

# Supply

MANAGEMENT  
INSIGHTS

ISSUE 2 – 2021

## PROFESSIONAL RISK MANAGEMENT

– Anticipate and  
navigate hazards



INVERTO  
A BCG COMPANY



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## Dear Readers,

In March of this year, the pictures went around the world - the Ever Given, a giant freighter with a cargo capacity of over 20,000 containers, ran aground in the Suez Canal, blocking one of the world's most important trade routes. This resulted in many companies having to wait for their goods, major production losses and a devastating financial impact.

In addition to the blockage of the Suez Canal, the delivery bottlenecks for microchips also sent many companies into crisis mode. In this Supply Management Insights, we highlight what structured and proactive risk management can do and how you can implement one.

Particular risks lurk around supply chains, especially in the areas of compliance and sustainability. For example, the Supply Chain Act passed by the German government will require large companies to be more transparent and to comply with environmental standards and human rights.

This is also playing an increasingly important role for private equity companies in their investment decisions, as we found out in the new edition of our private equity study.

Enjoy reading and stay away from risks,

**Thibault Pucken**  
on behalf of the Management Directors



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## Professional risk management

Relentless analysis and active countermeasures



### Lead Times

Stability and reliability are top priority

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### Private Equity

Clear goals and professional methods

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INVERTO Office  
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**The digital magazine:**

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Professional Risk Management

**TAKING**

**a Critical Look in the Mirror**



**For too long, companies have paid very little attention to risk management. The coronavirus crisis has meant that some of them have been forced to deal with the consequences of this mindset. Let's take a look at the lessons that companies have had to learn.**

In the end, it was a small, yellow digger that freed the 400-meter-long Ever Given, looking like a toy alongside the gigantic tanker. The Ever Given spent six long days blocking the Suez Canal at the end of March this year, bringing the most important sea trade route between Asia and Europe to a standstill. It was carrying goods worth around 2.9 billion euros and more than 450 other ships are thought to have been delayed as a result of the blockage.

Egypt claimed 900 million euros in compensation for lost canal fees, as well as for maintenance costs and the work to free the Ever Given. Many companies waited months for their goods to arrive.

Very few companies were prepared for this scenario, which clearly demonstrates how vulnerable global supply chains with their many branches have become. Although a good risk management system obviously will not prevent this kind of occurrence, it will help identify similar risks at an early stage and give companies the chance to put alternative countermeasures in place. >

A good risk management helps identify risks at an early stage and put alternative countermeasures in place.

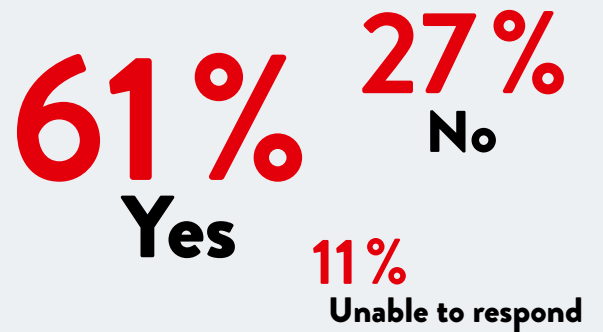
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### **An effective risk management system is worth its weight in gold**

In a situation like that, being able to act quickly is paramount. A proactive risk management department would have been able to immediately identify which goods were affected, the consequences the delay would have for the company, what they still had in stock, which alternative supply routes the company should switch to and which alternative suppliers could help fill the gap.

/ "Do you systematically identify and assess risks?"



For a long time, risk management was a very abstract concept that companies hardly cared about. It does not mean avoiding risks completely, as they are an inevitable part of entrepreneurial activity, but it does mean identifying risks at an early stage and being able to react quickly. The term has become significantly more tangible for many companies over the last year. The recent risk management survey conducted by INVERTO indicates that some 42 percent of participants surveyed were affected by unexpected supplier failures in the past six months.



Companies are now more aware of the importance of a good risk management system than ever before.

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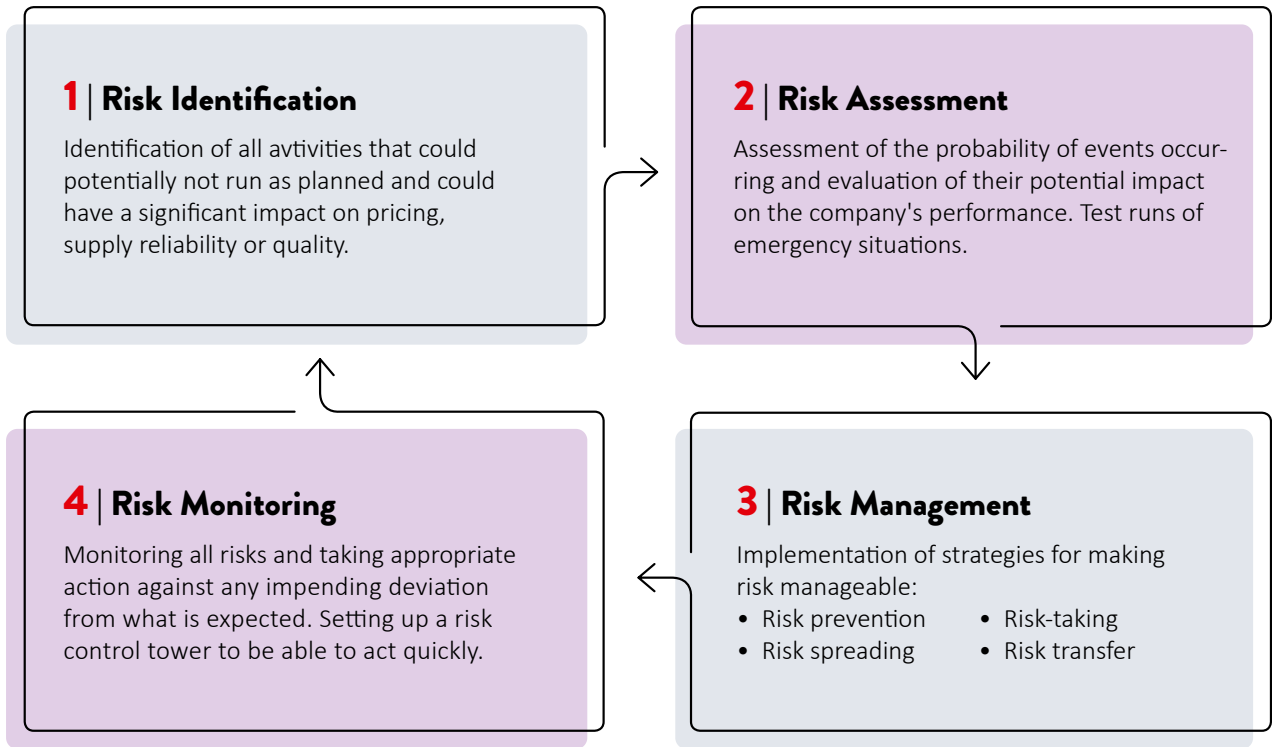


**For example,** a northern Italian supplier’s pandemic-related closure caused supply bottlenecks and, as a result, production downtimes lasting several days for one chemical manufacturer. The company was forced to source alternative products from other suppliers until their main supplier was back up to speed again. The chemical manufacturer subsequently changed its inventory parameters and also set up a task force, which now monitors similar risks on an ongoing basis and creates emergency plans for important supplier products.

The chemical company is not alone with its problems; there is also great uncertainty in other sectors. For example, most companies currently dependent on wood are accepting horrendous prices to secure their supplies. In the steel sector, there are currently no long-term supply contracts and prices fluctuate widely. And for deliveries by air or sea, even existing price agreements have been revoked. Companies have no choice but to accept the new conditions.

