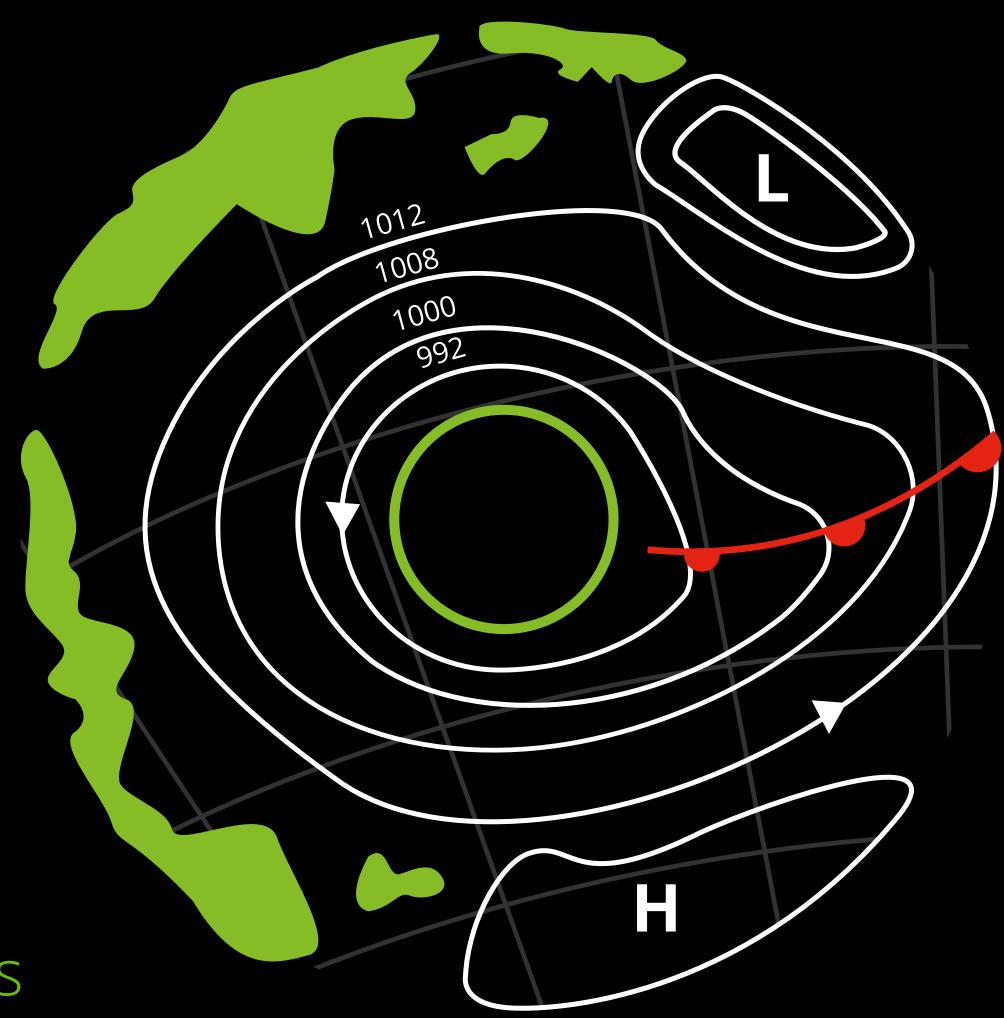
Deloitte.



Navigating the headwinds

Enhancing agility to regain momentum



Foreword

I'm pleased to share our latest Third-Party Risk Management (TPRM) survey with you. It's now reached its **eighth consecutive year.** The growing year-on-year participation levels from those responsible for TPRM in their organizations includes representation from the Americas, Europe, Middle East and Africa (EMEA), and Asia Pacific (APAC). This year, we received 1,356 responses¹ from 40 countries: our highest number yet. We believe the increasing popularity of this survey gives us a rich dataset to identify trends, draw conclusions, and benchmark organizational progress in managing evolving complexities. It also helps us to navigate opportunities arising from supplier and third-party relationships that are becoming crucial for organizational success.

This year's survey acknowledges the growing uncertainties in the macro-economic and business environment (often referred to as "headwinds") and their impact on TPRM practices. The survey aims to:



Better understand the impacts of such headwinds in managing supply chains and other third-party relationships.



Capture how organizations are transforming themselves to augment current capabilities that help them adopt innovative or adaptive responses to address these challenges.

Our survey was conducted between February and April 2023 against the backdrop of the continuing war in Ukraine and other geo-political challenges, the cost-of-living crisis (in many participating territories), alongside growing focus and investment on building stronger organizations that can support market stability while protecting the environment and addressing climate change issues.



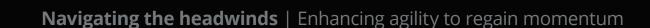
The results of this survey reiterate
TPRM's potential to power
performance. Our findings showed
that organizations with higher TPRM
maturity were more resilient and
more agile to adapt to challenges
in an ever-changing external
environment. The best organizations
have shown that a comprehensive
framework (risks interconnected,
real-time monitoring in place, well
sighted stakeholders) react quicker
to the impacts of any adverse events.

We identified the need to develop sustainable and resilient supply chains in our 2022 TPRM survey report. As we continued tracking progress made by organizations in this area over the past year, we saw that actions related to sustainability and responsibility were often planned and carried out without considering the impact and opportunities around overall organizational resilience and profitability. This has resulted in challenges to maintain commitment

This has resulted in challenges to maintain commitment and funding for these initiatives to achieve the desired impact. An integrated approach to augment current capabilities enabling the adoption of innovative or adaptive responses that considers the overall impact on the sustainability and resilience posture of the organization goes a long way. It would rationalize the impact of trade-offs to maximize the benefits from co-beneficial needs, including greater discernment over the end-to-end supply chain.

Having said that, the most significant overall challenge with Environment, Social, and Governance (ESG) risk identified in this report, is the lack of availability and trust in the related (internal and external) data, and the ability for organizations to make it actionable. An example of this is data around traceability, which often presents significant challenges to organizations. On the other hand, the biggest challenge with resilience has been the lack of integration of frameworks and data points associated with third parties, a shortage of exploring contingency options and immaturity in severe – but plausible – stress testing scenarios.

^{1.} While preparing our report, we have considered partially completed survey responses (to the extent survey questions have been answered by these respondents). Further details related to survey participants can be read in the Respondent profile section at the end of this report.



Foreword

This is a result of:

- higher levels of decentralization in organizations;
- poor coordination (internally within organizations and externally with third parties); and
- tighter budgets that have challenged technology investments to implement a stronger data-driven approach.

Alongside these actions, the more astute organizations with mature TPRM practices are aspiring to deepen their trust with their third parties. This shifts the focus of governance from administering questionnaires and other routine activities, to more collaborative conversations around innovation, strategic growth, and enhanced performance. At the same time, organizations are striving for operational excellence through ongoing digital transformation in response to increasing expectations from executive leadership, and evolving regulation that generates an increasing volume of requirements.

What follows is a deep dive into these current and emerging topics. Here's what our key findings showed:

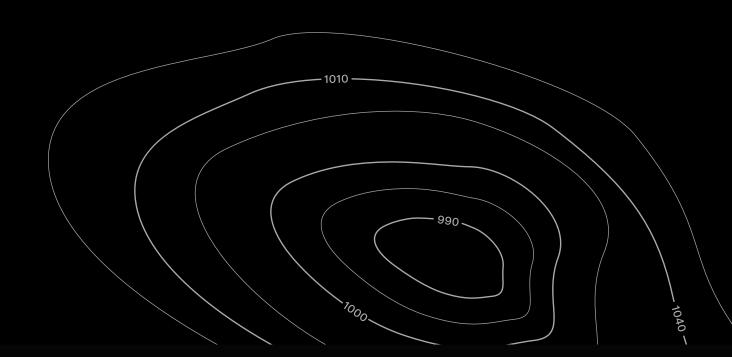
• We were pleased to see that the overall respondent sentiment on organizational TPRM practices continues to be positive in terms of its ability to help companies successfully navigate various headwinds, particularly in organizations that continue to enhance their capability and agility to meet evolving (and ever-increasing) expectations.

- Organizational cultures are becoming more supportive in understanding and managing ESG risks and opportunities with greater adoption of quantitative scoring and assessments (albeit focused on a specific subset of ESG areas) amid data quality concerns.
- Building resilient third-party relationships continues to be a key area of focus, with scope to better align with sustainability initiatives. Increased resilience is being enabled by alignment with business strategy and risk alongside a more centralized and coordinated approach enabled by technology.
- The four key elements that astute organizations are using to enhance third-party trust are transparency, reliability, capability, and humanity. This shifts the focus of governance away from administering questionnaires to, for example, more collaborative conversations around innovation, strategic growth, and enhanced performance
- The complex, inter-connected nature and accelerated velocity of existing and evolving risks is driving greater automation using techniques such as artificial intelligence (Al) and natural language processing (NLP). Companies are also harnessing the power of internal and external data and integration with other platforms across their organization. This will enable smarter segmentation, due diligence, and monitoring together with proportionate risk management mechanisms.

I hope the following wealth of insights will enhance your understanding of prominent trends and themes on a cross-industry basis, as well as those specific to your sector, as you steer your organization on its TPRM journey. As always, I welcome your feedback on what you're seeing in the marketplace, or if you want us to benchmark anything else in future reports. Our TPRM professionals can help you understand how this survey's findings reveal distinctive opportunities for your organization. To learn more, please **contact your local expert**.



Kristian Park
Global Lead
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Management
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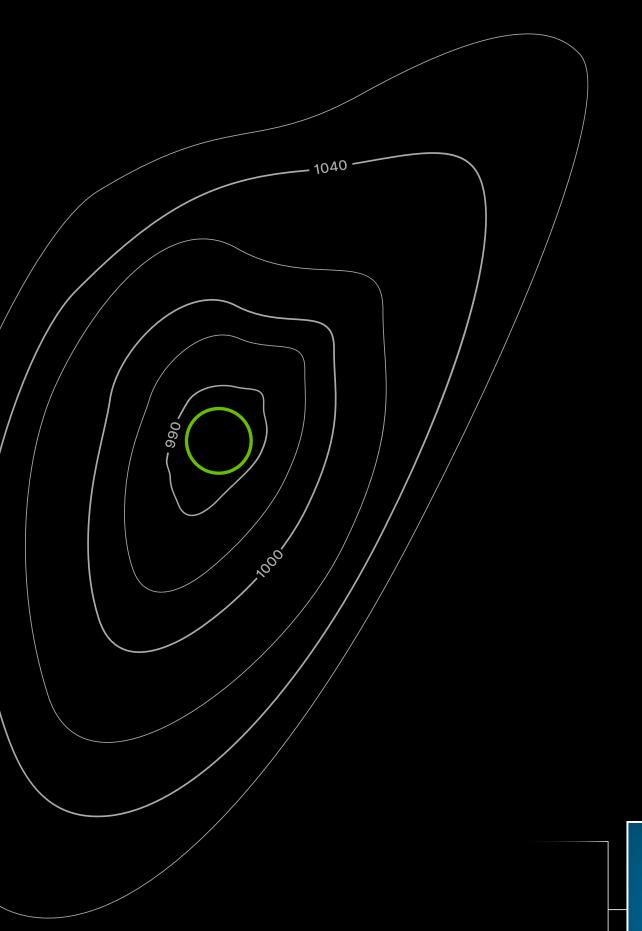




Key findings

The findings from the survey help us to understand how organizations are transforming themselves to augment current capabilities to address the growing uncertainties and other challenges in their business and macro-economic environment. Overall, those organizations that make appropriate investments and have higher levels of TPRM maturity can navigate the complexities of this environment in a more agile manner. This is also reflected in their ability to be more sustainable, resilient and enhance trust in their extended enterprise, often with ongoing digital transformation for operational excellence.

