by regulators as a potentially heightened risk in terms of bribery, embezzlement and corruption.

- [Bribery and corruption]
  With increasing globalisation, firms are faced with new challenges, as well as new opportunities. Part of this new environment is compliance with laws that are anti-bribery and anti-corruption, such as the US Foreign Corrupt Practices Act (FCPA) or the UK Bribery Act. The International Monetary Fund recently estimated that the annual cost of bribery is between $1.5 and $2 trillion, or approximately 2 percent of global GDP. To mitigate this risk and minimise associated reputational damage, the implementation of a structured and robust compliance programme, guided by best practice, is crucial.

- [Ultimate Beneficial Owner (UBO)]
  The leak of the Panama Papers in early 2016 highlighted how challenging it can be to identify an organisation’s Ultimate Beneficial Owner. A company might believe that it is doing business with one organisation, but then, as a result of a complex, multi-layered ownership structure, the UBO might be someone else – and they might have a completely different risk profile altogether.

Online registries only exist in around 60% of the jurisdictions where companies can set up in business. Furthermore, these registries often provide little information about the organisations that are registered with them. As a result, it could be that the UBO is actually a sanctioned entity.

- [Financial crime and sanctions]
  Financial crime includes any offence involving fraud or dishonesty, misconduct in, or misuse of information relating to a financial market, or handling the proceeds of crime.

Sanctions are political trade restrictions against specific individuals, governments, or goods being traded, which have been put in place with the aim of maintaining or restoring international peace and security.

To avoid incurring penalties for sanction breaches, companies need to understand and keep up with the various sanction regulations in all of the jurisdictions in which they do business. Payments in US dollars are automatically subject to US sanctions legislation, for example.

“Organisations could expose themselves to unforeseen risks by not knowing whom they are ultimately doing business with.”

Alessandro Sanos CAIA, Market Development Manager, Risk & Enterprise Thomson Reuters

- [Slavery and human rights abuse]
  According to the International Labour Organisation, nearly 21 million people across the world are victims of forced labour – the equivalent of the population of Beijing. Legislators are increasingly focused on this area, which presents huge reputational risks to companies. As a result of the UK Modern Slavery Act, since April 2015, firms in the UK with a turnover in excess of £36 million are obliged to publish an annual statement explaining the steps they have taken to ensure that their business and supply chains are not tainted by slavery and human trafficking.

- [Environmental crime]
  This risk category covers endangering wildlife, pollution, illegal logging, carbon trading, and water management crimes. Illegal logging has not been on the radar of many companies, but it is potentially an issue for organisations that are directly or indirectly tied to the timber industry.

- [Conflict minerals]
  Regulators are trying to break the link between the mining industry and conflicts. For example, gold, tantalum, tin and tungsten sourced from the Democratic Republic of Congo, or neighbouring countries, have a high risk of financing militia groups in the region.

The need for comprehensive due-diligence

Despite the broad range of risks present within supply chains, most companies primarily focus on monitoring financial crime and sanctions, bribery and corruption, and country risk. Thomson Reuters found that just 29% of respondents to its 2016 survey ‘Third Party Risk, Exposing the Gaps’ screen for sanctions legislation, for example.

Therefore, it is crucial that they undertake more thorough due diligence on high-risk suppliers and train employees effectively on their compliance obligations.
Building a sustainable supply chain

Companies are under pressure to bring goods and services to market quickly. At the same time, they want their supply chain to drive improvements in profitability. In the UK, retailers see management of supply chain costs as a way to offset the impact of sterling’s devaluation in the wake of the UK’s vote to leave the EU. On top of currency depreciation, retailers are wrestling with other cost challenges, including a rise in the National Living Wage, pressure to upgrade their technology, higher logistics costs and the introduction of the apprenticeship levy.

Changing supplier landscapes

Unfortunately, retail businesses are likely to be disappointed with the nimbleness, cost-effectiveness and efficiency of their supply chain, according to Barclays’ report ‘Chain reaction: Forces shaping the retail supply chain today’.

For example, many European retailers are looking to move their manufacturing operations away from Chinese conurbations with high production costs, such as Guangdong, Jiangsu, Shanghai and Zhejiang, either to inland China or to other destinations in Southeast Asia. Adopting that strategy introduces greater risk into their supply chain, since they may be working with unfamiliar suppliers.

Risk mitigation for buyers and sellers

Against this backdrop, banks are working with companies to ensure that sellers get paid and that buyers receive the goods they ordered, at the standard they expected. They also want to facilitate the creation of more harmonious relationships between buyers and sellers.

The chart shows the ‘risk ladder’ – the different credit risk management options and the level of risk mitigation they provide, depending on whether the purchaser of the mitigation product is a buyer or a seller. The range of options available will depend on the risk appetite and risk profile of both the purchaser and the company they are trading with.

Some of the options for giving and receiving payments carry more risk for buyers, yet offer increased protection to sellers. Others operate so that the seller takes on the majority of the risk.

The value of Supplier Finance

Supplier Finance schemes are increasingly popular among large corporates and also offer a means of mitigating financial supply chain risk. From a working capital management perspective, a buyer is better off by paying late; however, its suppliers are better off by receiving early. Supplier Finance helps to balance these conflicting objectives. If the buyer would like to extend their payment terms, using Supplier Finance helps suppliers by offering an early discounted payment. Therefore, the negative impact of a buyer’s term extension on its suppliers is mitigated.

The cost structure of Supplier Finance is based on the creditworthiness of the buyer - while applying the discount to a receivable, the buyer’s borrowing rates will be applied. These rates will be competitive compared to the supplier’s existing financing arrangements due to the different credit profiles of an investment grade buyer and its suppliers.

A new world of technology in trade

Technology is currently transforming every aspect of the business landscape including the supply chain. In particular, blockchain technology is set to revolutionise the process for issuing trade documentation. Blockchain technology is a distributed ledger that operates on a real-time, consensus basis – whenever a new user submits a new data block to the database, the majority of other users who have access to the same database must confirm its validity, creating an immutable record. As a result, blockchain is ideal for creating bills of lading, confirming the provenance of goods and declaring that the labour force involved was ethically sourced.

...banks are working with companies to ensure that sellers get paid and that buyers receive the goods they ordered.

An example is Barclays’ first-ever live trade transaction in 2016, working with innovative start up Wave. The Wave platform aims to speed up trade transactions so that they take place in hours rather than days, reduce costs for companies around the world, optimise internal processes for banks and reduce the risk of documentary fraud. The hope is that this can develop into an industry-wide improvement in how trade documentation is managed and vastly improve the nimbleness of complex global supply chains.

To find out more about managing supply chain risk please speak to your Relationship Director or see barclayscorporate.com.

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*Barclays, August 2016*