Companies are now more aware of the importance of a good risk management system than ever before. Of the participants in the INVERTO risk management survey, 61 percent indicated that they are systematically identifying their risks – up 23 percent on the previous year. There were 11 percent who did not answer, while 27 percent are only identifying their risks at irregular intervals, if at all. Despite this, almost every company needs to take action. “Systematically” most definitely does not mean the same to everyone and it is high time for the 27 percent who are still failing to identify their risks to address the issue. >

## / Risk Management Process



### Four steps to optimizing risk management

For companies, efficient risk management means taking a good look at their own attitude to risk and making a dispassionate assessment of their position. It all boils down to four steps: first, identifying risks; second, assessing them; third, managing them; and, finally, monitoring them. These steps create a cycle that repeats at regular intervals because risk management is an ongoing process of regularly updating the risk identification and assessment steps.

Procurement is better placed to take on supply chain risks than any other department as it has the most direct contact with suppliers and can therefore spot risks in the supply chain as early as possible. But efficient risk management also involves ensuring the company's own departments are in close contact with each other: finance, legal, R&D and logistics departments can all help assess the risks. Production can determine how important individual suppliers are for safeguarding supply reliability. For example, in order to manage risk efficiently, procurement must work with the other departments.

In order to manage risk efficiently, procurement must work with the other departments.

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## Identifying risks in the most detailed way possible

The first step for identifying the risks a company's supply chain is exposed to is to gain an overview by analyzing its product groups and suppliers. For example, product groups where there is a high proportion of raw materials or an anticipated shortage of a particular raw material can present a potential risk that needs to be monitored by procurement.

The responsible for procurement have to be able to distinguish between **five different risk types**: supply risks, risks of supplier failure, quality risks, price risks and compliance/sustainability risks. Supply risks occur when deliveries are disrupted or delayed; for example, when primary products are not available from upstream suppliers or there are interruptions in the logistics chain. Risks of supplier failure include supplier insolvency and suppliers being threatened by legal or political consequences in the country where they are based. Quality risks relate to consistent product or service quality, while price risks can be caused by shortened payment terms, exchange rate fluctuations or soaring raw material pricing. Compliance and sustainability risks occur when a supplier breaks the law, flouts environmental requirements or fails to observe social standards. **Supply chain laws** such as the German Supply Chain Act, which will soon be enforced, will increase these risks for companies, and the need to reduce CO<sub>2</sub> emissions in the supply chain – referred to as Scope 3 emissions – thus increasing sustainability risks for many companies.



### / Supply Chain Laws

Supply chain traceability is high on the agenda everywhere – be it the Modern Slavery Act in the UK, the Child Labor Due Diligence Law in the Netherlands, the German Supply Chain Act or the Loi de vigilance in France. The goal of all these laws is to track goods that were purchased abroad for any production processes that are environmentally harmful or that breach human rights in any phase of their supply chain.



### 1 | Supply risks



### 2 | Risks of supplier failure



### 3 | Quality risks



### 4 | Price risks



### 5 | Compliance/ sustainability risks

The greatest challenge lies in creating transparency, which ultimately determines the success of risk management. Therefore, strategic considerations are the focus at the beginning. Procurement must evaluate where and how it can obtain the necessary data. And once transparency has been created, a continuous process must be established to maintain this state in the long term.

Close exchange with suppliers is indispensable during this step. Only through regular discussions, self-disclosure and on-site audits with suppliers can buyers gain a true impression of the supplier's individual situation. Companies also need to analyze information such as business figures, certificates of compliance with environmental standards, press releases or news reports. In individual cases, it may also be necessary to look at selected production plants of the supplier during an on-site audit. Determining which procedure is appropriate also depends on the relationship with the supplier. >

## Most companies worry about their supply reliability

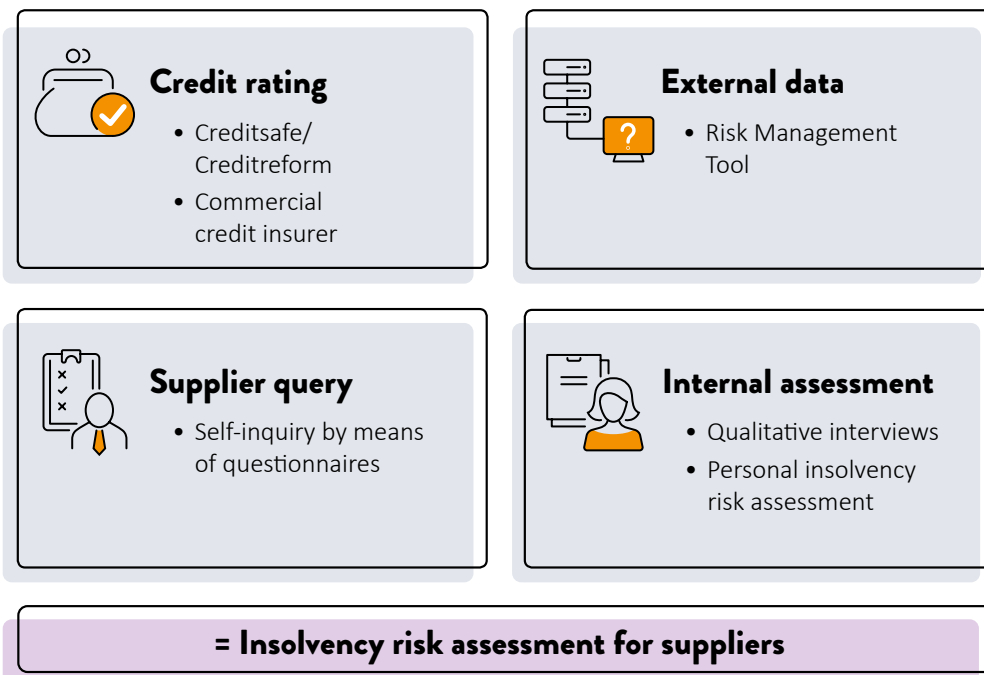
The weighting for individual risk groups will vary from company to company. The risk management survey conducted by INVERTO indicates that most participants are most likely to engage with supply risks, with 79 percent stating that this risk is currently their top priority. The figure was just 57 percent in last year's survey. Second place on the list goes to supplier failure risks at 56 percent (57 percent last year). Compliance risks are at the bottom of the list, with just 8 percent giving them top priority (down from 25 percent last year).

But is that justified? Quantitative data – such as procurement volumes, shares of raw materials, or sales figures – is a good basis for determining the risk. If a company cannot pass increases in raw materials costs onto their customers, for example, they are at a higher risk. If a company only obtains a specific product from one supplier, then it is exposed to a higher risk of supplier failure or having to accept price increases.

