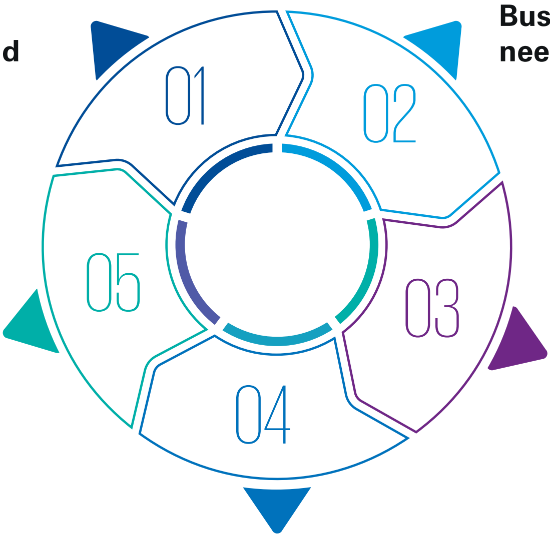
Manufacturers continue to struggle with TPRM

Most cite 'luck' in avoiding a major third-party incident amid the lack of technology, skills and funding

Industrial manufacturing

Third-party risk management (TPRM) has become crucial to success for today's industrial manufacturing businesses. As new global research by KPMG International reveals, however, manufacturers are enduring serious TPRM challenges that include major supply-chain disruption, insufficient skills and budgets, underperforming technology and soaring cyber threats.

In today's hypercompetitive global environment and the growing complexity of supplier networks, manufacturers are facing no shortage of challenges on the journey to TPRM maturity, according to KPMG's *Third-Party Risk Management Outlook 2022* report. Our findings should serve as a wake-up call on the need for sector businesses to reassess and enhance their TPRM capabilities and operating models.



Third-party incidents are disrupting businesses and damaging reputations

Businesses underestimate the need for strategic programs

Technology is failing to deliver on its promise

The challenge of limited resources is here to stay

Industrial manufacturing organizations lack fit-for-purpose TPRM programs

01 Third-party incidents are disrupting businesses and damaging reputations

Our report notes among its five key themes that third-party incidents are disrupting businesses and damaging reputations. Mitigating risk is now a major challenge for manufacturers, with 66 percent reporting significant 'supply-chain disruption, monetary loss or reputational damage' as a result of a third-party incident in the last 3 years.

Most (70 percent) say TPRM program inefficiencies are exposing them to brand and reputational risk — up from 65 percent in 2020. Nearly half (45 percent) say they have been overbilled in the last 12 months and most (64 percent) call value leakage around third-party billing a growing concern.

Supply chains in particular have become a major risk concern for manufacturers in today's pandemic-disrupted global business environment. We are seeing a domino effect in which some manufacturers and their suppliers, lacking raw materials and resources, are unable to meet the needs of the various businesses and sectors they serve. Auto manufacturing, for example, has been severely impacted by shortages of computer chips and various e-components used to operate today's digital on-board vehicle systems, the result being the inability to deliver vehicles and meet global market demand in a timely manner.

As the impact of the pandemic continues to disrupt supply chains — and as recent global events create further volatility among manufacturers' supply chain networks — the need for properly structured, risk-based TRPM programs has become critical. We believe there is no time to lose on the need to enhance TPRM maturity and the capabilities of sector businesses to consistently assess and monitor their suppliers.

70%

Say TPRM program inefficiencies are exposing them to brand and reputational risk

02 Manufacturers are underestimating the need for strategic programs

KPMG's latest report notes that 'businesses are underestimating the need for a sound TPRM program and failing to dedicate appropriate budgets.' TPRM leaders report a lack of engagement in business continuity amid a focus on tactical initiatives over strategic improvements in areas such as reputation and operational resilience.

TPRM is undervalued given its enterprise-critical role, according to 57 percent of sector businesses, with funding mainly dedicated to business-as-usual resource costs rather than strategic improvements. Managing cyber risk absorbs the bulk of spending for nearly two-thirds (64 percent) of businesses, and half of TPRM leaders also say they lack sufficient in-house TPRM capabilities to manage today's risk landscape.

Three-quarters of respondents say TPRM should be playing a much more active role on business continuity and that they urgently need to make TPRM more consistent across the enterprise.

Tight budgets are an ongoing reality in today's volatile and hypercompetitive global environment and soaring cyber threats are dominating leadership agendas and spending priorities. Along the way, however, manufacturing businesses are failing to recognize the importance and complexity of enabling TPRM across the enterprise. Sector businesses too often expect TPRM to be effectively covered by individual functions or business units — rather than creating crucial synergies and efficiencies via a truly risk-based and enterprise-wide approach.

