



Best Practices for Managing Subcontractors

Keeping the Extended

Enterprise Secure

The Need for Subcontractor Management

On August 2, 2014 an explosion in a factory owned by Zhongrong Metal Products Co.Ltd. in Kunshan – a city in the eastern province of China – killed at least 68 and injured 187 workers.¹ Subsequent investigations revealed that the explosion was caused by an exposed flame in a workshop filled with combustible metal dust.

Zhongrong used to manufacture aluminium wheel hubs for Dicastal, a Tier-1 component supplier for General Motors (GE). GE delegated the management and supervision of Zhongrong to its immediate supplier Dicastal and hence didn't conduct safety inspections of production facilities of Zhongrong with which they do not do business with directly. Component suppliers such as Dicastal are often required to source from Tier-2 suppliers who must meet both in-country environment and safety standards as well as quality standards. And in this case, since Zhongrong was based out of China, GM could luckily avoid costly penalties and sanctions.

Incidents like these are a reminder that lack of proper supplier/subcontractor visibility and negligible investment in worker safety and safe production practices leads to disastrous outcomes. Sadly, many organizations are yet to take the necessary steps to address this looming risk.

According to the Supply Chain Resilience 2019 report from Business Continuity Institute, organizations have shown gradual improvement in managing their tier 1 suppliers over the years. However, most of them today find it difficult to tackle risks arising from tier 2 and tier 3 suppliers who are often inducted by primary suppliers and function at the outer perimeters of the supply chain network.²

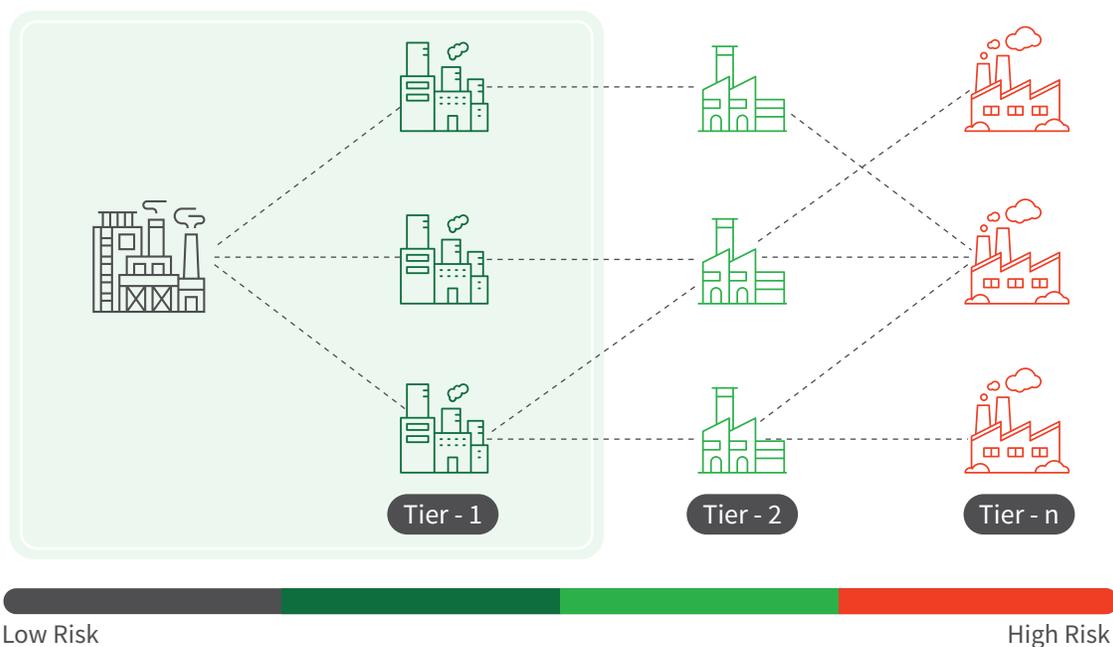


Figure 1: Tier 2 & Tier 3 Supplier Risk

While the report reveals that incidents with immediate suppliers were capped at below 50% for the first time since 2016, incidents in tier 2 increased to 24.9% in 2019 from 23.2% in 2018. Similarly, incidents in tier 3 increased from 11% in 2018 to 12.2% in 2019 (Figure 2). Such incidents result in substantial reputational and financial losses in the form of sanctions and penalties for the hiring firm, even if they occur a significant “distance” away, at the far end of the procurement value chain.