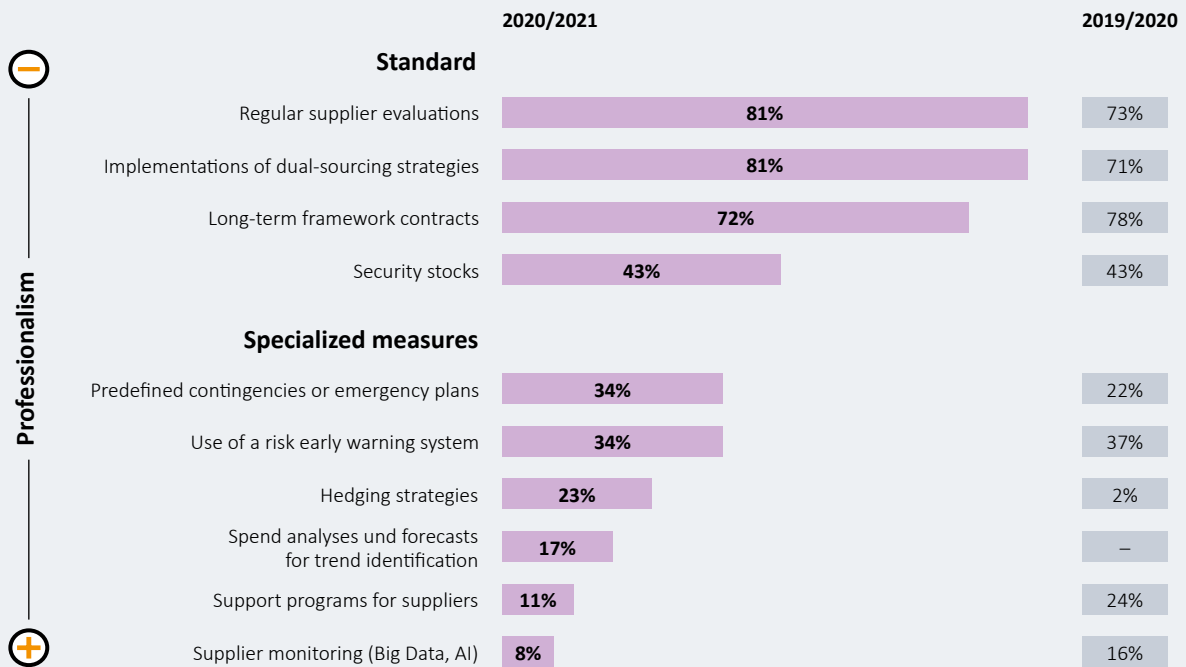
Companies should introduce a standardized evaluation matrix – such as a scoring or ranking procedure – to assess the likelihood of a risk occurring and this will also enable them to compare different risks against each other. One common approach is a point system from 0 to 100 based on a range of quantitative criteria, including regularly measurable delivery delays or price fluctuations. Qualitative criteria can also be incorporated, such as a supplier's capacity for innovation. This should be assessed through consultations between procurement and the relevant department.

Big data will also become more important in the future: for example, to compare supplier data, individual company requirements and macroeconomic developments, and to assign them a representative overall score. This will then give procurement an increasingly broad basis for decision making – although staff will also have to gain specialist data management skills and have the relevant tools.

## / Merging different data sources creates transparency (example of insolvency risk)



/ “What measures do you use to deal with procurement risks?” (Multiple answers possible)



**Managing risk to separate the wheat from the chaff**

Effective risk management requires concrete action plans. How companies handle a particular risk will depend on the case in question and they will need to find a balance between acceptable effort/expenditure and likelihood of that risk occurring. Market analysis is one option for identifying alternative suppliers and regular inspection of alternative materials can also minimize risks. Companies that have a good relationship with their suppliers could also opt for vendor-managed inventory.

The risk management survey shows that companies currently tend to use standard tools to manage risk, with 81 percent carrying out regular supplier evaluations and the same number implementing dual-sourcing strategies. When it comes to pricing stability, 72 percent use long-term framework contracts, while just 43 percent have reserve stocks to cope with bottlenecks.

Effective risk management requires concrete action plans.



Significantly fewer respondents implement the more sophisticated measures; only around 34 percent have pre-prepared emergency plans and the same number utilize an early-warning system for risks. 11 percent also have support programs for suppliers – which really come into their own in crises like the coronavirus pandemic – and just eight percent use big data solutions to monitor their suppliers. >

Even companies that have so far managed without, will no longer be able to avoid the issue of effective monitoring.

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### Everything converges in risk monitoring

Companies with an efficient risk monitoring system can react quickly and are in the best possible position to act at an early stage. Even companies that have so far managed without, will no longer be able to avoid the issue of effective monitoring with supply chain laws being enforced. A risk monitoring system can only operate properly if procurement maintains a regular dialog with suppliers, so it can **reassign risk categories** on an ongoing basis and **prepare emergency plans**.

**Risk monitoring** brings all the various threads together. Procurement should also share the results with the relevant departments, such as controlling and/or quality assurance. It is crucial that risk management is seen as an ongoing process; results must never simply be filed away in a drawer.





To this end, companies should set up an IT-supported **risk control tower** that bundles and illustrates all relevant key figures and information. It is important that all relevant departments and the management are connected to this system on a cross-functional basis so that everyone involved has access to the latest information at all times.

Introducing **this kind of system on a permanent basis** can help create a supply chain that is more stable and resilient in the long-term and to minimize the associated risks. This approach to risk monitoring will also build stronger supplier relationships, as both parties will have a better understanding of each other's needs.

## CONCLUSION

**From the Suez Canal and coronavirus to the crisis in the semiconductor market, the current situation very clearly illustrates the value of having an effective risk management system. It is crucial that risk management is recognized as an ongoing process.**

**In many companies, procurement will have to adopt a significantly more professional approach and take on the role of risk and information manager as well. Companies should also be open to new methods, such as big data solutions.**

**Implementing an efficient risk management system is a challenging process that involves getting to grips with company risk and requires several different departments to work together. It is essential that companies analyze their supply chains ruthlessly and honestly. On the other hand, once companies have taken the first step towards consistent risk monitoring, the effects can only be positive for them.**



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**Spotting potential supplier insolvency at an early stage can save companies a large amount of money and stress. Companies can manage the risk if they start early enough and take proactive measures, as demonstrated by an example from a mechanical engineering company.**

## **Foresighted** risk management

# Reacting before the traffic light turns red

**S**uppliers slipping into insolvency have long been only a theoretical risk for many companies. Transparency about these suppliers and early warning systems that ring the alarm when the first problems arise were – and still are – far too rare. The coronavirus pandemic has taught many companies that this risk is very real – and that it may cause huge revenue losses and competitive disadvantages in the months ahead.

Over the last year, concerns about future bottlenecks, production outages and the resulting sales losses have also prompted our client – a major German mechanical engineering company – to initiate a risk prevention project. Typically for many medium-sized companies, risk management has long been just one of many issues.

Risk assessment and supplier monitoring in many companies is still not given enough attention to, often not on the agenda until a supplier is already facing difficulties. As a result, any countermeasures taken are too late and too reactive. This was also the case with our client, who wanted to rework its supplier risk analysis procedures from the ground. Previously, our client relied almost entirely on information from a credit rating agency. As credit reports are majorly triggered by payment delays or defaults, taking this approach meant that the company would lose valuable time in responding to the situation.

We worked on a project with our client to set up a new warning system that would incorporate comprehensive qualitative aspects into their decision-making. We also implemented standardized processes that significantly increased transparency. Where our client had previously only been able to assess the risk of supplier insolvency at best for 10% of all cases, the new warning system boosted this figure to over 90%. This means our client is now able to identify potential insolvencies, take action at an early stage, develop relationships with alternative suppliers and, in the worst-case, use acquisitions to maintain production. The result is a crucial competitive advantage.



## Implementing Comprehensive Supplier Monitoring Processes

The name of the game in risk management is being able to react at an early stage. To make this happen, our client had to broaden the perspective and assess risks from various angles. In order to produce a comprehensive assessment for each supplier, we compared data from credit reports with the suppliers' own information and the impressions of in-house colleagues. We also included external data from ongoing press clippings in our evaluation. Our risk assessment process consists of four steps:

### Step 1: Collecting and Inputting Data

Specifically, this includes a supplier survey asking them about their current situation, an internal supplier-assessment by the buyer, and information from commercial credit insurance companies – who are much quicker than credit agencies to evaluate solvency. We also recommend monitoring the press to identify important news around suppliers immediately, to quickly react if necessary.