03 Technology is failing to deliver on its promise

Although TPRM is considered a strategic priority by 86 percent of sector businesses, technology is not yet fulfilling its promise to enhance TPRM capabilities. Manufacturers say just 43 percent of their TPRM tasks are automated and that 57 percent will be automated in 3 years.

Most firms (53 percent) are frustrated by the significant lack of visibility that technology is providing around third-party risk and business continuity. Key challenges to TPRM transformation include: data-breach concerns (41 percent), integration challenges (39 percent), a lack of skills (33 percent) and poor quality/inconsistent data (30 percent). About one in four also cite insufficient funding or poor ROI.

As our findings show, digital transformation remains a struggle for many sector businesses. As the transformation journey continues, manufacturers need to understand that there is no silver bullet or one-size-fits-all solution to today's TPRM challenges. Businesses should therefore identify their risk appetite and risk environment and strategically build out their TPRM programs from there, breaking down silos and making all third-party data accessible enterprise-wide to optimize third-party visibility.

Not to be underestimated along the way is the need to maintain the right balance between technology's automation capabilities and the ongoing need for human skills. Clearly defined roles and responsibilities among leadership are also essential for effective TPRM and businesses have room for improvement on this front, with half reporting too much grey area when deciding which team is responsible to meet emerging business continuity and risk management challenges.

04 The challenge of limited resources continues

As TPRM's remit expands across all risks, domains and third-party types, the challenge of managing limited resources will likely continue for manufacturers. Digital tools can help to streamline processes and enhance cost efficiency but in today's volatile and hypercompetitive reality, resource challenges and budget constraints are expected to continue to impact progress toward truly effective risk management.

Just 35 percent of sector businesses currently dedicate the resources needed to assess third parties prior to contract, while 36 percent monitor suppliers post-contract. Just 32 percent are taking 'a risk-based approach to ongoing monitoring.' Few businesses say they assess all third parties for ESG-related risks: 18 percent for environmental risks, 23 percent for social and 30 percent for governance risks. Those numbers are expected to increase in 3 years' time to about 26 for ESG, 31 for social risks and 44 percent for governance risks.

Manufacturers say the following TPRM risks have grown most rapidly in recent years: cyber risk (51 percent), tech innovation (46 percent), business continuity (40 percent) and ESG (33 percent). Three-quarters (74 percent) believe they urgently need to improve their assessment of fourth parties as the sub-contracting trend continues.

Taking a risk-based approach that provides a clear picture of various risks across the supplier network has become indispensable today and, as our findings show, sector businesses have considerable ground to cover on this challenge, with about one third failing to take a risk-based approach to ongoing monitoring.

Manufacturers need to strike the right balance between technology, talent and processes in order to create new efficiencies and effectively assess third parties enterprise wide. Also critical is the need to optimize how human skills are being retained, applied and combined with emerging automation capabilities, in order to uplift TPRM programs in ways that help to ensure consistent assessment and monitoring of increasingly complex supplier networks.

In an effort to balance ongoing constraints with the inevitable need to manage risk more effectively, we are seeing more companies turning to various outsourcing and managed services models for efficient solutions. KPMG's TPRM professionals are helping clients in manufacturing and beyond to address today's balancing act between limited resources and the inevitable need to enhance TPRM.

05 Manufacturers lack fit-for-purpose TPRM programs

Sector organizations are struggling to maintain fit-for-purpose TPRM operating models. It is somewhat alarming to note that most businesses (52 percent) agreed that luck rather than sound TPRM management has helped them avoid a major third-party incident during the pandemic. Just 42 percent say their TPRM program is 'well integrated with other risk and business functions,' while three-quarters say the pandemic has made clear that an operating model overhaul is overdue. Two-thirds believe they have a long way to go for their TPRM function to be a true strategic partner to their business.

The pandemic's rapid and profound impact on manufacturers should provide a wake-up call on the need raise TPRM programs to new levels of efficiency. We continue to see businesses relying on a decentralized approach to TPRM, one that typically provides a limited or selective focus among the diverse risks that typically exist. Without risk-based TPRM, businesses will continue to find themselves in reactive mode when third-party issues arise.

As sector businesses increasingly recognize the need to enhance or overhaul their programs without delay, more organizations are turning to KPMG professionals for an independent assessment of their programs. We take a three-phased approach that provides clients with an initial TPRM assessment, a target operating model, and a roadmap on how to uplift the program. While some organizations will wait for regulatory requirements to drive change, we are seeing a growing number take a proactive approach to today's risk challenges.

52%

Agreed that luck rather than sound TPRM management has helped them avoid a major third-party incident during the pandemic.

