Retailers continue to struggle with TPRM challenges

Supply chain, technology, skills and funding cited as key challenges in KPMG survey

Retail

Third-party risk management (TPRM) has become more important than ever for today's retail businesses. As new research by KPMG International reveals, however, the retail industry is struggling with major TPRM issues that include ongoing supply-chain disruption, insufficient skills and budgets, underperforming technology and soaring cyber threats.

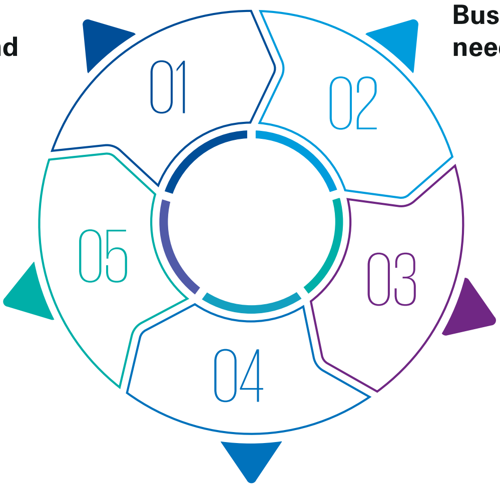
In today's hypercompetitive global environment and the growing complexity of supplier networks, retail businesses are facing no shortage of challenges on the journey to TPRM maturity, according to our findings in KPMG's *Third-Party Risk Management Outlook 2022* report.

01 Third-party incidents are disrupting businesses and damaging reputations

KPMG's latest global research notes, among its five key themes, that third-party incidents are disrupting retail businesses and negatively impacting reputations among consumers and markets. Mitigating risk enterprise-wide remains a serious challenge for most — with 71 percent of TPRM leaders surveyed reporting significant 'supply-chain disruption, monetary loss or reputational damage' during a third-party incident in the last 3 years.

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

Retail organizations lack fit-for-purpose TPRM programs

Half of businesses have been overbilled in the last 12 months and about two-thirds (65 percent) call value leakage around third-party billing a 'growing concern.' Three-quarters say current TPRM program inefficiencies continue to expose them to brand and reputational risks — up from 71 percent in 2020.

71%

Report significant supply-chain disruption, monetary loss or reputational damage during a third-party incident in the last 3 years.

As our findings show, most retail organizations are experiencing significant risk-management challenges and reporting at least one significant third-party incident within the last 3 years alone. The impact of the global pandemic has certainly taken a toll as supply-chain disruptions prove costly in terms of monetary losses and reputation damage. As businesses look to recover from the pandemic's disruption, forward-looking organizations should address this issue without delay in order to help minimize the costly impact it can have on revenues and reputations.

Inventory challenges are common, with many businesses facing a severe inventory shortage while others grapple with oversupply. To help ensure availability of goods to consumers amid today's supply-chain issues, diversification of supply-chain networks should be a priority for retailers. We are seeing more businesses pursuing this approach, shifting supply chains to new geographies or accelerating supplier onboarding in response to the pandemic's disruption and the imminent risk of goods shortages. But as businesses pursue quick solutions, there is no time to lose on the critical need to enhance TPRM maturity for the longer term amid the volatile and fast-changing global environment.

02 Retailers continue to underestimate the need for sound TPRM

KPMG's latest report notes that retail businesses are 'underestimating the need for a sound TPRM program and failing to dedicate appropriate budgets.' Our findings show that for two-thirds of businesses, managing cyber risk is absorbing the bulk of spending on risk management, while most (59 percent) also say funding remains dedicated to 'business-as-usual' resource costs rather than to TPRM improvements. Spending on limited 'tactical initiatives' are taking priority over 'strategic improvements' in areas such as reputation and operational resilience.

Most TPRM leaders, 54 percent, say TPRM is undervalued given its enterprise-critical role and 52 percent cite a lack of sufficient in-house TPRM capabilities to ensure business continuity amid today's prevailing focus on cyber security and 'business as usual' cost management. Three quarters believe TPRM should be playing a 'much more active role' on business continuity, while 79 percent say they 'urgently need to make TPRM more consistent across the enterprise.'

Reassessing spending priorities and dedicating new resources to TPRM enhancement and maturity is the way forward to enable TPRM across the enterprise. Unfortunately, leadership teams too often expect TPRM to be effectively covered by individual functions or business units — rather than creating the synergies that can arise from a coordinated, holistic approach that is risk-based and enterprise-wide.

03 Technology is not yet fulfilling its promise

While today's fast-evolving digital technologies offer unprecedented capabilities for modern TPRM programs, many sector organizations say their high hopes for technology are not being met. Retail businesses report just 47 percent of TPRM tasks are automated and that 59 percent will be automated in 3 years. Most firms (54 percent) are frustrated by the significant lack of visibility that technology is providing around third-party risk and business continuity.

Retail businesses cite the following key challenges to TPRM transformation: data-breach concerns (38 percent), integration challenges (32 percent), poor quality/inconsistent data (28 percent), and a lack of skills (27 percent).

38%

Cite data-breach concerns as a key challenge to TPRM transformation.