Key findings



Overall respondent sentiment on organizational TPRM practices continues to be positive in terms of its ability to help organizations successfully navigate the various headwinds, particularly in organizations that continue to invest in their capability and agility to meet evolving (and ever-increasing) expectations.

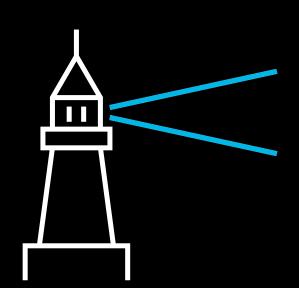
Organizational cultures are becoming more supportive in understanding and managing ESG risks and opportunities related to third parties. They're also taking on more quantitative scoring and assessments (related to specific ESG areas) amid data quality concerns. However, many organizations are missing the opportunity to recognize the synergies between their sustainability and resilience initiatives through a more coordinated approach.

Embedding strong resilience practices across the extended enterprise remains a major priority (as organizations shift their stances from "Just in Time" to "Just in Case"). This can be achieved by **integrating business strategy and risk** better, alongside a more **centralized and coordinated** approach enabled by **technology**.

Astute organizations with mature TPRM practices aspire to deepen trust with their third parties based on transparency, reliability, capability, and humanity. This shifts the focus of governance away from administering questionnaires to, for example, more collaborative conversations around innovation, strategic growth, and enhanced performance.

Rapidly evolving and interconnected third-party risks are compelling organizations to continue to pursue digital transformation for achieving operational excellence in TPRM.

These are further enabled by automation and smarter segmentation, due diligence, and monitoring by harnessing the power of internal and external data. This also ensures that the level of oversight is proportionate to risks involved.



Overall respondent sentiment on organizational TPRM practices continues to be positive in terms of its ability to help an organization to successfully navigate various headwinds, particularly in organizations that continue to invest in their capability and agility to meet evolving (and ever-increasing) expectations.

Summary



In this section we use survey data to demonstrate how the current business and macro-economic environment has once again reiterated

TPRM's potential to power performance in organizations. However, this is more achievable in organizations with relatively mature TPRM mechanisms. This is because it enables them to understand and navigate the growing complexity, velocity, and ripple effect of intertwined and newer risks better than their peers.

This sentiment is also reflected in higher-than-expected levels of personal optimism in those involved in third-party management activities at organizations continuing to invest into their TPRM capabilities.

A higher investment priority is to revisit existing TPRM frameworks/methodologies and ensure they remain environmentally fit-for-purpose, alongside a desire for human-centric systems-driven approaches. A stronger need for human-centricity tells us that the "tech over talent" approach in isolation doesn't work; particularly given the need for top talent to set parameters and drive action based on data generated through technology.

In our conclusion, we recommend tangible actions for organizations to determine and develop the appropriate level of capability that will help them to sharpen their response to supply-chain and third-party management challenges.

Key insights

Headwinds in the macro-economic environment continue to challenge third-party management.

Over the last eight years, our annual TPRM surveys have continually shown the progress made by many organizations in managing supplier and third-party relationships. However, the growing complexity and increasing dependence on third parties continue to present challenges to organizations.

The pandemic exposed further weaknesses, but before organizations could even fully address them, further macro-economic challenges continued to emerge across multiple areas (**Figure 1**) with serious shorter to longer-term implications.

These included the war in Ukraine and other geopolitical developments, multi-year inflationary trends, raw material and logistical capacity shortages, and climate change, to name just a few.

Some of these concerns appeared to have nearly reached their peak by the time this survey was open for response, while stricter monetary policies and rising interest rates continued to increase input costs and slow down consumer demand, amid fears of further economic downturn.

More than 40% of respondents also expressed concerns over their ability to meet increasing expectations around ESG.

This was followed by 39% of participants having **concerns related to logistic disruptions** they faced and 34% worried about **labor-market shortages**.



Figure 1. The most significant macro-economic and business environment issues ("headwinds") impacting supplier and third-party management

SLOWING DIGITAL INVESTMENTS

CURRENCY FLUCTUATION

SLOWER SUPPLY CHAIN TRANSFORMATION

MULTIYEAR INFLATION

INCREASING ETHICAL/RESPONSIBILITY EXPECTATION

GEOPOLITICAL CHALLENGES

INCREASING ESG PRESSURE STRONGER TRACEABILITY REQUIREMENTS

LOGISTICS DISRUPTION ECONOMIC SLOWDOWN/DOWNTURN

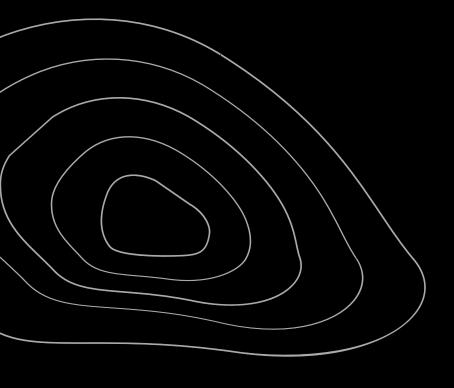
LABOR MARKET UNCERTAINTY/SHORTAGE

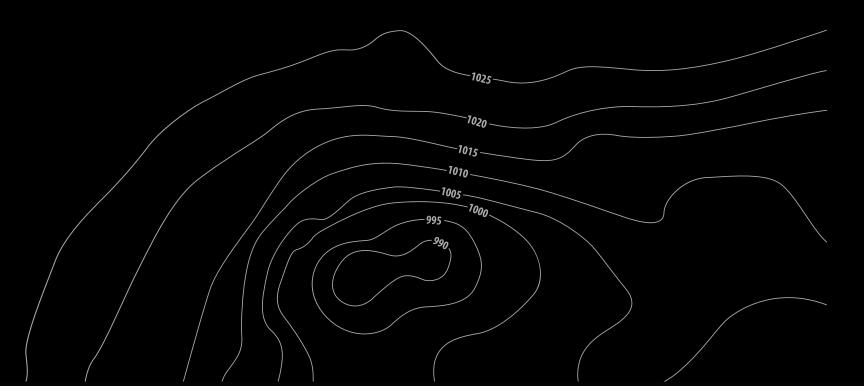
COMMODITY/LOGISTICAL CAPACITY SHORTAGE

Our current survey data shows that ongoing **geopolitical challenges** and **continuing multi-year inflationary trends** are identified as the top two headwinds making the biggest impact in managing supply chain and other third-party relationships for **61%** and **46%** of respondents, respectively.



More than 40% of respondents also expressed concerns over their ability to meet increasing expectations around ESG. This was followed by 39% of participants having concerns related to logistic disruptions they faced and 34% worried about labor-market shortages.





Overall sentiment in managing third-party relationships remains positive or neutral.

Despite these headwinds, the overall sentiment of 83% of respondents responsible for TPRM in their organizations remained optimistic or at least neutral, except for 17% where personal sentiment was more pessimistic.

Those who remained positive also mentioned ongoing investment in their TPRM capability, which fueled confidence in their ability to successfully navigate disruption and uncertainty. As a result, the proportion of optimistic respondents was higher for those with more advanced levels of maturity (Figure 2a).

This was also the case with the larger organizations who, we believe, had the financial commitment and resources to make bigger investments in TPRM over the years. Such organizations have a higher level of confidence in their ability to overcome disruption, compared to those that operate on a smaller scale.

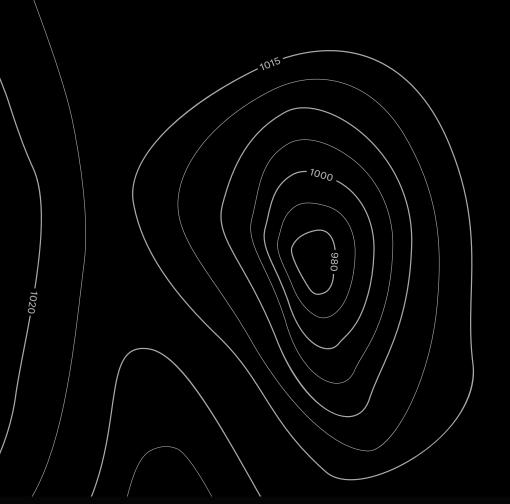
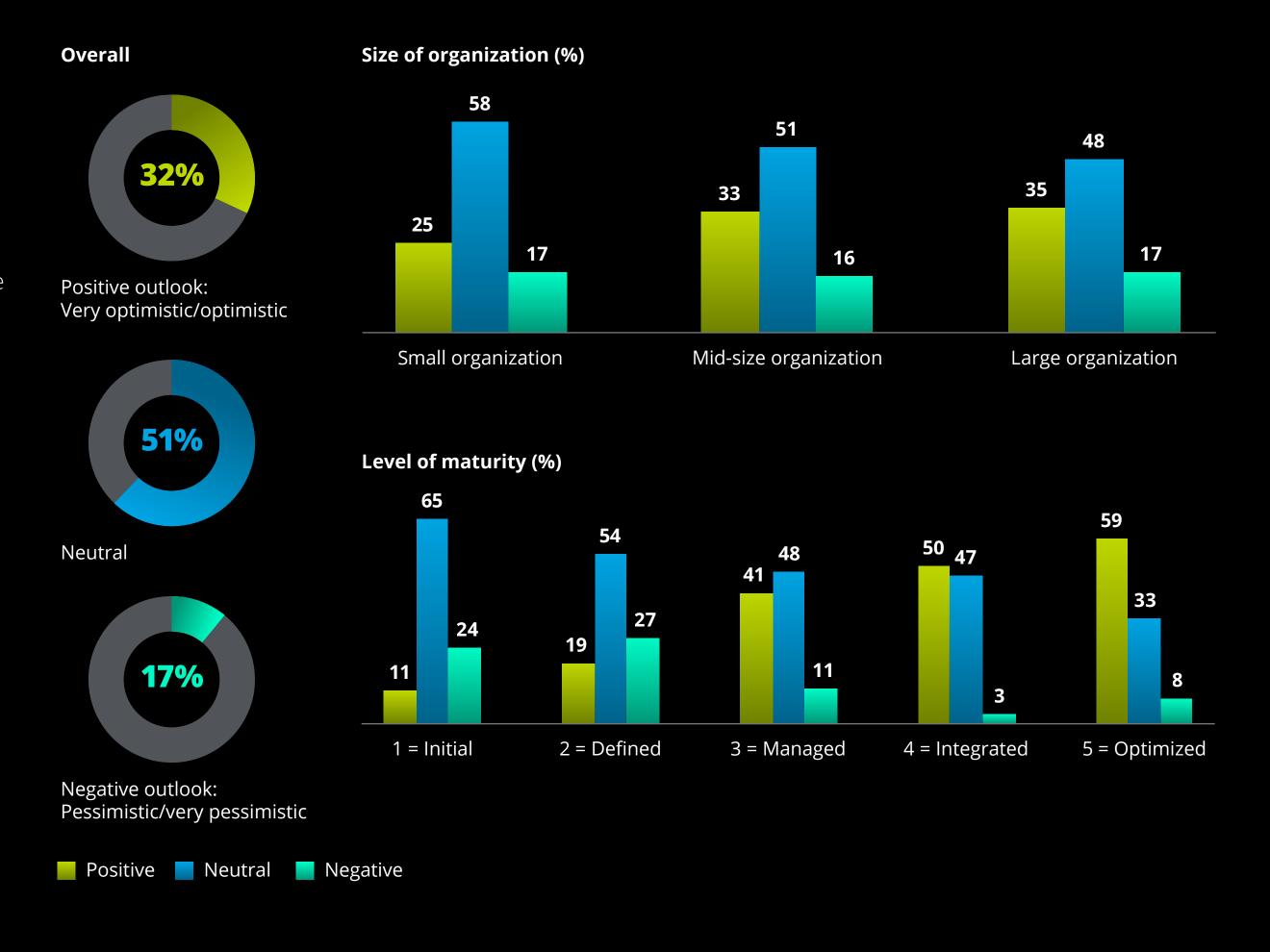


Figure 2a. Sentiment of respondents in managing third-party relationships going forward (overall, by size of organization and level of TPRM maturity)



industry and by region)

While we didn't see significant differences in positivity levels across industry segments (Figure 2b), respondents from the Americas and EMEA were far more positive than their APAC counterparts. This is possibly due to greater focus and investment so far in these regions, as shown in Figure 2b.