Supplier Incidents

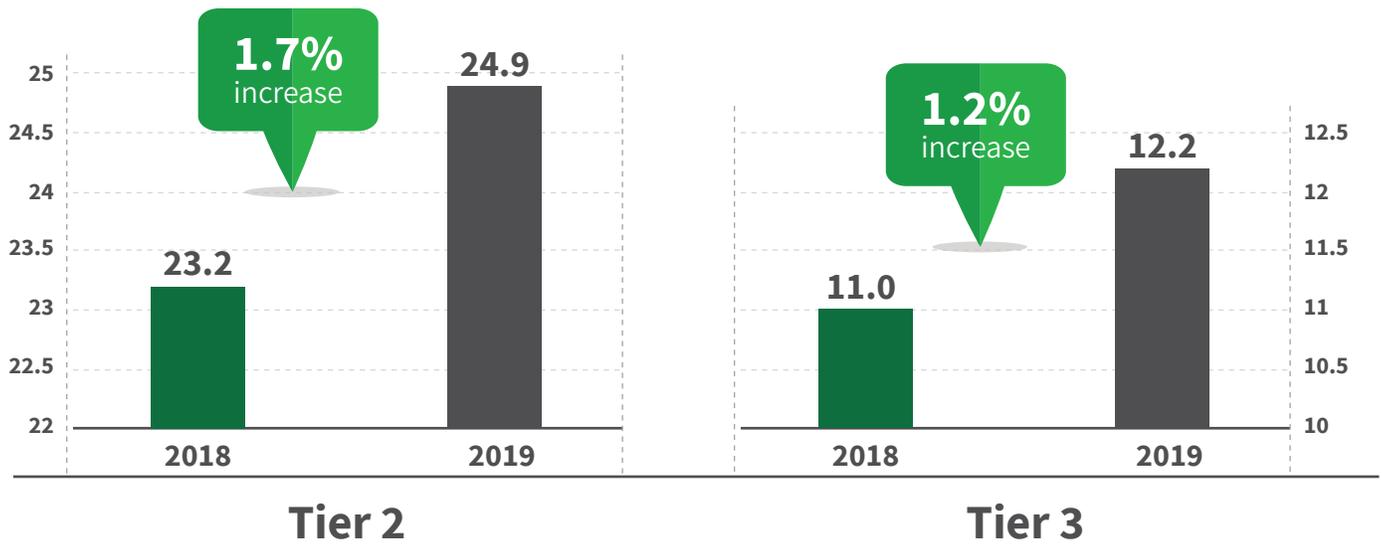
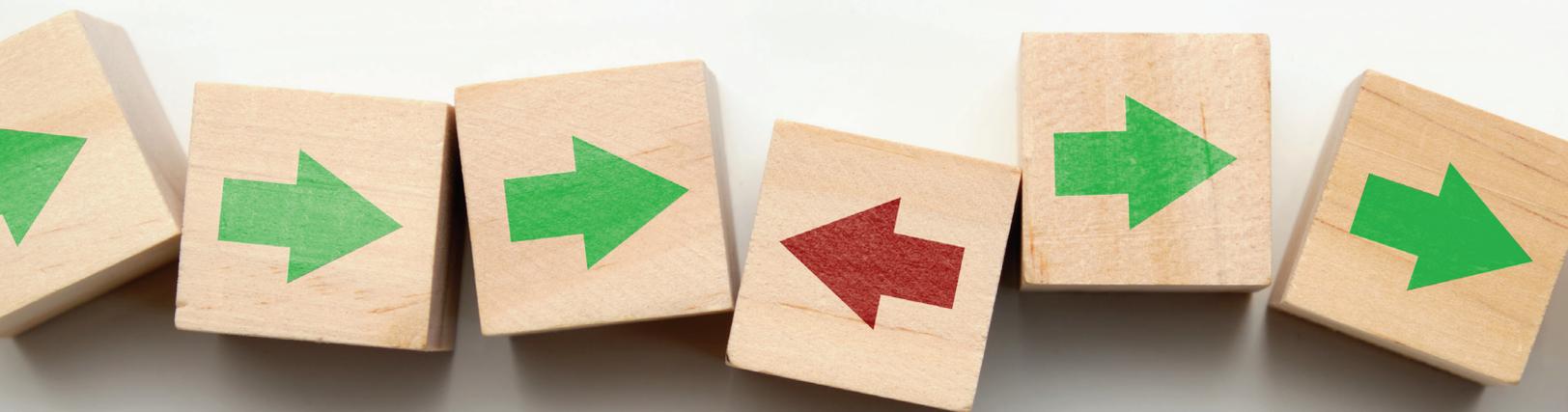