It is also essential to evaluate which impact each supplier has for the own production. If a supplier offers a unique product, or particularly holds a patent on this, then the evaluation should resonate this accordingly.

Once all the data has been collected, it is helpful to create a master database, for gaining an overview and creating a profound base for the assessments. We used the collected information to determine different levels of insolvency risk, making it easier to assess the situation for each supplier, especially for longstanding partners and in extraordinary situations. Using a mathematical If-Then model would have ignored qualitative criteria and assessments.



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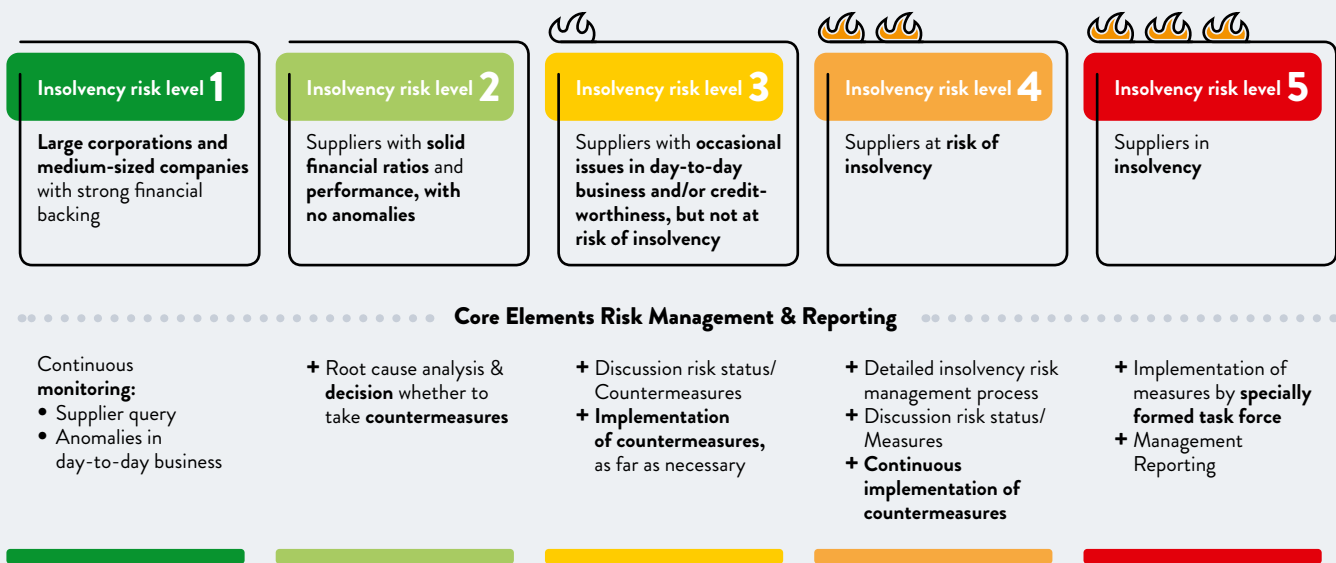
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### Step 2: Recognizing the Risk of Insolvency

The next step is to use the data to identify where ad hoc measures may potentially be required. It made sense for our client to classify its suppliers into five different categories, based on the risk of insolvency. Continuing to monitor suppliers in the first (best) category is useful, but specific measures are not required.

If suppliers are in categories two and three, then we recommend an initial comprehensive in-house assessment by all departments that have contact with the supplier to identify any irregularities in day-to-day operations (e.g. switching to cheaper materials, or asking for shorter payment terms). The next step is actively engaging with these suppliers – at executive level, if possible – and having a transparent conversation about the current observations. During the conversation, each supplier should answer specific questions about their financial and order intake situation – we compiled a catalog of questions for our client to use for guidance here. >

## / Suppliers allocated to five insolvency risk levels



Suppliers in the fourth category have severe insolvency risk and particularly need special attention, by running a comprehensive plan of measures. This includes having open discussions with the supplier's management about a joint future, as well as offering help. The support can be quite flexible, as offering upstream suppliers for a payment guarantee, offering advance payments for major orders or any other measures to help stabilizing the situation. This approach also includes measures that can improve or support a supplier's lines of credit with banks.

At the same time, we agreed with our client that the sourcing team should investigate alternatives and, if necessary, expedite approval processes. The team will give the board weekly progress reports in order to maximize focus on the subject.

If a supplier becomes insolvent (category 5), the defined procedure for our client is to respond actively and proactively implementing measures to safeguard an ongoing supply. These measures include holding meetings and opening negotiations with the insolvency administrator at an early stage. In return of giving preferential treatment, a long-term award of future orders could be placed or increasing prices as a last resort. If unique components are affected and losing a supplier would have serious consequences for our client, then the management team may also consider taking extraordinary measures – including examining whether it would be worth acquiring that supplier. In our client's case, taking this step was the best solution to secure a highly specialized component as well as the associated knowledge and – most importantly – to safeguard stable supplies to their customers.

### Step 3: Spotting the Warning Signs Earlier

The third step is to make significant improvements to the company's database. Instead of focusing on credit reports from credit agencies, it pays off to utilize information from commercial credit insurance companies, whose input is frequently underestimated. Especially because they are insuring credit defaults, these companies usually have excellent information about current financial situation of respective suppliers and they are prepared to share this information in real-time. Their focus on speed is their major advantage, given that most traditional business information is still based on past performance data such as annual financial statements, which rarely track sudden irregularities.

### Step 4: Introducing Continuous Monitoring

Once all the measures have been implemented, the next step is to refresh data on an ongoing basis and to visualize the output on a clear dashboard. This dashboard incorporates data on the creditworthiness of hundreds of suppliers that was collected manually, as well as ERP data that was captured automatically, and shows all stakeholders how endangered suppliers are by product group, and the overall risk trend at a glance. //

### CONCLUSION

It is essential to have a professionally prepared risk assessment for suppliers. Identifying potential problems at an early stage is key for companies to safeguard themselves against unwanted surprises. It is important that they start by creating transparency and then taking steps to actively implement the right measures for making their supply chain resilient. A company should also make sure that the risk assessment of its suppliers captures a range of aspects so that it gets an overview that is as up-to-date and as wide-ranging as possible.

# Experts

## on RISK- MANAGEMENT TOOLS

It is getting harder and harder for companies to maintain an overview of the ever more ramified supply chains, but Heiko Schwarz is here to help. He has more than 20 years of experience in the software industry, including at IBM. In 2013, he founded the start-up riskmethods in Munich and is the CEO. The company uses AI-based software to identify, assess and mitigate all types of risk in supply networks. This enables companies to protect supply, meet customer requirements, protect their image and reduce risk costs. We talked to Heiko Schwarz to find out how it works and which mistakes it helps companies to avoid.

# “There Will Always Be Black Swans”

## Interview with Heiko Schwarz, CEO of riskmethods, on the topic of **risk management tools**

**Heiko Schwarz, why can it be so dangerous for companies if they fail to maintain a comprehensive overview of their supply chain?**

Companies often underestimate the level of interdependency within supply networks. In tier 1, companies are now looking beyond traditional criteria such as financial stability and focusing more on diversification: in other words not just using one supplier or suppliers from the same region. Tier 2 is a different story though. Let's say that your company buys its ball bearings from three different companies in different regions. You might think that you've diversified your risk, but the steps you've taken don't go far enough because all three of your suppliers might buy from the same place. If their supplier is hit by a natural disaster, then your tier 1 diversification measures will not help you.