In our experience, the larger and more mature organizations who have been investing in TPRM over the years tend to be better equipped with a stronger understanding of how numerous factors driving interconnected risks come together. They can leverage this to create a competitive advantage for themselves. For example, they can dedicate more resources to the growing focus on reducing supply chain-related carbon emissions through effective engagement with suppliers and other third parties. This reduces their carbon footprint, while combating another interconnected risk of rising energy costs impacting operations.

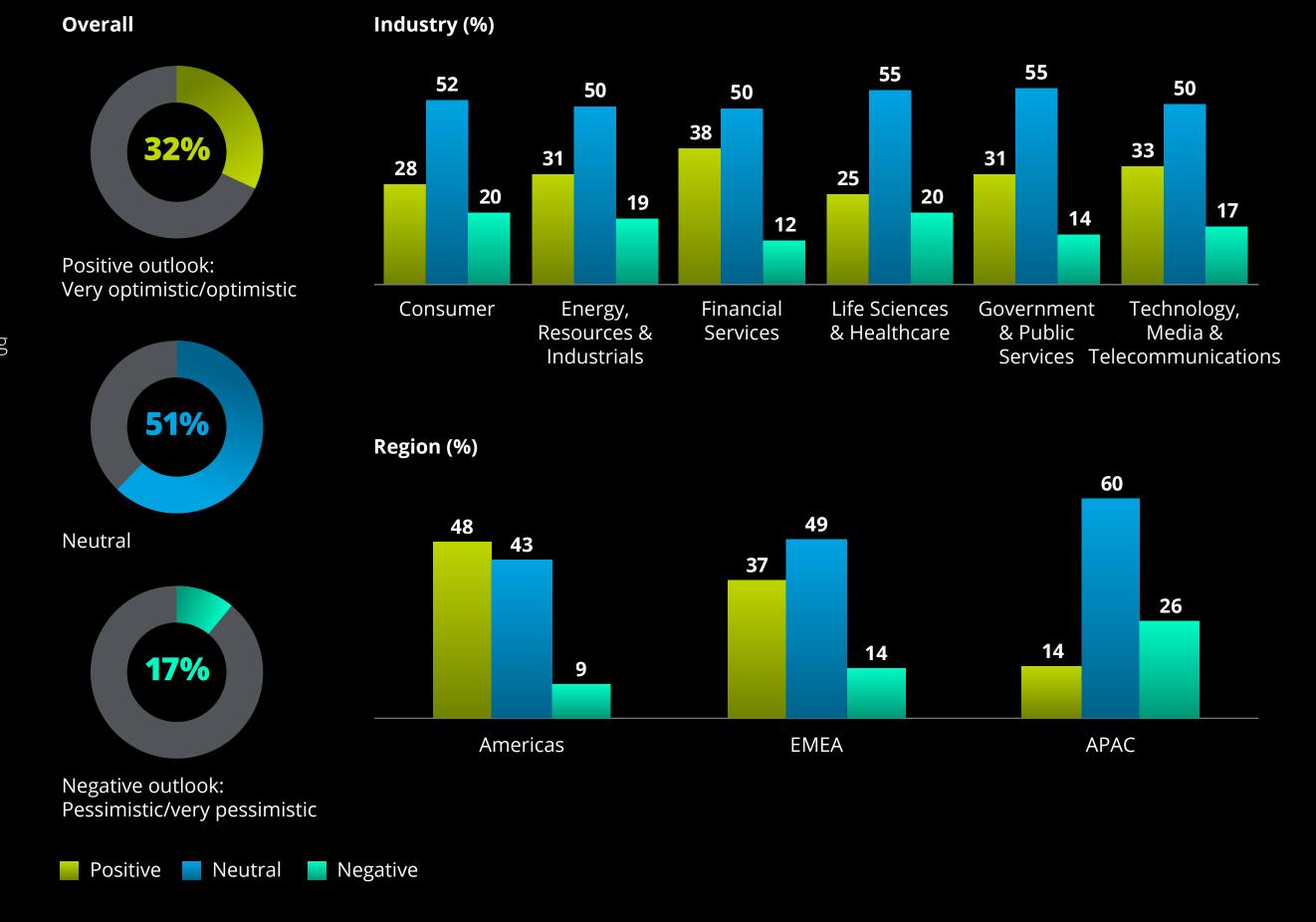


Figure 2b. Sentiment of respondents in managing third-party relationships going forward (overall, by

Changes to the overarching risk methodology, as well as enhancing human-centricity by strengthening the role of executive leadership and capability of TPRM teams, are now the top areas requiring focus and attention.

Improving technology and its influence on decision-making related to TPRM has historically been the primary area for additional investment, as identified in previous surveys. However, this year, it's changed. Here 63% of respondents told us that the top focus area for investment is **revisiting and refreshing the overall TPRM methodology used in the organization**, with related policies and standards (**Figure 3**). We believe this is in response to growing stakeholder expectations from organizations, also influenced by headwinds in the macro-economic environment. They're driving a need to reset and redefine approaches before they're implemented using technology.

- 48% of respondents expressed a need to strengthen the role of executive leadership in managing and governing third-party relationships, as well as skills and talent; while
- 47% of respondents said they wanted to effectively address current challenges and build trust across the more critical third-party relationships (explored further in <u>section four</u>).

With progress being made by many organizations in tech-enabling their TPRM frameworks over the past few years, there's now a greater degree of contentment on this front, albeit with room for further improvement as technology solutions evolve. However, at this stage, getting the right skills and talent into the program to leverage technology has also emerged as a newer and more immediate priority.

With progress being made by many organizations in tech-enabling their TPRM frameworks over the past few years, there's now a greater degree of contentment on this front, albeit with room for further improvement as technology solutions evolve.



Despite the emergence of these three TPRM priorities as immediate needs, 45% of respondents said that continued investment in technology and data for TPRM (seen in section five) is still important and continues to appear on the list of top five priorities, along with improvements to specific TPRM processes.

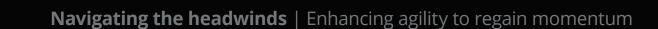
These top five priorities are consistent across organization size, maturity, and geography, although there are some interesting variances by industry (as shown in Figure 3). For instance:

- Technology and automation are the second highest investment priority for Financial Services (FS) but not for any other sector where the priority is lower.
- In four of our six industry segments, the need for "improving skills and talent" is of greater importance than "strengthening executive leadership".
- Improvement of TPRM processes is of heightened importance to Energy, Resources & Industrials (ER&I) and Life Sciences and Healthcare (LSHC).

Figure 3. Areas of priority action to address the challenges of TPRM in the current environment (overall and by industry)



^{2.} Includes creating risk based actionable intelligence and triggers to initiate remedial actions (such as off-boarding of third parties who have exceeded maximum acceptable risk parameters).



This survey shows only a slight improvement in overall TPRM maturity across our total respondent population over the last year. However, the cost of falling behind is now even higher.

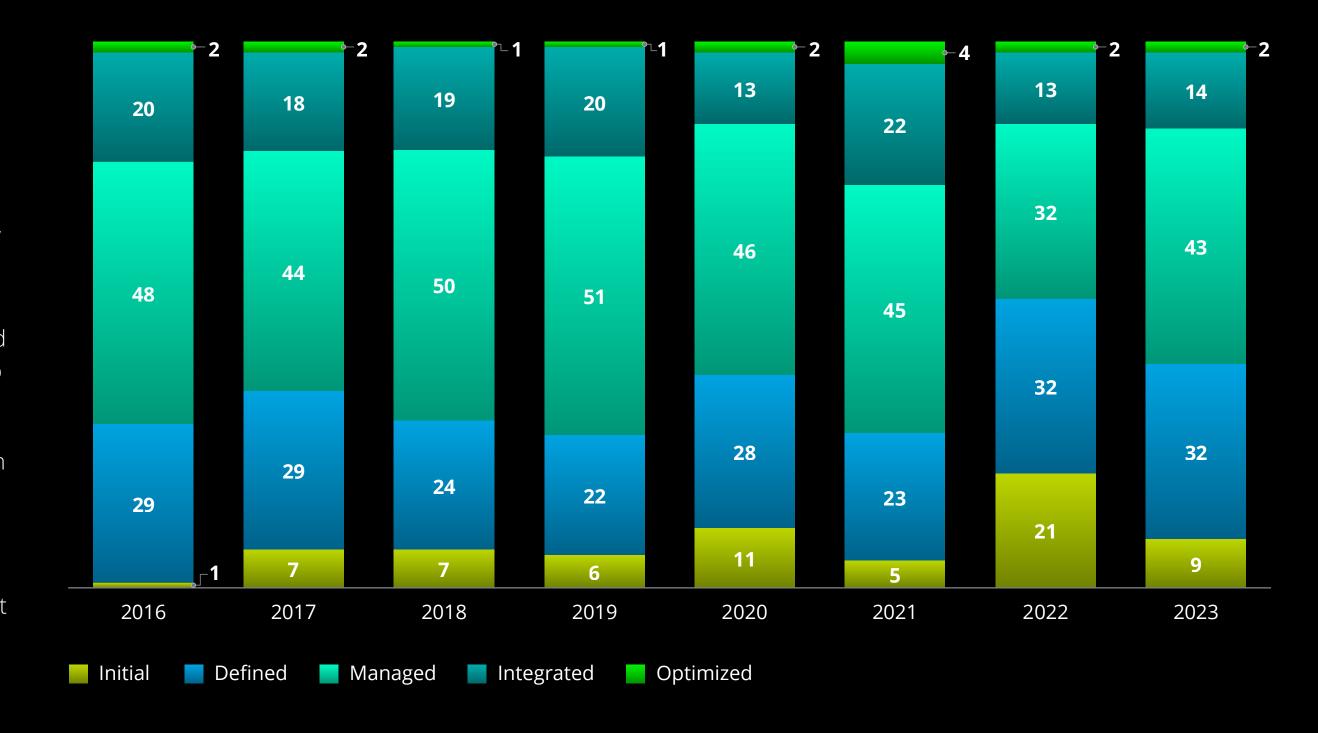
The relative proportion of organizations that self-assess being in the top two maturity categories has remained almost unchanged between last year and this year. Given the increased scope and expectation associated with TPRM programs that many organizations are feeling, many of them have worked hard to maintain these levels of program maturity against this rising bar.

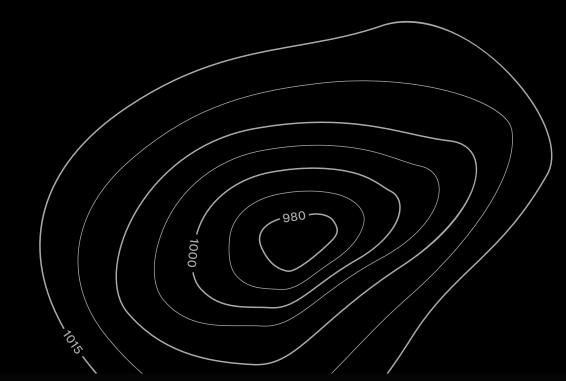
Those in the two highest levels of maturity (i.e., integrated and optimized) remain almost unchanged at 2% and 14% respectively. Organizations in the middle level seem to have increased from 32% last year to 43% in the current year (Figure 4). This shows some positive movement from the two lowest maturity levels to the middle level.