Figure 2: Tier 2 & Tier 3 incidents during 2018-2019



Underlining Sub-Tier Supplier/Contractor Risk Profile

As supply chains grow more complex, so do the risks in procurement, especially when visibility is blurred across multiple tiers of a supply chain. Today, most organizations rarely hold ownership of their supply chains beyond tier 1. They select tier 1 contractors who in turn induct tier 2 or tier 3 subcontractors forming an entire value chain. In most cases, failure of one subcontractor results in a cascading impact causing disruptions across the supply chain.

It's important to understand that with each subsequent tier of subcontractors, operations and associated responsibilities tend to move farther away from the hiring organization. In such circumstances, it can be difficult for a company to gauge the potential risks arising from its tier 2 and 3 subcontractors, let alone mitigate them. The following are some of the most common risks posed by subcontractors which continue to challenge supply chain resiliency:



Legal and Regulatory Violations

Conflicting material usage, corruption, inhuman working conditions and data abuse are just a few examples of legal violations stemming from poor management of subcontractors. As regulations and enforcements become more stringent going forward, hiring companies may find themselves responsible for illegal supply chain operations across borders – regardless of whether they are aware of them or not.



Workplace Safety Violations

Often companies have little to no insight on the safety standards followed by tier 2 and tier 3 suppliers and subcontractors. This oversight can prove to be costly as a single workplace incident can result in massive repercussions for a company in the form of government sanctions, downtime and productivity loss.



Data and Identity Theft

Digital security of supply chains is still very much in nascent stages. While progressive incumbents across industries rush to implement high-tech security solutions across processes, report of data breaches in supply chains continue to make headlines. Even companies that manage their own data with the most robust security firewalls may fall victim to hackers if their third-party vendors utilize the information through less secure systems.



Reputational Damage from Unethical Practices

Did a subcontractor follow the right environmental practices while on site? Did a tier 3 supplier manipulate child workers in an abusive work environment? Companies need to have the right answers to these questions in order to ensure that they do not face reputational damage arising from sanctions. And, such practices may be prevalent across supply chains of all companies, let alone the big wigs. In the past, well-known brands such as Apple and Nike have suffered significant damage to their reputation while unknowingly indulging in poor supply chain practices overseas.³

Child labour and modern slavery still exist today. Can you be sure they aren't occurring in your supply chain?



High-Impact Incidents

Environmental catastrophes, fluctuating markets, tariff wars, systemic events, and geopolitical events can potentially impact pricing and quality of services of subcontractors. However, the majority of subcontractors do not have the right infrastructure to absorb the consequences of an unexpected international event or natural disaster.