**Why don't companies have this level of transparency and why do they simply look at their direct suppliers?**

Companies have ignored the issue of risk management for a long time now; the most they may have done is running credit checks on their business partners. Only in the last ten to 20 years have there been a few impacts that have triggered a noticeable change of heart – the financial crisis and the Fukushima disaster, to name just two. Since then, many companies have started looking for ways to protect themselves against risks like these.

**But they haven't really managed it.**

It goes without saying that it's a very challenging process. Companies have to take a lot of risks, and a lot of information sources, into consideration to create a comprehensive picture. Data from credit agencies, insurance databases, media reports, platforms where supplier employees can post complaints – plus the data held by the company itself. As a general rule, the more precise the better. When it involves something like establishing the exact costs of a production failure in the supply chain, then you need complete transparency. >





**Heiko Schwarz**  
Founder and CEO of riskmethods



**That sounds like an absolute mountain of data!  
How much actual use is all that data to companies?**

Obviously raw data won't tell you very much. You need software that can analyze this amount of data and use it to set priorities: in other words, to identify which events will have the greatest impact and which are most likely to occur. And that is where we come in. We work with our customers to create a score card in our software that gives a clear breakdown of the risks to which the company is exposed and where. This score card acts as a centralized storage point for all types of risks and for information from external and internal data sources, and it standardizes all this information to produce usable key figures and risk profiles. We also use artificial intelligence and algorithms, which could be another reason why companies haven't had risk management on their radars before now.

**Could you explain that final statement?**

The technology that helps to analyze this amount of data and extract the relevant information for each customer hasn't actually been around that long. Big data analysis has taken a huge leap forward in the last ten years. A company like ours wouldn't have been possible before that leap as analysis on this scale, with manpower alone, would have been out of the question. Artificial intelligence ensures that the right people receive relevant, credible and up-to-date information at the right time so that they can proactively manage risks across all sectors. The AI algorithms learn which media reports on potential risks have practical relevance for supply networks, for example, and ignore anything that is irrelevant. Earthquakes, for example, can have very different effects depending on the region, industry and – of course – their severity.

**What types of risk does the software display to users?**

They can define the software to suit their individual requirements, as each industry will focus on different areas of importance. Production downtime is a fundamental risk for industrial companies in particular, but sustainability is also becoming increasingly important. Do my suppliers use child labor? How do they handle production waste? Our software can also take these kinds of factors into account. And the discussion about the German supply chain act means that it is becoming increasingly important topic Europe-wide and elsewhere for many companies.





**Identifying risks is one thing, but drawing the correct conclusions is something completely different. Can your software help with this as well?**

It can definitely indicate potential actions. If an analysis tells you that an important supplier is based in an earthquake zone, then you can either work with them to reduce their vulnerability or you can prepare emergency plans to deal with supply shortages if an earthquake happens – and, in an extreme case, the only solution may be to bring in additional, alternative sources. The software can present possible courses of action, e.g. by analyzing the extent of the damage or making suggestions, but the final decision about how to approach the situation is always down to the company.

**How reliable is your forecasting model when it comes to unprecedented events? After all, these tend to hit supply chains particularly hard: just look at Fukushima, the coronavirus pandemic, the Suez Canal blockage, for example.**

We wouldn't have been able to predict Fukushima as it actually happened, but we were aware that the region was prone to earthquakes and tsunamis. So we would have issued warnings about the risks and potential mitigating measures to companies with important suppliers based in the region. Although we can't foresee the Suez Canal being blocked up as it was, we can say that bottlenecks or intersections in the supply chain are repeatedly prone to disruption – but the extent of this particular case was definitely not predictable. But what we can do is predict the potential consequences very precisely and present potential courses of action, so that being prepared pays dividends.

**And the pandemic?**

There will always be unexpected events, things that are impossible to predict. Every model has its limits and I don't dispute that at all. But these findings will obviously be included in future analyses, so the system will improve continually over time. And when the pandemic started, we were able to warn our customers in plenty of time about developments that would otherwise never have been identified. We work with an agricultural machinery manufacturer, for example, who has an important supplier in northern Italy. When the schools there were shut down, our software identified this as the precursor to a lockdown and notified the company. Our customer reacted immediately – and the supplier's factories in the area were actually forced to close soon afterwards.

**Have the events of the last year also given you a boost?**

I'm reluctant to exaggerate things. Yes, the pandemic has helped raise awareness about risk management, but it has been one of the top three priorities in procurement over the years, even before COVID-19, and it's been moving up the list. In other words, the responsible parties were already aware of the importance of risk management in their supply chain. At the end of the day, taking proactive measures can save them money and protect their reputation. Recent surveys have shown that risk management is the top investment priority for chief procurement officers, alongside digitalization. //

# Experts

on  
**SUPPLY CHAIN  
LAWS**

**Supply chain traceability is high on the agenda everywhere - be it the Modern Slavery Act in the UK, the Child Labor Due Diligence Law in the Netherlands, the German Supply Chain Act or the Loi de vigilance in France. How companies are supposed to implement the requirements still remains a mystery to many.**

## Supply chain laws

# Shedding Light on the Dark

**S**upply chain laws have the potential to significantly shake up the European economies. It may mean that companies are more sustainable in what they do, and that suppliers in other countries are mindful of human rights. As criteria such as sustainability and human rights have already been important to both customers and employees for a long time, implementing the relevant measures under a new law could even give companies competitive advantages.

On the other hand, the law may also mean that companies are strangled by red tape and forced to pay expensive penalties, suddenly at a clear competitive disadvantage compared with foreign competitors. The idea is both right and necessary: after all, its intention is to ensure that human rights are respected and to apply appropriate pressure on international suppliers as well. What is often not clear, however, is exactly how companies are supposed to go about this. After all, supply chains are widely ramified, and in the long term, companies should also influence downstream suppliers.



### Identifying Actions Early

In most cases, companies must ensure that they implement the relevant specifications within their individual business areas as well as asking the same of their direct suppliers. This means that companies should get involved with indirect suppliers if they become aware that one of these suppliers is not complying with human rights. Creating and maintaining an overview of every direct and indirect supplier will be quite a challenge for companies and many will have to completely rejig their internal processes. But the good news is that it can be done – provided that companies get to work immediately.

Smaller suppliers should also be aware that larger ones will be passing the pressure onto them. If an automotive OEM, for example, has to audit its supply chain for human rights standards and other sustainability criteria, it will make sure that any smaller companies that it works with are also observing those specifications. Therefore, even though laws in some countries are linked to company size, ideally all companies should be prepared to meet new sustainability and human rights requirements.

### Using Effective Risk Management as a Starting Point

Companies should start by taking a look at their existing risk management systems. In some cases, this will involve taking a self-critical stance and deciding whether a structured risk management system is actually in place, or whether the company has simply reacted to previous crises. Major corporations tend to be well organized already, but they should still audit their existing system to identify any areas where expansion might be required.

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Procurement is in an ideal position to implement supply chain laws. No other company department has a close enough relationship with suppliers to gain a good overview and identify risks. This means that procurement has even greater responsibilities and is a more important link than ever between company departments and suppliers.

**Bringing Suppliers on Board**

The next step is for companies to inform their suppliers about the new requirements and then request the necessary data. It might, in many cases, mean that they need to extend their contracts or even to renegotiate them from scratch. Additional audits are therefore unavoidable for companies who have to come up with specific questions to check how far their suppliers are meeting these requirements. Fundamentally, this involves adding qualitative factors to existing audits.