Increasing scrutiny of dependence on a growing third-party ecosystem makes the cost of falling behind on TPRM maturity even higher. That's because the impact of individual third-party incidents or failures is growing larger than we have seen in the past. Also, the degree to which customers are informed, together with the ease of switching, can lead to a higher loss of customers and revenue due to third-party failures.

Third-party failures can also create a negative impact on reputation, with potentially larger fines and penalties due to failing to meet regulatory/legislative requirements or other financial losses attributable to the actions of such third parties.

Figure 4. TPRM maturity trends since the start of our annual global TPRM surveys in 2016 (%)





What can you and your organization do differently?

The overarching objective of many of the organizations we speak to is to invest in and establish appropriate levels of TPRM capability to remain both robust and agile in the face of an evolving third-party risk landscape, and to drive performance.

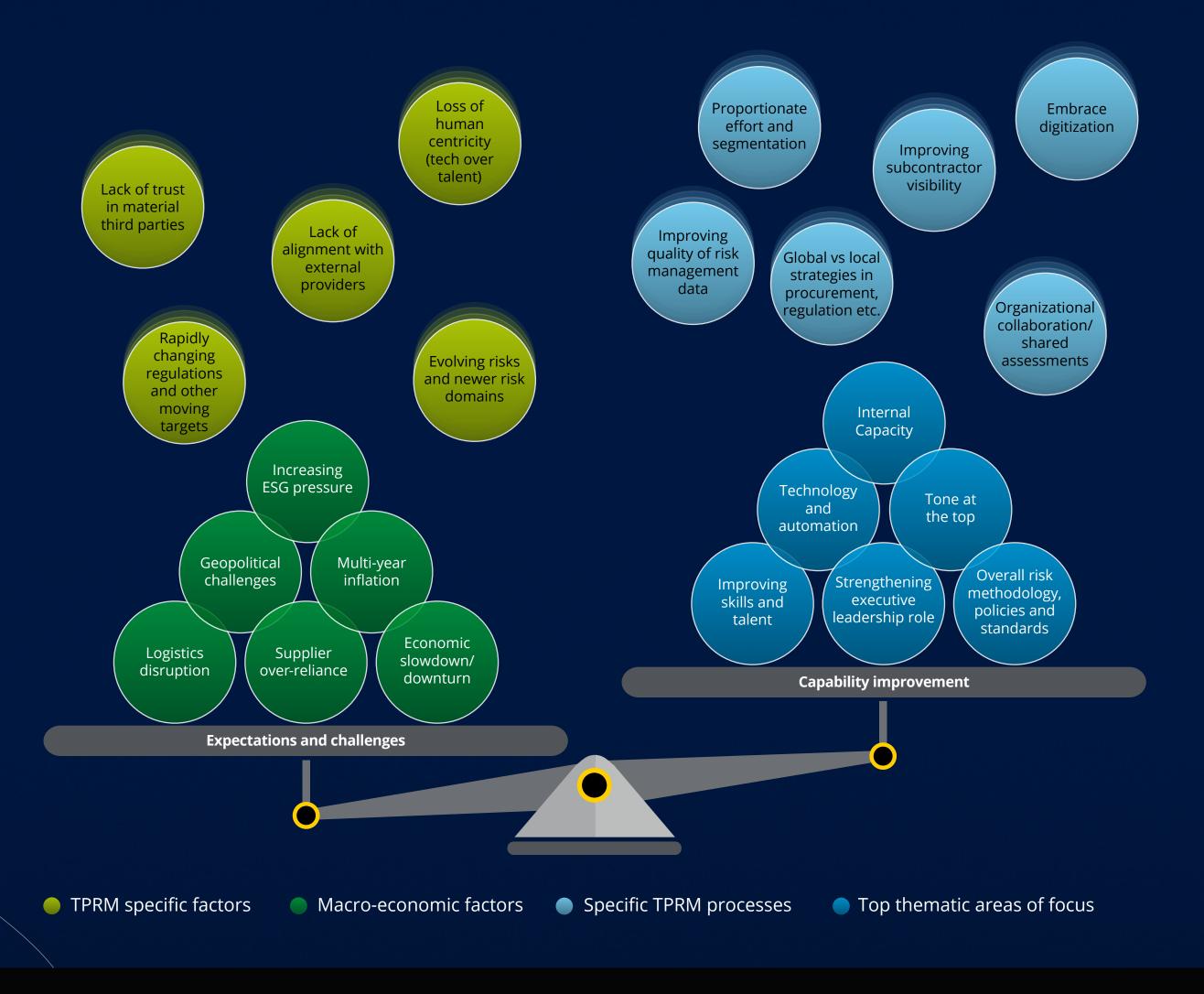
How can you achieve this?

As the number, scrutiny, and complexity of organizational third-party relationships continues to grow in a highly challenging environment, we believe that TPRM teams will continue to face greater pressures.

These include better understanding and managing the ever-changing risks, compliance, and regulatory requirements, building trust and collaborating better with critical third parties, producing more actionable insights, and helping the organization respond to the challenging environment.

The ripple effect of the interconnected risks means that data must be consolidated and analyzed across the enterprise, as well as incorporating external sources to clarify complex dependencies.

Figure 5. Balancing expectations and capability



The more astute organizations must address specific thematic areas – as seen in <u>Figure 5</u>. This could include:

- exploring opportunities to complement in-house capability with external assistance (e.g., for surge capacity when needed or specific regions/skillsets);
- embracing opportunities to digitize and automate processes where possible, while retaining a human touch when interpreting outcomes;
- trialing options to increase material subcontractor technology;

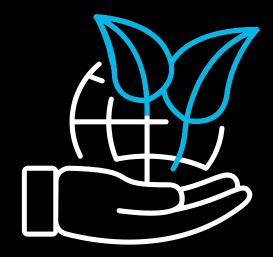
When it comes to balancing expectations with capability, there will never be a one-size-fits-all approach. Organizations must determine what their appropriate level of risk mitigation is to ensure TPRM capability balances the evolving risks and expectations, aligned to the risk appetite and other circumstances specific to the focal organization. Organizations who expressed optimism around the future of TPRM are certainly in a better position to achieve this balance.

We believe this will act as a competitive differentiator, improving efficiency, effectiveness, and

Understanding the complex dependencies to take on the headwinds is easier said than done. On a lighter note, one of our survey respondents adapted a quote from a popular children's film to explain the underlying sentiment. They said:

"We need a learning robot in our organization [to take on the headwinds]. Every moment it spends [helping us in] tackling the external environment only increases its knowledge of how to get better in fighting [the uncertainties]."





Organizational cultures are becoming more supportive in understanding and managing ESG risks and opportunities related to third parties. They're also taking on more quantitative scoring and assessments (related to specific ESG areas) amid data quality concerns. However, many organizations are missing the opportunity to recognize the synergies between their sustainability and resilience initiatives through a more coordinated approach.

Summary

In this section, we track the progress made by respondents over the last year in ensuring that organizations and their third parties act in a responsible and sustainable manner, reinforced by a **stronger organizational resolve. Organizational cultures that are more supportive of ESG initiatives** are being driven by **emerging regulations and legislation**, growing customer expectations, and tangible benefits that are acknowledged by stakeholders. Organizations appear to be **prioritizing some ESG areas** over others, to avoid regulatory action, manage stakeholder expectations, or strengthen competitive positioning. However, this is often planned and carried out without considering the impact and opportunities related to overall organizational resilience and profitability. This, in turn, has led to challenges in receiving sufficient funding and commitment to achieve the strategic payoffs.

Last year's survey showed how the use of judgmental or ad-hoc approaches in many organizations presented a significant challenge in assessing risks related to various ESG areas. The increasing use of **robust quantitative approaches has been the biggest change** since last year. It's enabled these organizations to move from ad-hoc or more judgmental assessments to a stronger quantitative/data-driven approach. **However, the quality of data remains a concern.**

We also recommend organizations to strategically reposition their ESG initiatives with a more integrated approach with their resilience initiatives. These would consider the overall impact on the sustainability and resilience posture of the organization. It would also go a long way in rationalizing the impact of trade-offs to maximize the benefits from co-beneficial needs, such as a better understanding of the end-to-end supply chain.

Key insights

Our survey results highlight the growing organizational resolve in being sustainable and responsible.

Our last three TPRM surveys have reported a growing emphasis on social purpose from boards and C-suites as a key element of integrated business strategies. The extended enterprise, with its complex third-party and subcontractor relationships at various levels, is **key to ensuring this** as the engaging organization must ascertain whether their third parties behave responsibly and sustainably by acting under the three pillars of ESG.

56% of respondents believe that their organizational culture has become much more supportive in understanding and managing ESG risks in their extended enterprise (third-party ecosystem).

16% disagreed, while the remaining

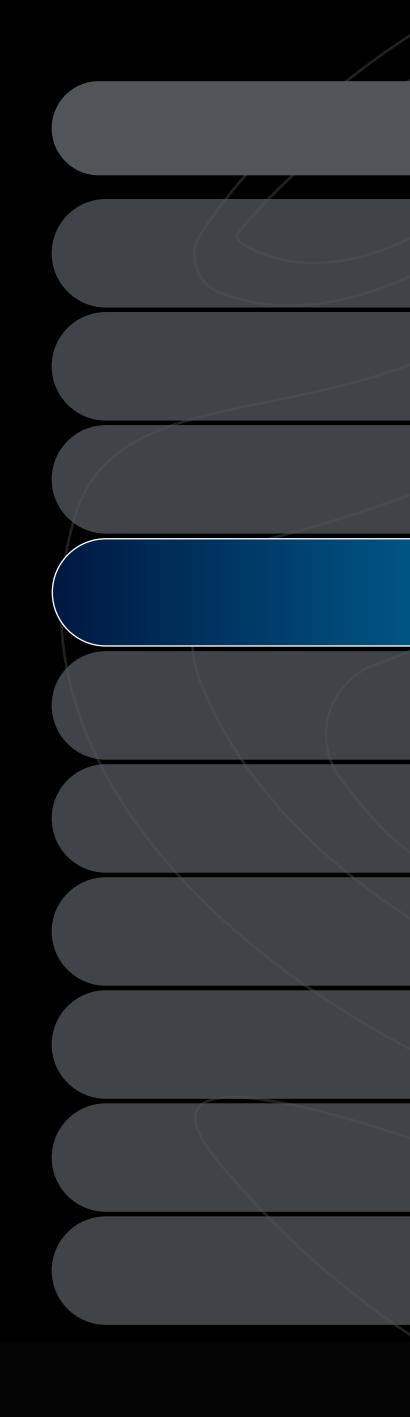
28% remained neutral.

We believe that this growing executive support is due to a confluence of regulatory pressure, C-suite attention, customer behavior, and stakeholder expectations. This helps drive a more sustainable and ethical approach to supply chain and third-party management. The latest ESG-related regulations and standards tell us that the need for transformation is now urgent and critical for businesses.

National and regional legislation is emerging in different parts of the world, including the U.S. and Canada, the UK, Germany, the EU, and APAC countries such as China, Japan, Singapore, and Australia (covering diverse areas such as climate change, human capital, exploitation and diversity, circular economy, critical minerals, environmental protection, etc.). These legislations place stringent obligations on organizations to report and implement strategies in areas such as protecting and respecting human rights conditions, while managing their environmental impact in their international supply chains.

Global organizations are waking up to these emerging requirements and have lots to do. One respondent observed:

"We're just nibbling around the edges instead of addressing this multi-faceted challenge at its core in an integrated manner."