It goes without saying that the lack of sub-tier supplier/contractor management can lead to a major fallout, both from a financial and an operational standpoint. Research reveals that in 2019 organizations incurred losses of more than USD 60,000 with more than 1 in 20 incurring losses of more than 125 million USD for a single supply chain disruption incident. Now, with 24.9% of disruptions occurring in tier 2 and another 12.2% of the disruptions happening in tier 3, the importance of managing subcontractors becomes quite apparent.⁴



Loss of productivity and customer complaints due to supply chain disruption cause more disruption than the financial cost

“Top 5 impacts or consequences arising from supply chain incidents/disruptions over the past twelve months”



50.3%
Loss of productivity



41.5%
Customer complaints received



39.9%
Increased cost of working



36.1%
Loss of revenue



33.9%
Service outcome impaired

The majority of supply chain incidents incurred losses of over €50,000 for organizations in 2019, with more than 1 in 20 incurring losses greater than €100 for their single largest disruption

What was the approximate financial cost (in Euros) of your cumulative supply chain incident in the last 12 months?

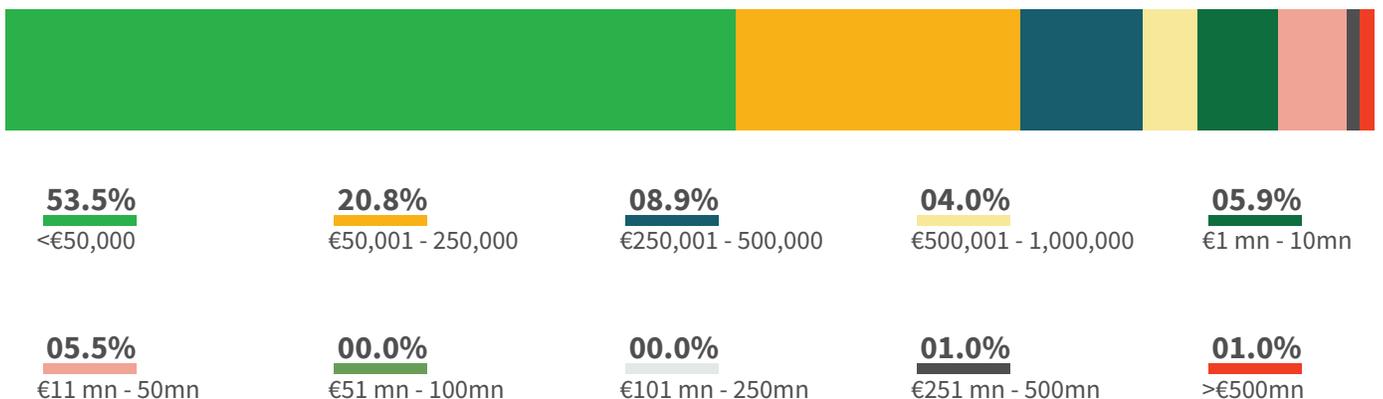


Figure 3: Impacts of Supply Chain Disruptions; Source: BCI Supply Chain Resilience Report 2019

Mitigating the Fallout – Bolstering Subcontractor Management Initiatives

Managing subcontractors comes with its own set of challenges and the entire process can be cumbersome. But the failure to act may be the biggest risk an organization can take. The following are some of the best practices for companies that seek to achieve optimum supply chain governance and resilience through robust subcontractor management:

Map your supply chain

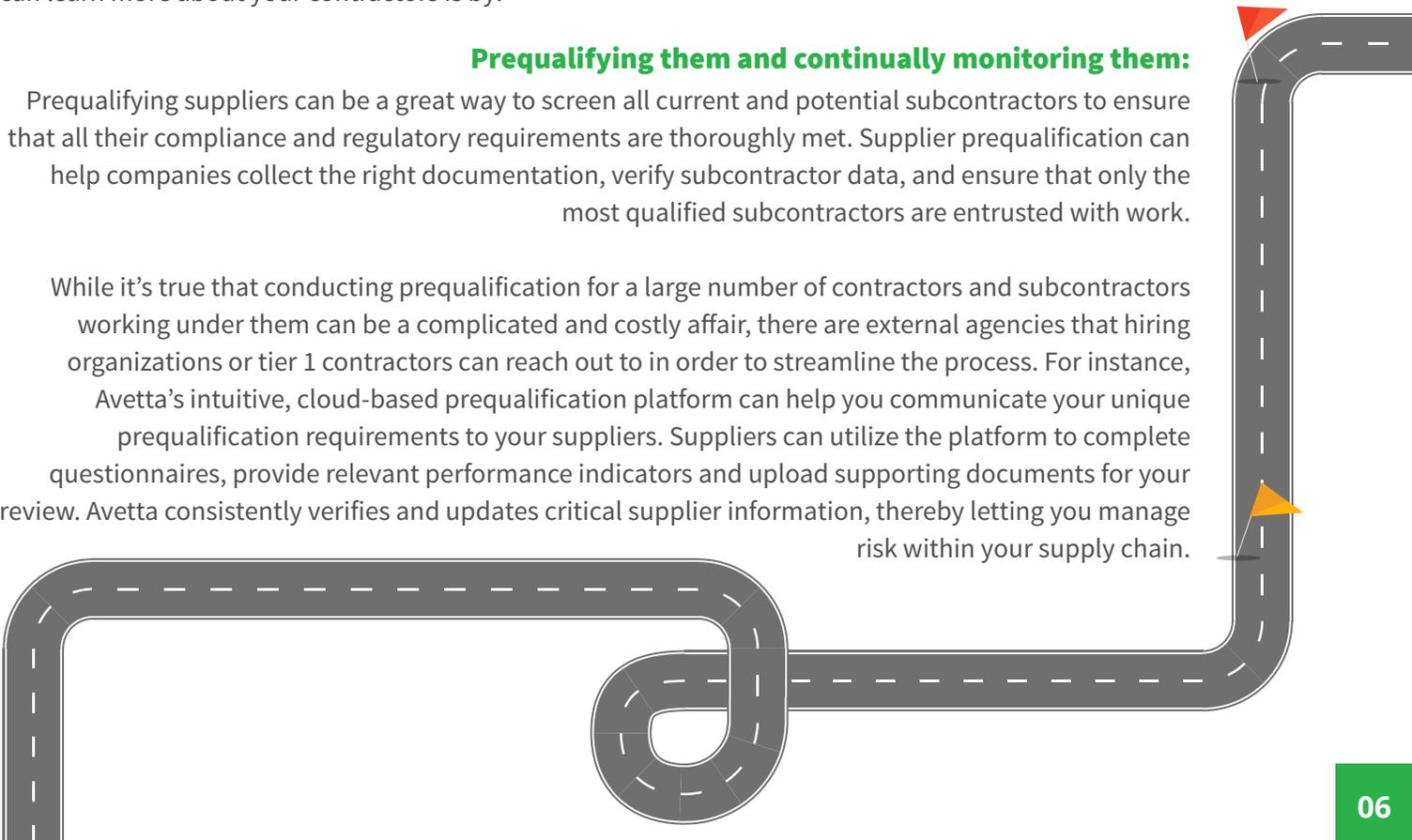
Mapping supply chains is more than just taking into account the disruption risks posed by your suppliers – you also have to bear in mind who your suppliers' suppliers might be and treat the lower tier risk as your own. The continued growth of procurement as a function depends on the knowledge that the function possesses about its supply markets, including the sub-tier suppliers and contractors. In fact, much of the value also rests in the functions ability to share key supplier information with decision makers across other verticals.

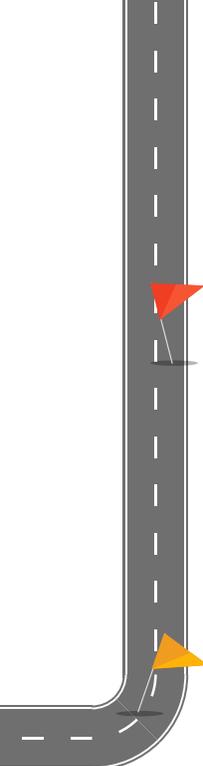
The first step towards building resilience into your sub-tier contractor management, is mapping suppliers according to their risk profiles. This involves collating and disseminating critical compliance information from subcontractors, not just at an organizational level, but on an employee level as well. As a starting point, you should initiate a knowledge-building exercise creating a repository of critical supplier information. Some of the ways you can learn more about your contractors is by:

Prequalifying them and continually monitoring them:

Prequalifying suppliers can be a great way to screen all current and potential subcontractors to ensure that all their compliance and regulatory requirements are thoroughly met. Supplier prequalification can help companies collect the right documentation, verify subcontractor data, and ensure that only the most qualified subcontractors are entrusted with work.