There is no one-size-fits-all solution to TPRM when implementing technology today, yet we often see businesses failing to appropriately assess their risk profile and TPRM needs prior to implementing technology.

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 in today's customer-centric retail environment. Clearly defined roles and responsibilities among leadership are also essential to effective TPRM, and businesses have room for improvement on this front, with more than half (55 percent) reporting too much grey area when deciding which team is responsible for which aspect of business continuity and risk management.

04 The challenge of limited resources is here to stay

The challenge of managing limited resources in today's hypercompetitive business environment and the growth of supplier networks is continuing for retail businesses. Digital solutions can enhance cost management, but budget constraints remain a significant challenge as TPRM's remit expands across all risks, domains and third-party types.

Our findings show that just 34 percent of businesses are assessing third parties prior to contract, while 38 percent are monitoring suppliers post-contract. Just 28 percent say they are taking 'a risk-based approach to ongoing monitoring.' As the complexity and scale of supplier networks increase, there is considerable room for improvement in assessment and monitoring practices.

Despite growing consumer awareness and activism on environmental and social issues that can impact retail brands, meanwhile, few businesses are assessing all third parties for environmental, social, and governance (ESG)-related risks — 25 percent for environmental risks, 28 percent for social and 29 percent for governance. Those numbers are expected to increase in 3 years time but not significantly — rising to about 32 percent for ESG, 34 for social risks and 36 for governance risks.

Businesses say the following TPRM risks have grown most rapidly in recent years: cyber risk (46 percent), tech innovation (38 percent), business continuity (35 percent), ESG (34 percent) and reputational/brand risk (31 percent). The vast majority (81 percent) also believe they urgently need to improve their assessment of fourth parties as the sub-contracting trend continues.

Amid prevailing budget constraints in today's retailing environment, it has become critical for businesses to strike the right balance between the technology, talent and processes needed to create new efficiencies and assess third parties on an enterprise-wide scale. Not to be underestimated is the importance of optimizing how human skills are being retained, applied and combined with automation capabilities, in order to uplift TPRM programs in ways that can help ensure consistent assessment and monitoring of supplier networks.

05 Businesses lack fit-for-purpose TPRM programs

While the vast majority of retail businesses, 87 percent, say TPRM is a 'strategic priority,' sector organizations are clearly struggling to maintain fit-for-purpose TPRM operating models. Most (56 percent) agreed that luck rather than sound TPRM management has helped them avoid a major third-party incident during the pandemic, and 70 percent say they have a long way to go for their TPRM function to be a true strategic partner to the business.

Just 35 percent say their TPRM program is well integrated with other risk and business functions such as procurement, legal or finance, and more than three quarters (77 percent) believe the pandemic has made it clear that an operating model overhaul is overdue.

77%

Believe the pandemic has made it clear that an operating model overhaul is overdue.

As KPMG professionals stress to clients, effective TPRM should be approached as an ongoing work in progress — with programs continually evolving in response to both specific and emerging risks to the business. As the pandemic's disruptive impact has made clear, the need to remain flexible and responsive to change is crucial today, requiring businesses to drive ongoing improvements in their use of technology, people and resources. Simply put, the TPRM journey should be continuous and unique to each organization's ever-evolving risk environment.

06 Priorities and next steps toward TPRM maturity

TPRM should be high on retail-sector agendas this year. Taking a risk-based approach can help businesses in determining their risk profile and their appropriate level of maturity. While TPRM programs will likely vary among organizations based on specific risks posed by third parties, each TPRM maturity journey should begin with a clear focus on the third parties that impact the organization's most-critical services.

Retail businesses at the early or medium stage of maturity should adopt programs that allow them to manage every third party appropriately. Success should include steps such as:

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

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

— **Ongoing monitoring:** For third parties supporting critical services, retail organizations should establish thorough and ongoing monitoring programs that aim to ensure each third party is consistently meeting expectations.

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

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

— **Automation:** Forward-looking businesses can 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 further streamline risk tiering of third-party services, tighten the criteria used to define 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 should understand and define how they plan to 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 their third-party network. A unified framework supports consistency across the program, enhanced data quality and accountability.

— **Management of fourth parties and affiliates:** In mature programs, 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.

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 with regulations 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 — ultimately illustrating whether the operating model is fit for purpose and sustainable.

Transforming the TPRM program: KPMG firms have developed a model end-to-end TPRM program based on our collective cross-industry and global experience. The KPMG Powered Enterprise Risk — Third-Party Risk Management 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 can be vital to a program's success.

Uplifting an enterprise-wide TPRM program is a major initiative that requires a clear roadmap, sufficient resources and full leadership commitment. Technology automation and capitalizing on the digitization trend will likely continue in the coming years. In response, KPMG professionals have developed relationships with key technology and industry utility providers to help drive efficiencies around process and due-diligence automation, and the monitoring of controls. We are helping to drive greater integration across TPRM, procurement, contract-lifecycle management and other risk functions to take advantage of advances in these areas.

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 capabilities internally.

As our survey highlights, retail-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, among others. This allows for momentum to be established around the program while helping to manage costs.

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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