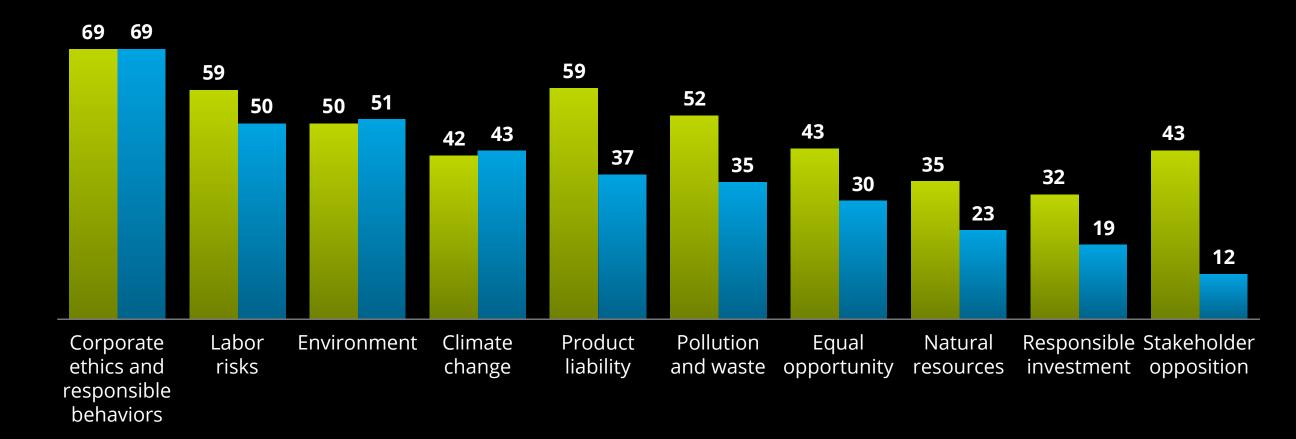
In a similar approach to last year, we see organizations focus on a subset of ESG areas and less on others.

- **Corporate ethics** (including anti-bribery and corruption): Unchanged from last year at 69% of respondents.
- Labor risks including human rights, health and safely, labor laws/standards: 50% down from 59% last year, presumably with the pandemic coming to an end, but likely to increase due to increasing legislative focus on human rights.
- **Environmental issues**: 51% a marginal increase from 50% last year.
- Climate change: 43%; a small increase from 42% last year.

On the other hand, the risk areas within ESG that appear to be getting the least focus include:

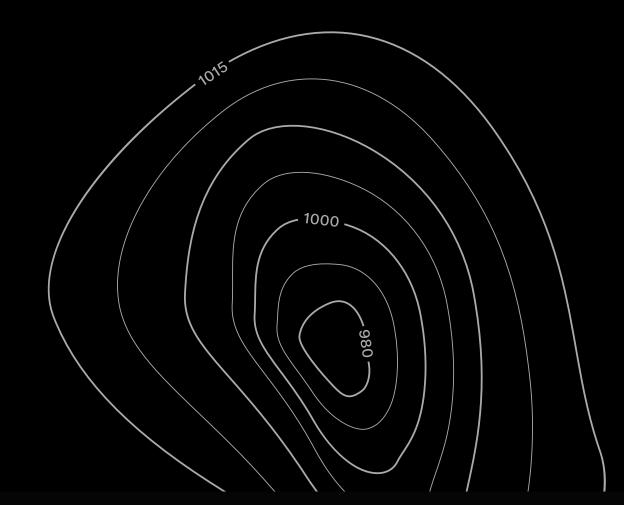
- focusing on ensuring equal opportunity: 30% (down from 43% last year);
- the protection of natural resources: 23% (down from 35% last year);
- making responsible investments: 19% (down from 32% last year); and
- managing stakeholder opposition: 12% (down from 43% last year).

Figure 6. ESG focus areas, current vs last year



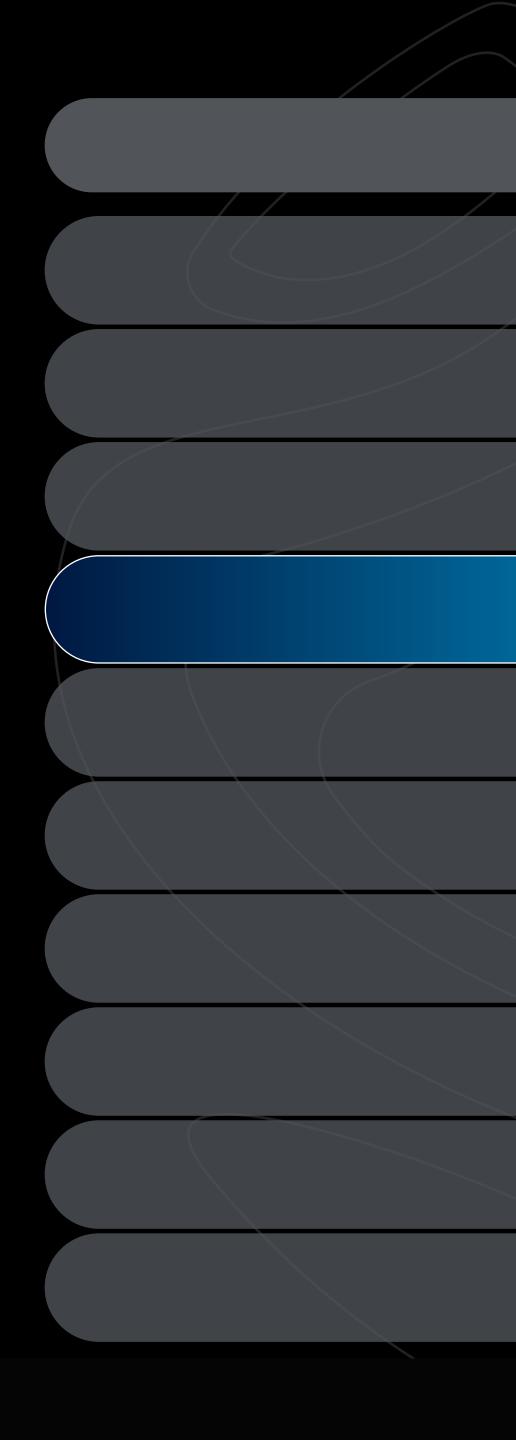
Proportion of respondents who focused on each of the above ESG areas in ensuring that their third parties behave sustainably and responsibly.

2022 (%) 2023 (%)





The latest ESG-related regulations and standards tell us that the need for transformation is now urgent and critical for businesses.

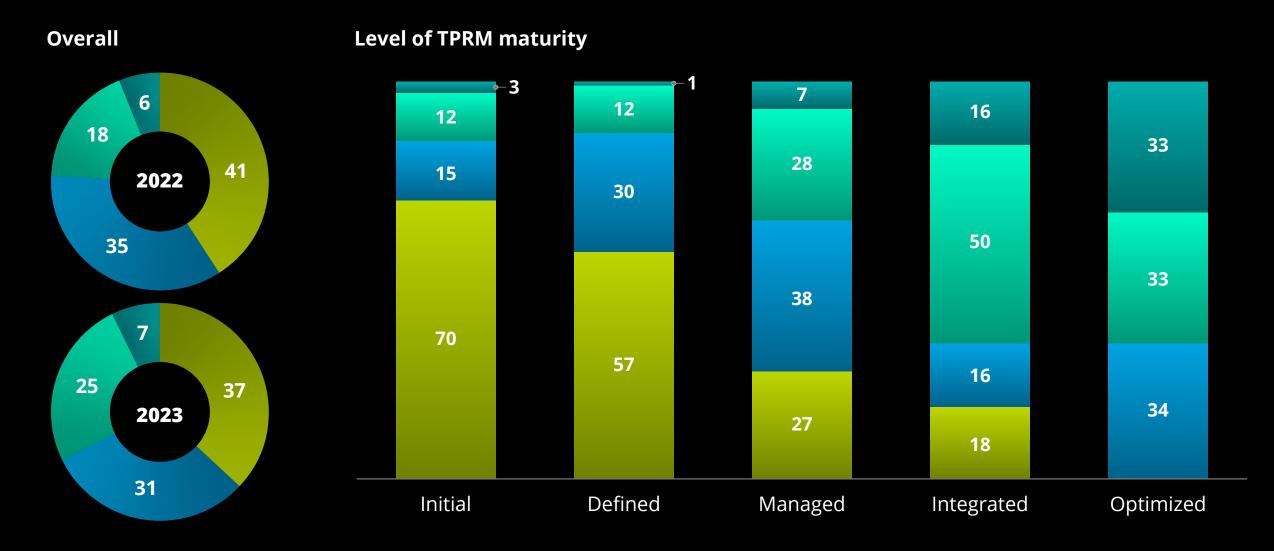


Organizational ability to assess and prioritize ESG areas effectively and objectively appears to have slightly improved.

- This year 7% of respondents believe they have mature processes with a blend of quantitative and qualitative mechanisms that enable ESG assessments, which can be compared to the organizational risk appetite. This was up from 6% last year.
- A further 25% use quantitative scoring methods to assess such risks and supplement them with expert inputs and ESG tools. This approach has increased materially from 18% last year with the adoption of quantitative approaches for objective risk assessment.
- However, the remaining 68% (down from 76% last year, which indicates an overall improvement) acknowledge that they either do not understand their actual capability level or, at best, have a relatively low level of organizational capability in this area. This results in ad-hoc approaches or judgmental evaluations at these organizations to assess and prioritize ESG risks.

As seen in Figure 7, ESG assessment and prioritization approach can be correlated directly with the level of overall TPRM maturity in responding organizations. This reflects higher levels of leadership focus and investment in ESG for organizations who have achieved greater TPRM maturity.

Figure 7. ESG assessment and prioritization capability: current vs last year (overall) and by level of TPRM maturity



- **Low** level of organizational capability (%)
- **Ad-hoc** assessment and prioritization of ESG risks (%)
- **Quantitative** scoring methods to assess ESG risks based on expert inputs and ESG tools (%)
- **Mature** processes to prioritize ESG risks based on severity (%)

One of our respondents explained:

"Assessing and reporting sustainability is a much heavier task compared to controls documentation and assessments that we had earlier implemented for Sarbanes-Oxley compliance during 2003-2005. This time, it can't be done as an immediate response as the related internal and external information is not readily available. It's also unclear to what extent the management team understands our difficulty in doing so."

The quality of ESG data remains an area of concern, particularly from external sources.

In last year's survey, 89% of respondents reported facing significant challenges with regards to ESG related data, whether it was generated internally or externally. This appears to have improved, but still remains to be a concern for many.

This survey captured more granular data, which shows that the respondents are almost split equally three ways:

- nearly one-third of respondents believe that the quality (value, integrity, and usability) of internally generated data is low or very low quality.
 A similar proportion felt the same sentiment towards externally generated data (e.g., data obtained through third parties and external agencies);
- at the other end of the scale, 33% of respondents believe the quality of their internally generated
 ESG data is high or very high, with 30% believing the same of the external ESG data they collect; and
- this leaves approximately **the remaining one-third** in the middle category.

The qualitative responses and comments from participants showed us that low levels of trust in ESG-related data were driven by three factors:

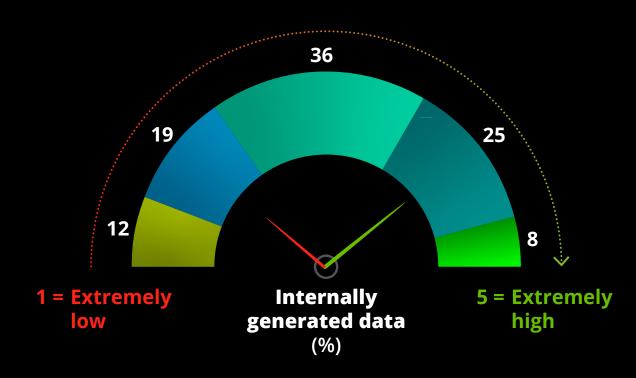
- the unavailability of data;
- a lack of awareness around types of data that could be relied upon; and
- how to translate it into actionable intelligence.