While it's true that conducting prequalification for a large number of contractors and subcontractors working under them can be a complicated and costly affair, there are external agencies that hiring organizations or tier 1 contractors can reach out to in order to streamline the process. For instance, Avetta's intuitive, cloud-based prequalification platform can help you communicate your unique prequalification requirements to your suppliers. Suppliers can utilize the platform to complete questionnaires, provide relevant performance indicators and upload supporting documents for your review. Avetta consistently verifies and updates critical supplier information, thereby letting you manage risk within your supply chain.





Audit subcontractors and their processes

Prequalifying your subcontractors can help you understand their compliance stance. Regular audits provide you with the opportunity to understand the difference between the expected compliance standards and the reality. This is undeniably the best way to understand whether proper policies and procedures are in place or whether they are being actively followed by the subcontractors.

Avetta's supplier audit services help companies gain complete visibility on their sub-tier supply chains through sustainability evaluations, field audits, implementation audits and so on. They can help you identify and address potential risk vectors and other factors that are hard to locate such as supplier quality and sustainability.

Assess supplier performance at regular intervals

Once a baseline performance metric has been established, regular audits can help companies measure supplier performance improvements over time. Onsite audits can help you closely identify local practices, associated behavioral challenges and improvement opportunities that conventional questionnaires often fail to capture.

Frame a robust contract

It is imperative that the contractual language is clear and underlines the key responsibilities and risks of each stakeholder. This can ensure their ownership of the project to a similar or a clearly drawn out capacity. Often, murky language can transfer both the risks and responsibilities of a subcontractor to the prime contractor. Also, the inclusion of contingency clauses and dispute clauses institutes reciprocity and accountability.

Develop training programs for effective Worker Management

One of the best ways to minimize risk and workplace incidents is to train subcontractors about the compliance requirements and the importance of being compliant. Training programs such as sessions on workplace safety, sustainability, quality, and safety orientation programs can go a long way in ensuring that there is awareness among employees when it comes to health & safety and sustainability compliance.

In order to ensure that the training is imparted in the right manner, you can leverage an online training tool for maximum outreach. Avetta's Worker Management system for instance, can allow you to save time and resources by enabling contractor employees and even subcontractors to undergo site-specific training and induction online before they arrive onsite. Avetta verifies and ensures that everyone that comes on your worksite has the right qualifications and trainings regardless of whether they are tier 1, 2 or 10.

Join a common supplier network

Businesses should, under no circumstances, solicit and award purchase orders or work rights to tier 1 suppliers who work with subcontractors with poor standards for safety, ethics, conduct, and protection of human rights. In order to ensure that you have a qualified pool of subcontractors to work with, you should associate with a common supplier network. For instance, companies joining the Avetta network can check which suppliers are compliant with health and safety standards before awarding service purchase orders. Those suppliers can also validate their subcontractor information within the network, giving the hiring client confidence in another tier of the supply chain.

As more suppliers and subcontractors get added, visibility increases and risk diminishes. To date, Avetta has more than 3 million workers and 360K connections within the network.

Not all supply chain challenges can be solved by individual efforts and some require industrywide collaboration. By teaming up, peer companies sharing common supply chain networks can work together to establish common best practices and standards for optimum performance and ensure that subcontractors are evaluated on same metrics. These partnerships can also help in preventing training redundancy, audit fatigue and unnecessary documentation for a common pool of suppliers and subcontractors working to achieve similar client requirements.

Rounding Up

Subcontractor management is a complex yet highly important process that can be the defining factor dictating the success or the failure of a project. Often with millions at stake, it becomes imperative that all stakeholders are performing optimally to ensure the success of the operations. Failing to do so may have far-reaching ramifications not only across the organization but across communities and families as well.