Procurement can then classify suppliers into a range of categories: who is at risk of failing to meet their obligations, who needs to be put under pressure and who would the company prefer to get rid of completely? But convincing suppliers to support the new requirements is where it gets complicated – or even difficult or impossible when it comes to suppliers from Asian countries such as China. At the moment, all we can do is hope that the legislation will recognize that companies do not have greater leverage. Initially, it will be crucial for companies to follow proper processes: announcing new regulations, requesting documentation, conducting extended audits and then reassessing suppliers.

**CONCLUSION: Every Cloud has a Silver Lining**

All of these measures involve increased time and effort, of course, so companies should start by focusing on their direct suppliers. When they audit these suppliers, they should also ask them about the situation with their suppliers. If this does not produce any information about potential violations of human rights or flouting of environmental standards, then at the moment companies will not need to do any further investigation. Smaller companies in particular also have the option of working together – for example, sharing information about supplier risks – to share the load. Risk management software can also help to shed light on the darker areas.

Despite all the uncertainty, and criticisms, companies should try and see the opportunities that these laws create: they can actively help to implement global social and environmental standards which will also create economic advantages for them in the long term.

Lead Times

# Reliability – The Top Priority

Although rising raw materials prices, transport costs and customs duties can threaten a company's margins, nothing has a greater impact than production downtimes. As a consequence, lead times are increasingly in the spotlight. Our survey on lead times and the subsequent interviews with experts revealed that ensuring stability and reliability is more important than fast or cost-effective transport methods.



For decades, we took prompt deliveries for granted, even if goods had to travel halfway around the world. Then the coronavirus hit and the ensuing changes in the transport industry are still affecting us. Some rates for sea and air freight have risen drastically, while reliability has fallen significantly.

This has forced companies across all industrial sectors to rethink their existing lead times strategies and align them with possible new supply chains. We have identified four particular trends:

### Integrating Regional Suppliers

Although many companies are considering their requirements for regional suppliers, the aim is often to use these providers to supplement existing structures, not to replace them. Diversification leads to increased stability and reduces dependence on individual suppliers or regions. Nevertheless, our interviews with experts from the automotive and mechanical engineering industries have revealed that they use single sourcing strategies for key components. Companies should rely on a range of providers wherever possible, even if doing so means more work in terms of coordination and inspection.

### Increasing Inventory Levels

Before the coronavirus pandemic, many companies only had small warehouses and relied on just-in-time deliveries. As the current situation is dominated by uncertainty, the approach of building up higher inventory levels has increased significantly. At the same time, companies are investing in digital storage management systems to make sure that these inventory levels are transparent at all times. Suppliers are also facing more stringent requirements to ensure their deliveries are reliable.



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## 1. Integrating Regional Suppliers



## 2. Increasing Inventory Levels



## 3. Alternative Transport Methods



## 4. Implementing Digitization

### Identifying Alternative Transport Methods

Air freight capacities have contracted drastically and become significantly more expensive, so companies that mainly used this transport method before the pandemic have been forced to look for alternatives – and not all have been successful. To give an example, Henning Körner – Global Strategic Buyer at Olympus – has reported that rail transport and hybrid models are out of the question for the medtech company's sensitive products. In the long term, Olympus intends to increasingly shift to using sea freight (see interview). Overall, it is clear that many companies have become more flexible in their choice of transport methods, with reliability also being prioritized here.

### Implementing Digitalization

In many cases, the instability in supply chains in recent months has exposed a striking lack of transparency. In order to remedy this along the full supply chain, companies are investing in digital solutions across all sectors. End-to-end supply chain digitalization is crucial to making it possible to track deliveries in real time and react to risks quickly. Integrating external sources and creating interfaces with suppliers and customers is going to be one of the major challenges in the next few years. >



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## Olympus: Ensuring Reliable Lead Times

# Tracking Every Product in Real Time

The Olympus Corporation is a worldwide operation, producing medical technology as well as technical equipment for science and industry. Its products include microscopes, endoscopes and surgical devices. Transporting these sensitive items is challenging, which is why logistics costs account for 25 to 30% of the company's total indirect spend. We asked Henning Körner, Global Strategic Lead Buyer Supply Chain Management at the Olympus office in Hamburg, about what he sees as particularly important in logistics management.

### **How much has the coronavirus pandemic affected Olympus' supply chains?**

We have had to accept significant price increases: prices for air freight went up by 55% and sea freight by 30%. But it is not as reliable as it was: we now have to wait up to two days longer for air freight and with sea freight it can be on average seven days longer.

### **How do you see the situation developing?**

Although we hope that the situation will return to normal by the end of the year, the cycle will be difficult to break. Prices will remain high until the airlines increase their capacity, but more air traffic will only be possible once the global pandemic is reasonably under control. Generally speaking, I don't expect passenger revenue to return to the pre-crisis level quickly. That will probably not happen until 2024 and we may see a slow reduction in freight prices until then.

### **And reliability?**

Problems here are also caused by a lack of capacity, plus the imbalances between Asia and the rest of the world caused by the pandemic. As a result, I don't expect reliable delivery deadlines to be restored until near the end of the year either.

### **Has the pandemic affected your logistics strategy?**

Short lead times were and are still important to us, as they reduce the amount of capital that is tied up. Every extra day makes a huge difference with our high-quality products. Before coronavirus, however, freight methods and routes were established and reliable, which meant that we didn't really need to worry about lead times so we could focus on speed and quality in logistics. This has changed significantly. We now use a matrix that gives equal consideration to capital costs, freight costs and lead times and that switches between air and sea freight if necessary. And that approach is here to stay. Climate change is increasingly causing extreme weather conditions and ships are being built bigger and bigger, making them more susceptible to accidents, so we have to assume that unscheduled delays will continue to increase.

### **Does this mean that you are changing the share of freight methods that you use?**

Before the pandemic, air freight in inbound transport accounted for 75%, sea freight for 10%, and road transport for the remaining 15%. In future, we intend to expand sea freight to up to 60% for intercontinental freight, creating a "swimming inventory", in order to save on logistics and storage costs. How long it takes us to achieve this goal depends on when the sea route situation stabilizes again. Adherence to delivery deadlines is even more important than short lead times and this unfortunately cannot currently be guaranteed on sea routes.



**Henning Körner**  
Global Strategic Lead Buyer  
Supply Chain Management



We've trialed rail traffic via the New Silk Road as well as hybrid models such a combination of air and sea, but these options are not suitable for our products. The devices that we produce are very sensitive, so every time the goods are transferred, the risk of damage increases. Minimizing this risk is our top priority, so our tenders include stringent requirements and we have a demanding onboarding procedure for new service providers.

**Could local-for-local production and nearshoring be suitable solutions?**

I think that would be difficult because our plants are highly specialized and all locations ultimately need to have the same skills for local-for-local and nearshoring to be effective. That doesn't really work.

**How do you want logistics to evolve at Olympus in the next few years?**

This is included in our End2End Supply Chain strategy and has two strands: first, continuing digitalization and second, focusing on intensifying the vertical integration of suppliers. Here in Europe, for example, we no longer manage 100% of our transport operations ourselves as we have handed these activities over to our warehousing service provider as part of a 4PL solution. The fact that we just have an interface to the service provider simplifies things significantly for us.

We want to use digitalization to make everything as transparent as possible, so that we have an overview of risks and always know exactly where our products are. That means we can provide our customers with the information they need whenever they need it. This has been underpinned by creating the corresponding interfaces so that customers are also integrated into the supply chain. The long-term goal is to have live tracking throughout the supply chain from raw materials to customer delivery, including incorporating our rental devices and repair services. We want to use this to make the service and repair processes as efficient as possible as well, minimizing downtimes. We are currently at the brainstorming stage: what the design for a control tower should look like and which dashboards are most suitable for managing the flow of goods and information. We are planning a gradual implementation over the next two years. //



## Private Equity Study

# Operating all levers

Private equity firms have literally applied all levers on the top and bottom line in order to beat the pandemic and stabilize margins. Closer inspection reveals, however, that procurement still has a long way to go to exploit the full potential.