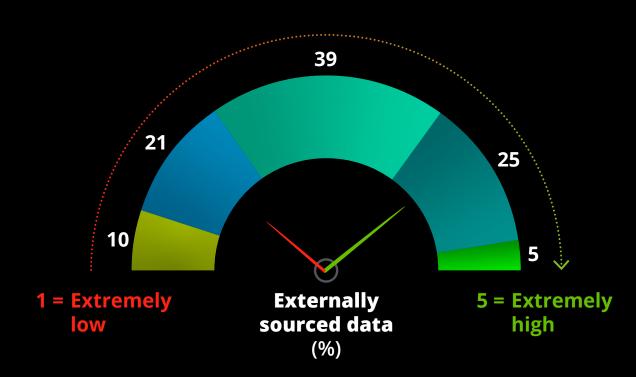
Together, these factors are hindering progress. We believe one of the biggest drivers of improvement will be better traceability and transparency across the entire supply chain. As discussed in **section three**, this will enable not only a better ESG performance, but will also enhance resilience across the organization, and maximize the impact of such initiatives, to present a stronger business case for investment.

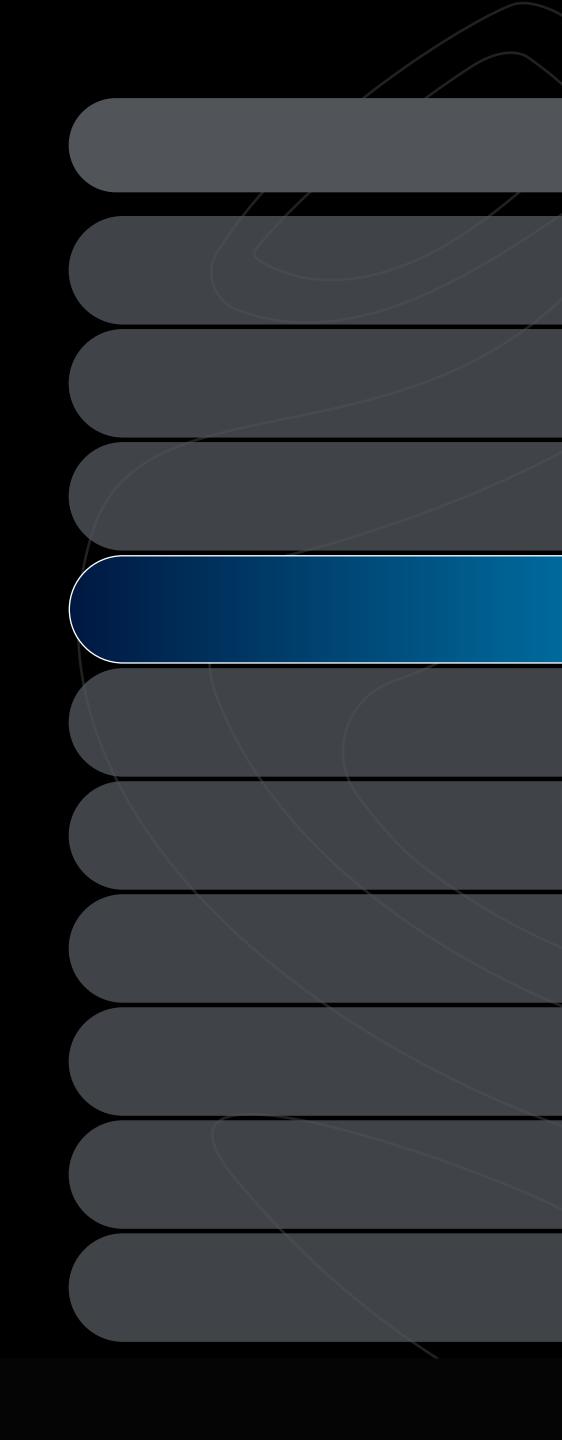


Together, these factors are hindering progress. We believe one of the biggest drivers of improvement will be better traceability and transparency across the entire supply chain.

Figure 8. Levels of reliability and trust in ESG data









There's a significant opportunity for better alignment between ESG and resilience initiatives in most organizations.

The volatility and uncertainty of the macro-economic and business environment have made third-party resilience and ESG initiatives "must-haves." It's worth noting, however, that most organizations are still in the very early stages of their ESG journey, although more advanced in their thinking on resilience since the pandemic. We believe there's an opportunity to embed sustainability into the supply chain, while considering the wider impact it might have on resilience and vice versa.

Taking advantage of the synergies between these two goals offers immense potential for long-term optimization. Therefore, we believe that the prioritization and implementation of sustainability improvements should be guided by resilience considerations.

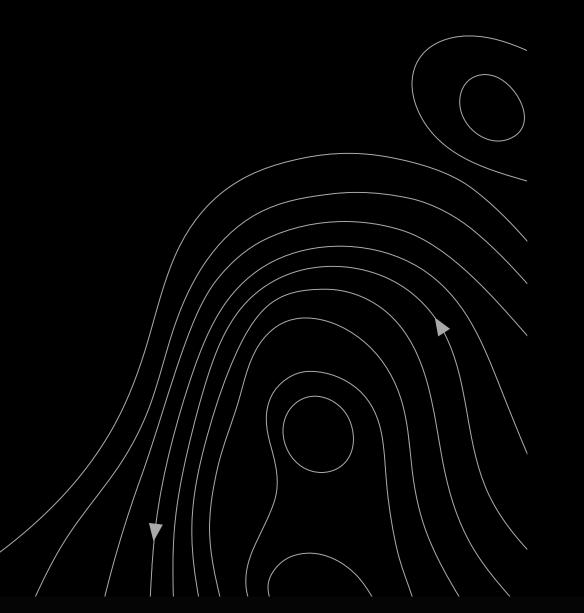
While multiple studies have shown that a stronger focus on ESG creates more resilient organizations, these two concepts can also sometimes be in conflict.

Organizations may need to make conscious trade-off decisions – such as finding a second supplier who isn't as ESG-focused as the earlier sole-supplier and enhancing resilience by reducing concentration.

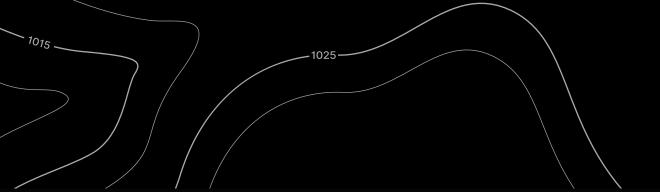
The most mature organizations regard such trade-offs as a chance to optimize and gain better alignment. For example, organizations who have achieved a high level of traceability and transparency in their supply chain, and a higher degree of supplier engagement and trust (see section four) are better positioned to optimize such decisions and realize the desired synergies.

For example, the ability to trace back deeper into the supplier's sources of supply (of say, agricultural produce such as palm oil) in a trusted relationship with the supplier could enable the buyer procure from only those plantations that do not exploit child labor, damage rainforests or endanger species like orangutans or Sumatran tigers within the same cost arrangement.









What can you and your organization do differently?

Board members and executive leadership who have accountability over TPRM should accelerate ESG initiatives in their organizations well in advance of emerging legislative/regulatory deadlines. So how can we turn this into actions that have a long-term and meaningful impact? Organizations should expand their focus on to newer and emerging risk areas within ESG, particularly those covered by the evolving regulation and legislation mentioned earlier.

In addition, more mature organizations are making the necessary investments to reduce/mitigate risks from subcontractors and other relationships that go beyond those directly contracted, who will continue to present significant and growing challenges.

Currently, we're seeing such organizations gaining an understanding of their material subcontractors in several ways. Firstly, many of them understand what their third parties are doing to manage/mitigate risk in these organizations (i.e., strength of third parties' TPRM program). Secondly, these organizations have good insights in place to determine where fourth parties (subcontractors) are also their third parties. This potentially means organizations might have additional insight on material fourth party practices over and above a monitoring feed/risk intelligence, so that deterioration in risk posture can be detected and challenged. How well they can do this will be reflected in their ability to generate relevant ESG data, make objective assessments, and report across all third-party relationships.

This can be explored further in a Deloitte article **To be sustainable or resilient or both**, April 2023. The change of pace in today's world compels organizations to respond to an overwhelming number of developments at once.

While it's sensible to react to events and adjust to trends, organizations tend to swing dramatically between efforts to optimize supply chain resilience and sustainability. For example, an organization could consciously ignore the pressure to reduce Scope 3 emissions in a limited number of situations by resorting to air freight (even at a higher cost) where there is a specific customer need to justify this over-ride.

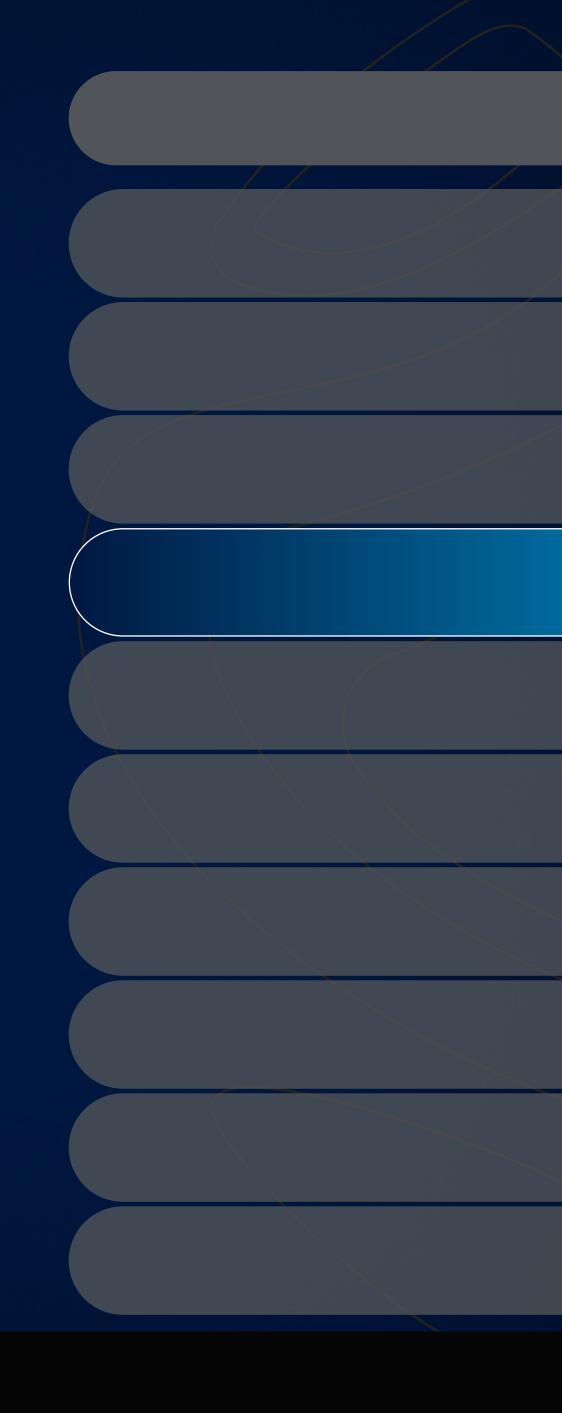
As a result of such pressures, organizations find themselves stuck in an endless game of whack-a-mole, as they scramble to strike down whatever demand pops up first and forget about it as soon as a new one emerges. Organizations often backtrack on commitments, ditch initiatives, and brush aside long-term strategies to address the latest challenge. This approach is reactive and counterproductive. While addressing the immediate issue at stake, these tactics can also take organizations two steps back in their pursuit of longer-term strategic objectives. This calls for a transformational change to adopt a more strategic approach based on long-term thinking, which also addresses organizational culture.