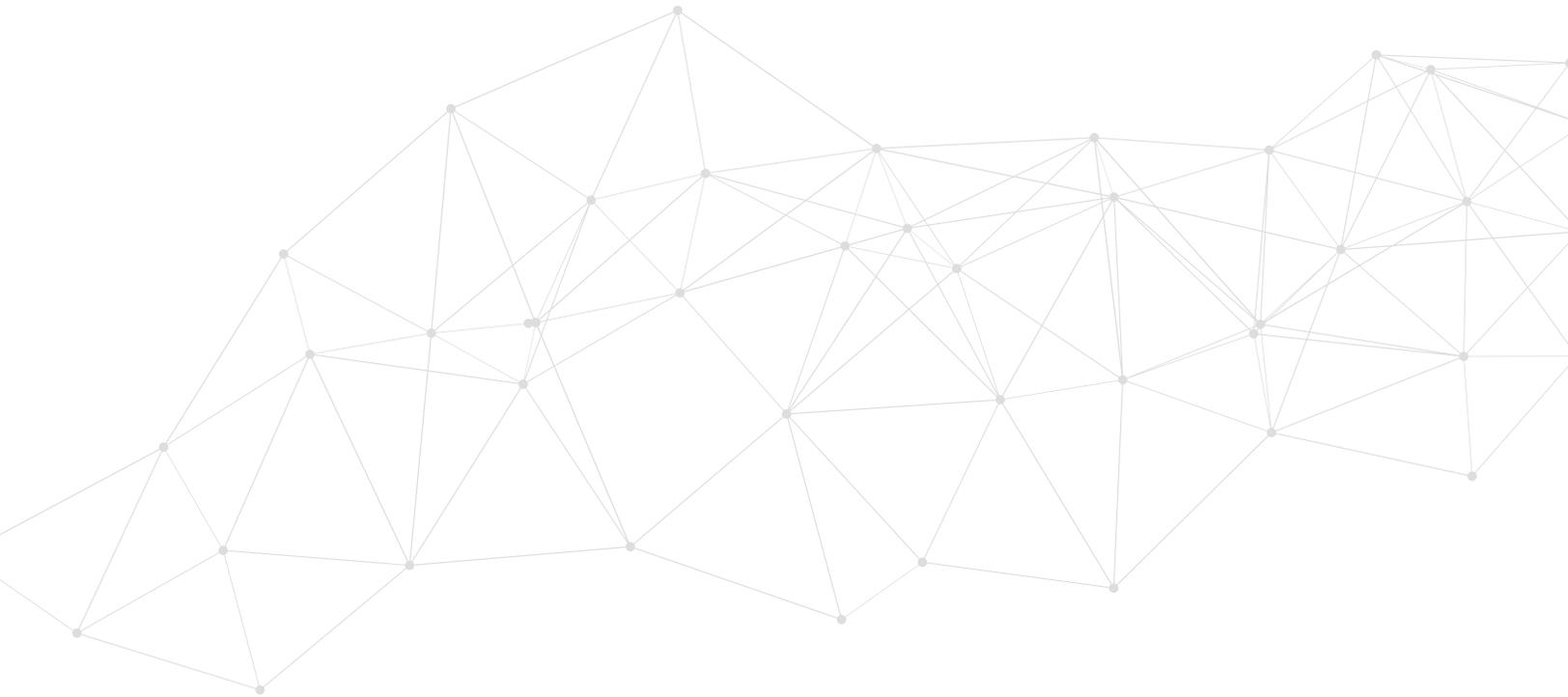
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¹Source: China Factory Explosion in Jiangsu “Kills at least 68”;
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²Source: BCI Supply Chain Resilience Report 2019;
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³Source: The 11 Greatest Supply Chain Disasters;
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⁴Source: BCI Supply Chain Resilience Report 2019;
<https://continuityinsights.com/bci-supply-chain-resilience-report-2019/>



About Avetta

Avetta connects global organizations with more than 100,000 qualified suppliers, contractors, and vendors across 100+ countries. We support the continued growth of supply chains through trusted contractor prequalification, safety audits, monitoring, and more. With real results in reducing incident rates, our highly configurable solutions elevate safety and sustainability in every workplace.