06 Priorities and next steps toward TPRM maturity

TPRM should be high on manufacturing-sector agendas this year. Taking a risk-based approach will help businesses in determining their risk profile and their appropriate level of maturity. Each TPRM maturity journey should begin with a clear focus on the third parties that impact the organization's most-critical services. Sector businesses at the early or medium stage of maturity will need programs that allow them to manage every third party appropriately. Success should include steps such as:

— **Pre-contract to due diligence:** Appropriate assessment prior to executing third-party contracts has become indispensable and a key area for improvement.

— **Taking a risk-based approach:** Amid resource constraints, manufacturers should focus first on the third parties that impact their most-critical services, and expand efforts as the TPRM program matures.

— **Ongoing monitoring:** For third parties supporting critical services, manufacturers should establish thorough and ongoing monitoring programs that can help ensure each third party is consistently meeting expectations.

— **Program governance:** To enhance decision making and resolve issues and disruptions in a timely manner, businesses need to ensure that all roles and responsibilities are clearly defined.

Businesses at a more-advanced stage of maturity should focus on the following steps to optimize their TPRM programs:

— **Automation:** Forward-looking businesses should increasingly automate their end-to-end workflow, using technology to accelerate processes and decision making while enhancing cost efficiencies.

— **Taking a risk-based approach:** To streamline risk tiering of third-party services, tighten the criteria for what is critical or high risk, allocate available resources to highest-risk arrangements, and evaluate the need for on-site due diligence.

— **Off-boarding and disengagement:** Organizations need to understand and define how they will exit a relationship when performance is unsatisfactory, helping to ensure that customer services remain seamless and uninterrupted.

— **Service-delivery model:** We see an ongoing trend for businesses to establish a unified, enterprise-wide center of excellence. This is an efficient way for organizations with limited resources to cover third-party networks. A unified framework supports program consistency, enhanced data quality and accountability.

— **Management of fourth parties and affiliates:** Fourth parties are no longer out of scope as supplier networks expand. Businesses need appropriate controls that include contract documentation and consistent alignment with TPRM programs.

07 KPMG can support TPRM leaders in achieving their goals

Today's TPRM leaders need a structured and phased approach in order to gain appropriate levels of attention and investment from their boards and management. KPMG professionals are providing TPRM teams with support for the following crucial activities:

Assessing requirements and program scope: A crucial first step is identifying how regulation is evolving across jurisdictions. Many global regulators are scrutinizing third-party risk management from a broader outsourcing perspective, with a sharper view on privacy, cyber security and ESG, for example. Ensuring compliance and being prepared to respond to regulator queries to avoid financial or reputational damages is a key TPRM requirement.

An effective TPRM program also relies on the integration of diverse components among processes, people, delivery models, governance, data and technology. Understanding program performance and capabilities across these areas can reveal an organization's current level of maturity and where to act among existing strengths and weaknesses.

Transforming the TPRM program: KPMG has developed a model end-to-end TPRM program based on our collective cross-industry and global experience. Our Powered TPRM program represents an 80-percent solution of what good looks like, while allowing for configuration according to specific client requirements. There is no one-size-fits-all approach to TPRM — calibrating a full suite of components for a mature organization is vital to every program's success.

Uplifting an enterprise-wide TPRM program is a major initiative that requires a clear roadmap, sufficient resources and full leadership commitment. KPMG firms have developed relationships with key technology and industry utility providers to help drive efficiencies around process and due-diligence automation, and the continuous monitoring of controls.

Running the program and planning for the unexpected: A fully operational TPRM program requires more resources to execute the pre- and post-contract assessment and monitoring activities. TPRM capabilities encompass a cross-organizational operating model and practitioners need a wide set of skills to manage the full suite of risks. This can make it harder to secure all capabilities internally.

As our survey highlights, sector organizations are being challenged by limited resources and skills and thus seeking more-efficient TPRM. Some are relying on diverse technology enablers and alternate delivery models to address their capability gaps and enhance efficiency.

Given our strengths in risk and compliance, along with our global footprint, KPMG professionals are helping clients execute the ongoing risk-assessment components of their TPRM programs, including cyber reviews, control assessments, sanctions and anti-bribery, and corruption reviews.

Key takeaways

In conclusion, our advice to businesses pursuing the journey to TPRM maturity is that there is no time to waste in today's fast-moving environment and the accelerating pace of change. As new risks and challenges emerge, businesses cannot afford to sit still or rely on quick fixes. TPRM maturity is a journey that requires businesses to invest the time, funding and resources needed to reach their destination with effective, future-focused programs that are truly flexible, scalable and sustainable.

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