**S**o far, private equity firms and their portfolio companies have largely emerged from the coronavirus pandemic relatively unscathed. Although 80% of the experts who responded to our survey reported declining sales in their portfolio companies, these have only caused a fall in profits for around half the respondents (55%). Compared to the pre-pandemic situation, private equity firms are clearly operating more defensively. Respondents in our 2019 private equity survey put the focus squarely on implementing top-line measures to boost the value of their portfolio companies. Expansion and add-on acquisitions – top-line measures that dominated the 2019 survey along with sales investments – have become significantly less popular in the latest study, however, with the focus shifting to the bottom line.

This is astonishing, given that 76% of respondents are currently seeing their investment opportunities either rising or staying the same, while 82% are noticing investment prices falling or remaining unchanged. These figures could be interpreted as a sign that the climate for acquisitions is positive: since there is still dry powder stored in the arsenals, we are now seeing a renewed willingness to invest.

#### Portfolios Less Dependent on Economic Developments but More Sustainable

At the same time, private equity firms have increasingly shifted their focus to industries including professional services and pharma/healthcare – and both of these areas are less dependent on the economy than manufacturing industries, for example. Although industrial goods are still in the top three investment targets, they have fallen sharply to 37% compared with the 2019 survey, where they accounted for more than 50% of all investments.

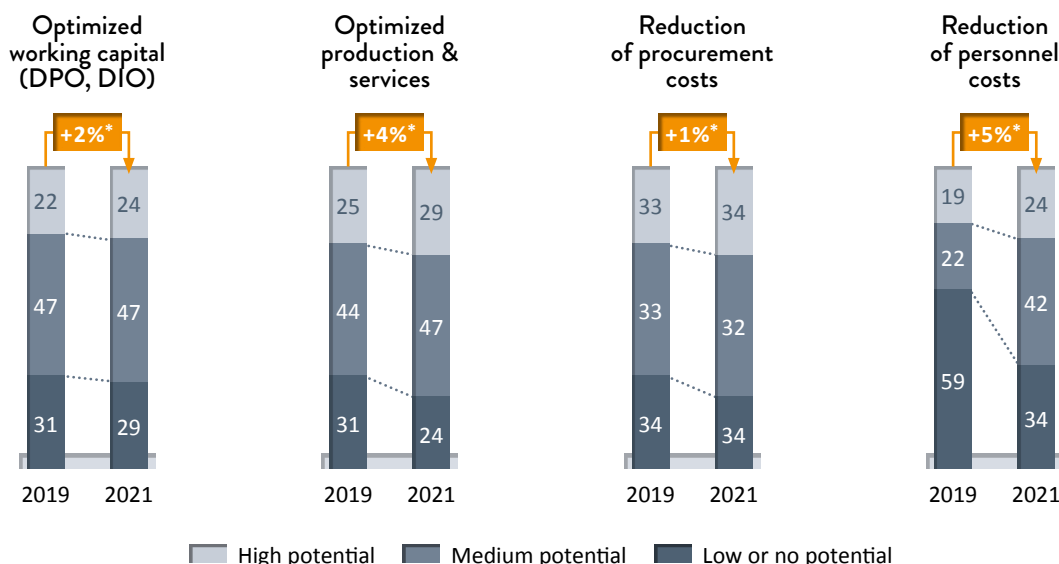
ESG (environmental, social, governance) criteria have also retained their importance, with 55% of respondents saying that sustainability criteria play an important role in investment decisions and that this has not been affected by the pandemic either. Just 9% of survey respondents report that the issue has become less of a priority due to coronavirus.

#### Bottom Line Gains Importance

After more than a year of pandemic, it is clear that all the companies that responded to the survey have intensified their efforts on the bottom line and that all areas are consistently seeing greater potential for creating value than two years ago.

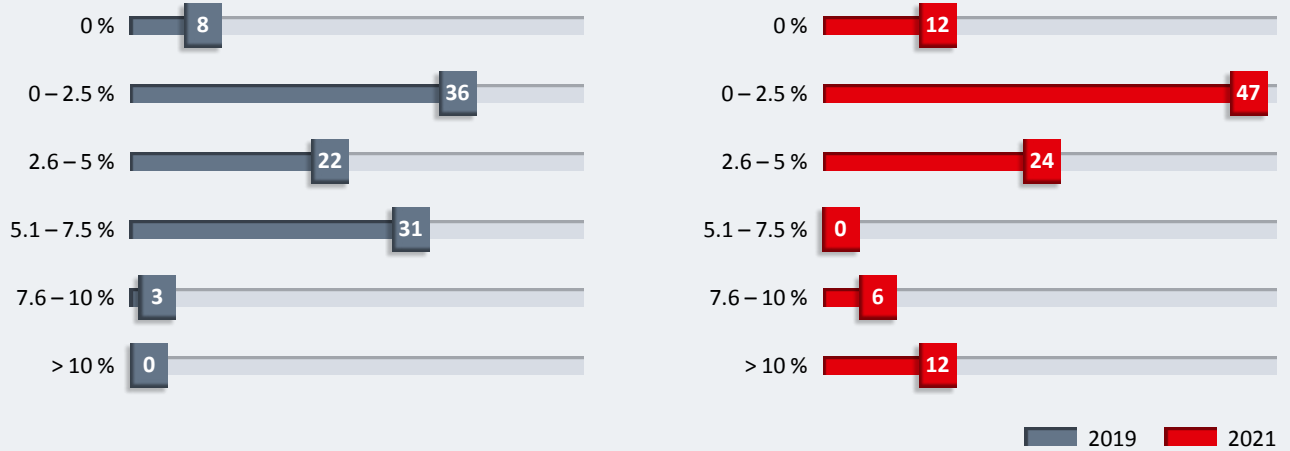
This is no surprise, given that top-line operations are usually linked to investments, while the fields of action on the bottom line involve savings, cost reductions and stabilizing cashflow. In other words, these measures have an immediate effect and mostly do not require initial investments. As the pandemic forced many companies to restrict business operations or even close completely – unlike the usual economic crises – it is understandable that reducing staff costs became more important. But we believe that, in many cases, this more likely involves reducing working hours, rather than laying staff off and, we expect to see the skills shortage, once again, becoming the main staffing issue when the pandemic is under control. >

### “Potential of bottom line measures for value creation (2021 vs 2019)” (in Percent)



\* Comparison “High Potential” in percentage points

**“What is the average P&L relevant annual value contribution made by procurement?” (in Percent)**



**Less average performance and a stronger tendency towards low and high contribution showcase a widening gap in performance between firms**

**Standard Strategies Widely Used, More Sophisticated Concepts Less Common**

On taking a closer look, it was clear that portfolio companies in procurement are implementing measures that promise to deliver a rapid improvement in results: bundling, renegotiations, tenders, and so on. This is where private equity firms can also operate across companies, pooling suppliers for all their portfolio companies, for example, or bundling requirements for several companies in their portfolio.

While these measures are necessary and effective, and they achieve quick results, they only offer limited leverage. If companies want to exploit the full potential for cost reductions, they should also utilize more sophisticated concepts such as demand management – conducting a precise analysis of all requirements – or technical respecification – such as looking for substitutes for raw materials. Private equity firms are perfectly aware that they could do more in this area. When it comes to sophisticated levers, 43% of survey respondents are aware of potential that is still untapped.

To realize the full potential for cost reductions, companies should also apply advanced measures.