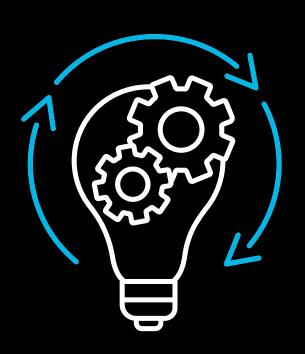
Organizations should first map out various activities and processes that involve third parties, while assessing the inherent risks related to the various ESG domains.

On a process and technology level, organizations should aim to graduate from ad-hoc and subjective assessments into more insight-driven, formalized quantitative processes. For example, by risk-scoring based on reliable data (i.e., data from trusted sources). As a result, they need to continue investing in technologies that integrate the collection, and also improve availability, accessibility, and timeliness, of ESG data from internal and external sources. These will inform better decision-making in tandem with resilience considerations and trade-offs.

Many will seek the support of external agencies to help them achieve this.

As a fundamental pre-requisite to improve the quality of ESG data, organizations will also need to develop a better understanding of the information required and how to obtain it from internal and external sources. To do so, organizations should first map out various activities and processes that involve third parties, while assessing the inherent risks related to the various ESG domains. Such inherent risks are typically driven by the nature of the activity/processes (e.g., inherent risks may be higher where third parties are used to transport hazardous chemicals). They could also be driven by secondary factors such as the geography in which the third party is based and where key activities are carried out. A holistic, end-to-end view of all relevant third-party relationships is a critical success factor in identifying these data-related needs and addressing key ESG considerations effectively across all organizational activity.





Embedding strong resilience practices across the extended enterprise remains a major priority (as organizations shift their stances from "Just in Time" to "Just in Case"). This can be achieved by integrating business strategy and risk better, alongside a more centralized and coordinated approach enabled by technology.

Summary



In this section we present specific steps our respondents are taking to be more resilient in their extended enterprise.

The management of supply chains and other third-party relationships has evolved with a focus on efficiency ("Just in Time") and not resilience ("Just in Case"). Many organizations have been slow to shift gears at a time when the business and macro-economic environment has changed. Even today, many of them aspire to save costs or improve performance by only focusing on individual processes or specific suppliers more holistically, while lacking proper integration and alignment between business strategy and risk management. This calls for a higher degree of centralized control in the governance of third-party ecosystems, better coordination (internally and externally), and the need to invest in real-time data-driven insights to thrive amid disruption and uncertainty.

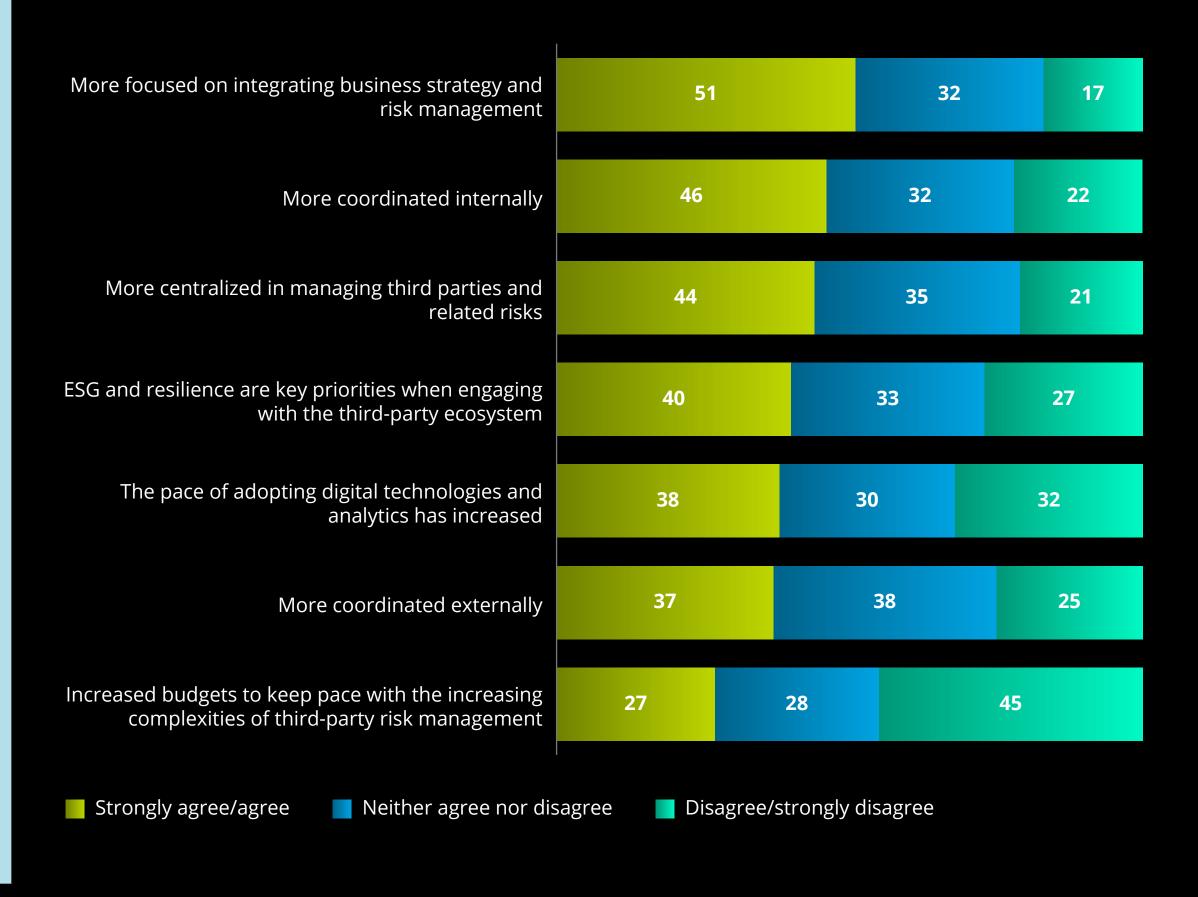
Elevating resilience to a strategic priority requires focus and investment at the board and C-suite level. As a reality check around the need for appropriate levels of investment, our survey also shows how the level of personal optimism in being able to achieve this transformation drops sharply in organizations where budgets aren't increasing to adequate levels relevant to the current scenario.

Building on insights from earlier surveys, visibility into various levels of subcontractor relationships remains a challenge. For the first time we investigate several types of concentration risk to see where the impact is the highest. As shown in section two, organizations must enhance transparency, traceability, and trackability, across their third-party relationships and their subcontractors. This must be a top priority for informed decision-making and a targeted response to help organizations become more agile and be better prepared in navigating unfamiliar or challenging situations.

Key insights

Our current survey provides evidence of a stronger resilience mindset in more progressive organizations. Here TPRM is being used to transform, and enable, resilience into a strategic objective. This is increasingly being reflected in the following tangible actions (Figure 9).

Figure 9. Strategies to enhance organizational resilience (percentage of respondents)



As with ESG, 40% of respondents strongly believe that resilience is **already a key priority when engaging with their third-party ecosystem. Only 27% disagreed** and the remaining 33% neither agreed nor disagreed. Our survey data shows that third-party resilience being a priority is reflected in the following tangible actions across two key themes identified by our respondents:

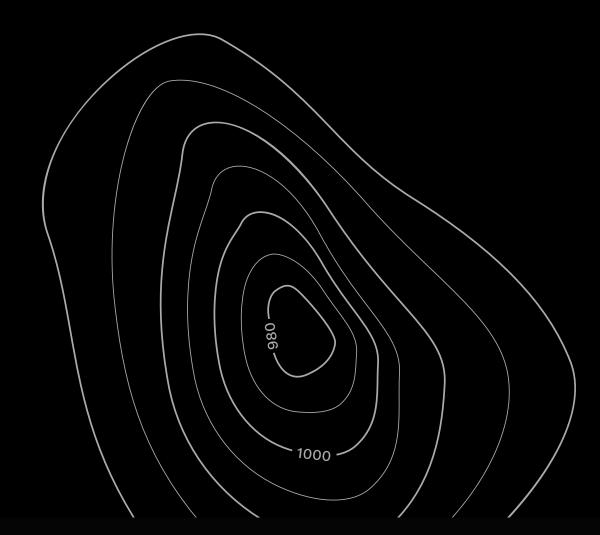
1. Driving a more centralized approach for better strategic alignment and coordination

- 51% of respondents strongly agree or agree they have become more focused on integrating business strategy and risk management related to third parties, compared to what they were doing a year ago. A further 32% said they retained a consistent level of focus. The former category of respondents believes this has helped them prioritize action and investment in a manner that's more relevant to their businesses. We believe this will allow organizations to carry out risk-scenario planning with a comprehensive and strategic perspective that's essential when building greater resilience.
- 44% of respondents strongly agree or agree that they've become more centralized in managing third parties and related risks over the last year. A further 35% said they retained similar levels of centralization consistent with their approach during the last 12 months. We believe that increasing degrees of centralization will give them more control over critical risk management activities with greater consistency across the breadth and depth of the business. Central coordination also helps to ensure they get the right Subject Matter Experts (SMEs) involved in a timely manner to inform decisions, which will enable a resilient organization. In turn, these SMEs will also help them recognize deviations, where justified, using consistent technology solutions (implemented through a more centralized approach across geographies and business units) as the carrier of strategic intent.

• 46% of respondents strongly agree or agree that they've **become more coordinated internally** (within the organization). 37% felt similarly strong about increased coordination in their extended enterprise in managing third parties. A further 32% (internally) and 38% (externally), respectively, said they retained previous levels of coordination.

Overall this demonstrates many organizations are making positive shifts. This provides them with the ability to break internal silos across various supply-chain management functions – such as sourcing, procurement, finance, risk management, legal, compliance and data management teams, to establish a more integrated end-to-end solution. Better external coordination also enhances trust across third-party ecosystems – as seen in section four.







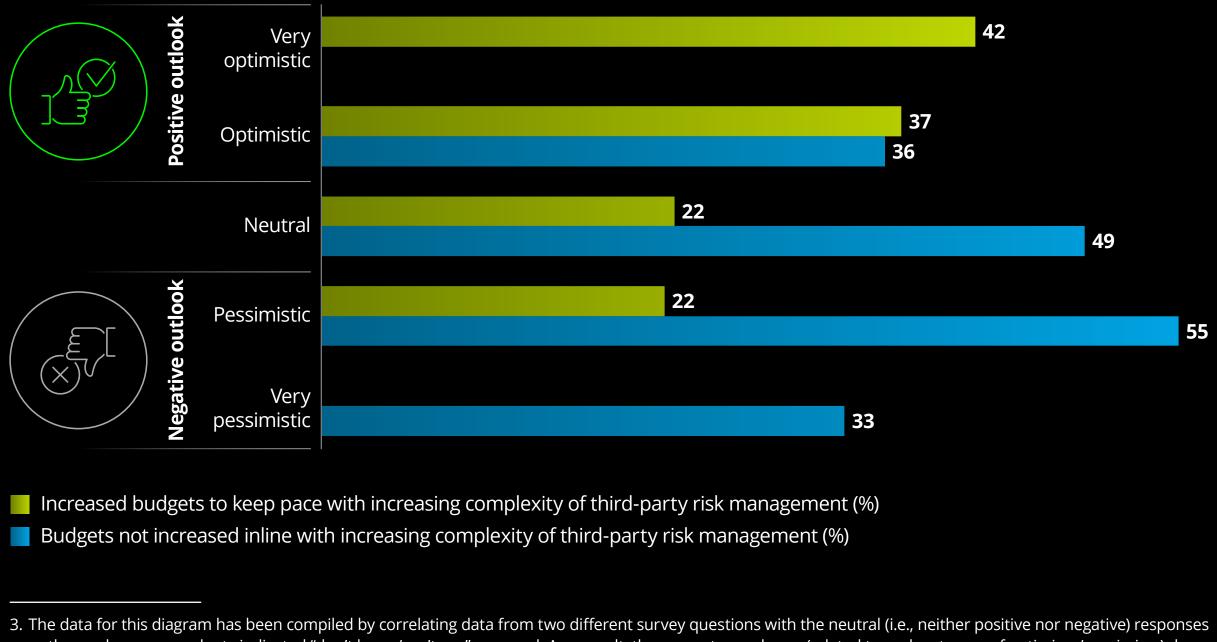
2. Digital technologies to enhance resilience

- 38% of respondents have increased their pace of adopting digital technologies and analytics to effectively manage information related to third parties in the current business environment. A further 30% retained their earlier momentum in this direction.
 This digital thread, often accompanying a real-time end-to-end view of third-party processes and risks, will help to reduce the impact or improve the timeliness of response in a crisis.
- This is achieved by enabling efficient and reliable decision-making in a proactive manner to manage the headwinds, before a potentially disruptive third-party event or even a knee-jerk response, counters such an event. As discussed in section five, the increasing use of Al and digital twinning used to challenge and test planning and design assumptions, identify failure points, and assess the performance of existing and new infrastructure projects, can help to drive effective decision-making and policy implementation.