In the area of procurement digitalization, just over half (51%) of respondents report missed opportunities. Admittedly, selecting and implementing digital solutions requires investment, so it is understandable that resources are not available if the pandemic has disrupted sales. Put simply, however, digital projects offer a fast and measurable return on investment, so private equity firms should definitely push for this in procurement projects.

**Good Procurement Organizations Make For Significant Value Creation**

The value that is delivered by procurement departments in portfolio companies varies greatly; in almost 75% of companies it is up to just 5% per year. Even so, 18% of respondents are achieving a value contribution of over 7.5%. These differences are also clearly visible in exits after five years on average. While the majority reports an overall contribution of up to 10% by procurement, the best procurement teams achieve value contributions of over 25%.

**The discrepancies can fundamentally be linked to three criteria. The biggest value contribution through procurement was achieved by private equity firms that:**

#### **Set clear goals**

Of the companies with above-average success, 67% of the private equity firms set clear procurement goals, compared to just 33% of the firms with a value contribution of less than 2.5%.

#### **Use all the standard levers at their disposal**

89% of the particularly good buyers use the full set of standard levers, compared to just 69% of procurement teams achieving average results.

#### **Bring in external consultants**

Of all survey respondents, 54% reported that they involve external consultants in procurement for their portfolio companies. The top reasons given for this strategy are the need for an objective perspective (52%), a lack of skills and specialist knowledge within the company (48%) and lack of staff (41%). Generally speaking, the companies that rely on the expertise of consultants perform better than those that do not. //



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## **CONCLUSION**

**Setting clear goals and consistently applying professional methods significantly improves the results procurement can achieve – and with them, the success of the company as a whole. Strategic investments in digitalization also improve procurement performance and should definitely be pursued. As sustainability criteria are becoming increasingly important for companies, private equity firms should make sure that procurement goals are aligned with the specified ESG criteria in their portfolio companies. This will enable procurement to make the best possible contribution to creating social and environmental added value.**



### **Study Design**

For this edition of our survey, we spoke to 55 experts from private equity firms. The investment focus is predominantly on central and western Europe, while around 33% of respondents also invest outside Europe. Most of the private equity firms who responded manage portfolios worth between 100 million and 10 billion euros.



**Thibault Lecat has been the Managing Director for INVERTO in London for over a year. He is an expert in procurement transformation and digitalization with a focus on the development and deployment of future-proof business models that can adapt to rapidly changing business environments. In this interview, Thibault talks about how he has adapted to the new realities over the past year – his first year at INVERTO – and what's next for the UK team.**

## **INVERTO office** Great Britain

# “The next act in the INVERTO story”

### **How did you get involved in procurement consulting?**

After my studies in France, Canada, and Australia, I started as a software developer and worked in London and Hong Kong. I first encountered the topic of procurement optimization while working for a leading consulting firm in the UK.

### **Why then the switch to INVERTO?**

When INVERTO approached me, it became rapidly clear this was going to be my next challenge - the idea of shaping INVERTO in the UK from the ground up, building a diverse team and strengthening its position in the market was very appealing to me. We have a unique standing in the market, with BCG and INVERTO working together, we don't just excel in offering top level strategic advice, but also offer the execution strength to turn that strategy into reality. This delivery strength, coupled with deep expertise in both direct and indirect procurement categories and best in class tools and databases, impressed me from the outset. Additionally, INVERTO's strong and supportive culture played a key role in my decision.

### **How did you experience your first year at INVERTO? Did your expectations come true?**

Not really - three weeks after I started, Covid "hit", which of course changed everything. Instead of going to clients, I spent most of my time at home; in fact, I didn't experience my first face-to-face meeting with a client until nine months after I started! Nevertheless, I think we managed the situation well. What sets INVERTO apart for me is the pragmatic approach to solving

problems and the sense of cohesion. Everyone in the company has been incredibly supportive of the development of the London office and we used the downtime wisely to strengthen our core capabilities and redesign some of our offerings.

### **How do you manage to keep the team together during Corona?**

The feeling of achieving something together and jointly shaping the future of our UK firm has already welded us very closely together. To lift this feeling to a more personal level, we organized a lot of informal events last year, from virtual games to cooking events, casino evenings and wine tastings. To get to know each team member personally and motivate them, I also try to have one-on-one meetings as often as possible. And finally, I invested a lot of time to support everyone in working remotely effectively and in dealing with project workload.

### **What is particularly important in projects at the moment? What challenges are companies in the UK currently facing?**

Margin improvement and cost reduction continues to be the focus for most companies, and Corona has only intensified this for some industries. We are also observing that more and more companies are wondering what exactly does their procurement department stand for and in what way can it add further value to the company further value for the company beyond cost reduction. More broadly, procurement departments in the UK are increasingly concerned with geopolitical factors, risk management and sustainability.



**Are there differences with other European markets?**

The general response to Covid was very different. The UK economy was hit harder in some cases but more in the short term. The current vaccination program has sent very positive signals: the country is coming back stronger and the economy is picking up very quickly. Another unique development is, of course, Brexit, which has now come on-top. Ultimately, however, this has helped some companies.

**How so? What role did Brexit play?**

As part of their preparation, most companies stocked up on inventory before the UK's departure from the EU. As the effects of Brexit were not as severe as feared, they were able to put this extra inventory to good use during Covid and thus come through the crisis better.

**What steps is INVERTO planning to take to gain a foothold in these market conditions?**

Our goal is to continue to grow the INVERTO brand and be perceived as the preferred partner in procurement. To achieve this, we want to further expand the leadership team in London this year and continue to work closely with BCG to provide leading edge solutions to our clients. We want to impress them with outstanding quality and great results. Of course, all this will only be possible by focusing on hiring and retaining top talents.

I am also the proud sponsor of the "Very Diverse, Very INVERTO" initiative as I believe diversity is the foundation to any great team. Moving the dial on sustainability and preserving our closely-knit culture will remain priorities too.

**What is important to you personally in your free time, how do you spend your non-working time?**

Until recently I used to be part of a semi-pro theatre company putting on shows across London. Although the audience was relatively small (c. 150 seats), standing in front of "strangers" to be Shakespeare's Oberon or Feydeau's Monsieur Tournel or even Oscar Wilde's Lord Darlington for a couple of hours was an incredible experience.

Nowadays, however, I direct most of my energy towards my young family, with whom I spend as much time as possible - I have three children. Otherwise, I love everything that makes my heart beat a little faster, such as motorized paragliding, skydiving and scuba diving.

**What should definitely be on our "bucket list" for a trip to London?**

For me, as a theatre enthusiast, it would be "Secret Cinema" - an immersive cinema experience where you dress up and enter a physical universe in the role of a protagonist, based entirely on the selected film. You get to interact with the characters and become part of the story!



## Digital Procurement:

# Faster and better decisions with advanced analytics

It is not for nothing that data is considered the currency of the 21st century. Effective use of the growing flood of data will determine tomorrow's competitiveness - only companies that succeed in extracting the relevant data and building the analysis in such a way that it can support decision making will benefit in the long term. We illustrate what is important when using advanced analytics in procurement and how you can implement the relevant processes in your company.



**Cover story in  
the next issue**

Procurement optimization of indirect requirements:

## Challenges and underestimated potential

Companies should examine their cost structures and make use of professional cost reduction measures. The optimization of indirect procurement is often neglected because its potential is underestimated. The numerous expense items are too complex and lack transparency. Nonetheless there are efficient solutions, such as demand management and tail-end management, to make the most of indirect spend.

### Download Whitepaper

[inverto.com/en/indirect](https://inverto.com/en/indirect)



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