However, optimism around the ability of a mature TPRM framework, to positively impact the performance of an organization, appears to have a strong correlation with organizational budgets:

- Only 27% of respondents believe their organizational budgets have increased to keep pace with the increasing complexities of third-party risk management. 45% disagree with this statement, and the remaining 28% are neutral.
- As set out in Figure 10, our survey data also shows optimism around the capability of TPRM to make transformational changes that address volatility and uncertainty in the external environment is directly related to organizational budgets. All respondents who expressed a very high level of personal optimism with regards to TPRM in the year ahead represent organizations who are either increasing their TPRM budgets or at least maintaining them at a healthy level (i.e., not reducing them).

Figure 10. Optimism in the transformational power of TPRM compared to budgets³



^{3.} The data for this diagram has been compiled by correlating data from two different survey questions with the neutral (i.e., neither positive nor negative) response or those where respondents indicated "don't know/can't say" removed. As a result, the percentages shown (related to each category of optimism/pessimism) do not add up to 100%.

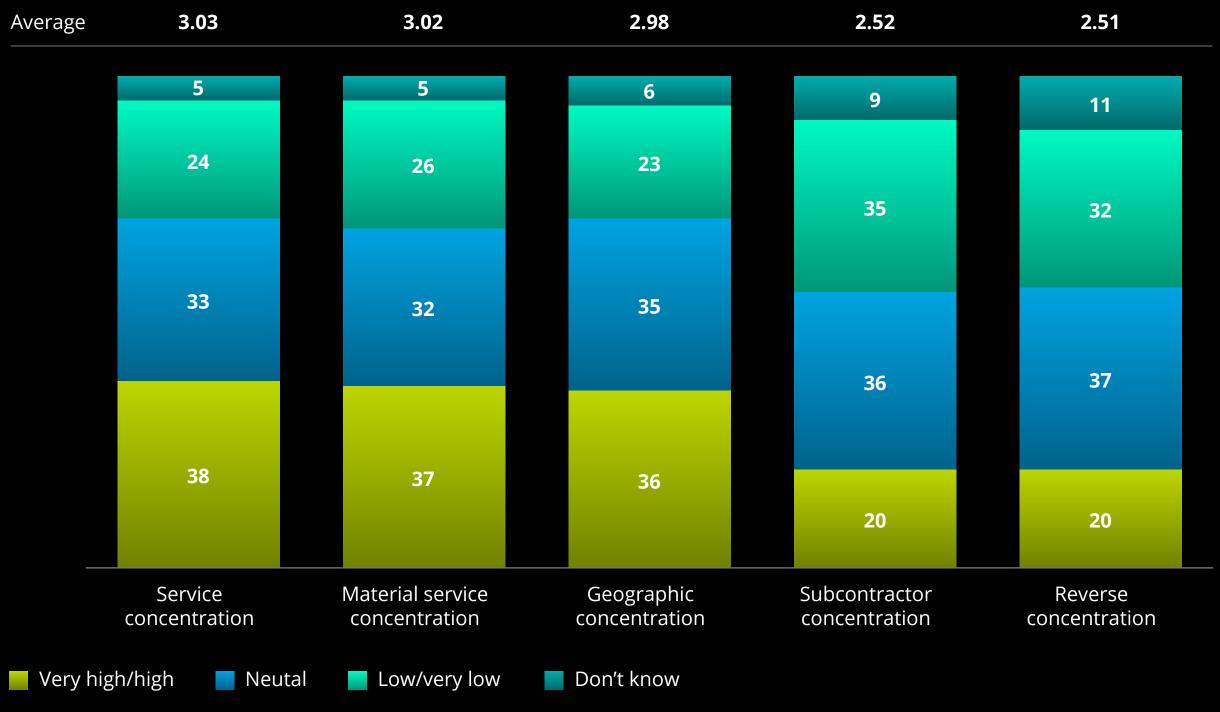
Transparency, traceability, and trackability, across various levels of subcontractor relationships (e.g., fourth and fifth parties) continues to be poor, and challenges resilience initiatives in organizations. This exposes organizations to concentration risks, most of which can potentially remain hidden away in lower levels of third-party relationships. The lack of such visibility doesn't necessarily mean that there's concentration risk. However, it does mean that concentration risk beyond the third-party level may remain undetected, until the engaging organization faces a third-party incident with adverse consequences.

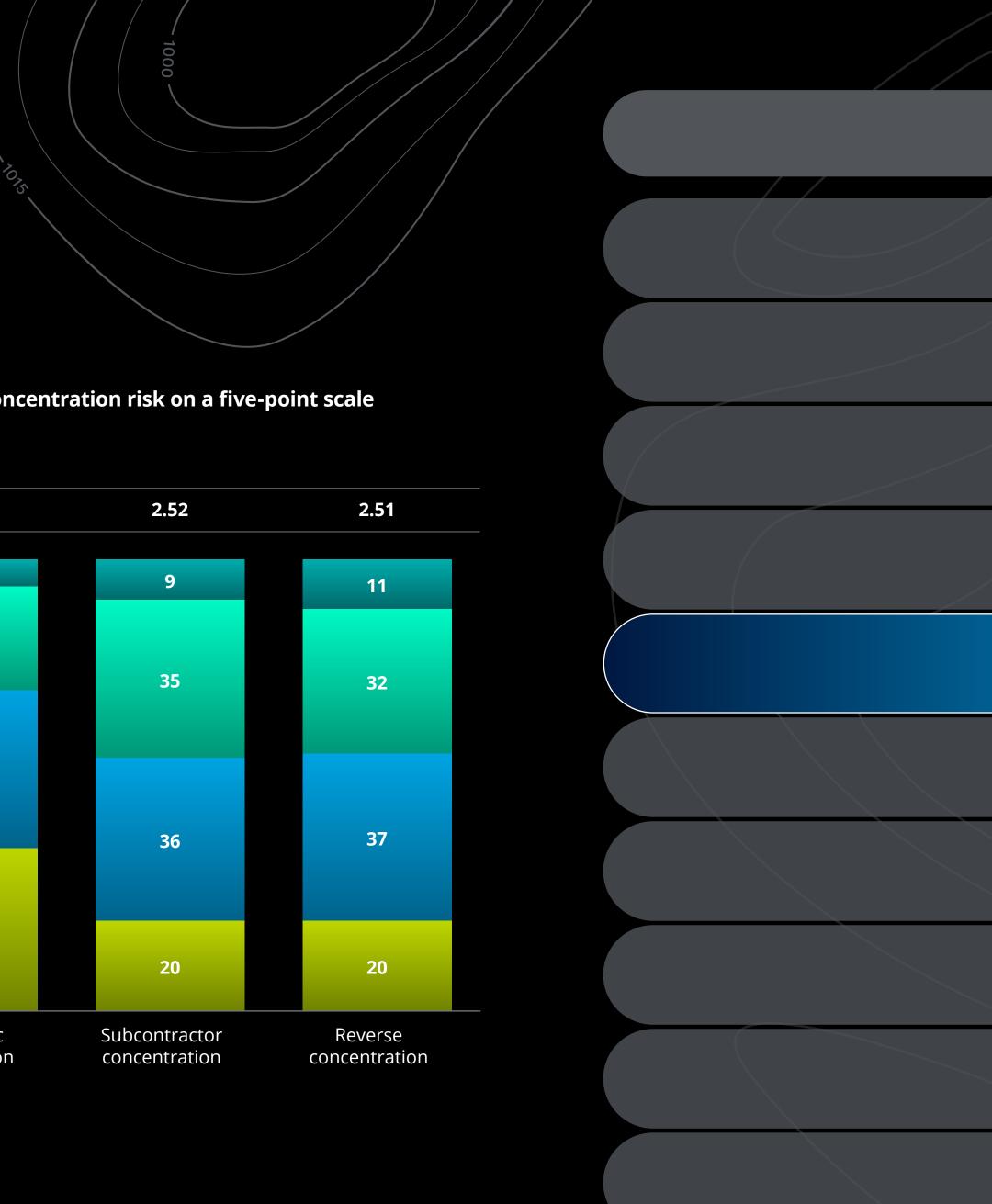
Our survey captured, on a five-point scale, the relative capability of organizations to measure and manage concentration risk where 1 = very low and 5 = very high. Based on this analysis, we've summarized the organizational capability to measure various aspects of concentration risk below, from highest to lowest, in terms of overall capability. This shows that subcontractors and reverse concentration present the most challenges to organizations and greatest area for improvement in TPRM (Figure 11).

- **Service concentration**: For example, significant reliance of an organization on a single third-party for a considerable proportion of important activities or category of relationships. Weighted average score: 3.03.
- **Material service concentration**: Weighted average score: 3.02.
- **Geographic concentration**: For example, significant reliance on third parties from the same geographic region for a significant proportion of important activities or category of relationship. Weighted average score: 2.98.

- **Subcontractor concentration**: Weighted average score: 2.52.
- **Reverse concentration:** Understanding the proportion of a critical third party's business that comes from your organization. Weighted average score: 2.51.

Figure 11. Capability of organizations to assess and manage concentration risk on a five-point scale (percentage of respondents)





What can you and your organization do differently?

It's time to change the resilience mindset.

Resilience has traditionally been assured by plans, procedures, and compliance, and focused on recovering organizational assets in a crisis.

But how can we effectively embed it across organizations and their extended enterprises?

The macro-economic and business headwinds and related uncertainties discussed in <u>section one</u> are forcing organizations to be more agile and better prepared in their response to unfamiliar or challenging situations. This will require investment in changing organizational roles and structures and the fundamental approach to specific TPRM processes enabled by technology solutions (as seen in <u>section five</u>).

For example, this will be essential to better understand the more critical and material third-party relationships, or newer and virtual relationships that have emerged alongside the growing proliferation of cloud technologies. However, further work must be done to capture the additional data required. This may include specific locations from where critical third parties operate (to map them against geopolitical and other emerging risks), supported by further tools to monitor resilience and trends in real-time, such as risk intelligence and adverse media monitoring. Organizations must invest further in developing, maintaining, and stress-testing comprehensive continuity and exit strategies.

Many organizational leaders, as well as regulators in some industry sectors such as FS, recognize that it's not enough to rely on a reactive strategy if the vire to be ready to meet the potential skill demands

if they're to be ready to meet the potential skill demands and pace of change brought on by sudden shocks and future challenges. Therefore, it's not enough to merely incorporate business continuity management when developing operational resilience capabilities. Detailed what-if scenarios are also needed, in the event that organizational resources can't be recovered in the way they have been salvaged in the past.

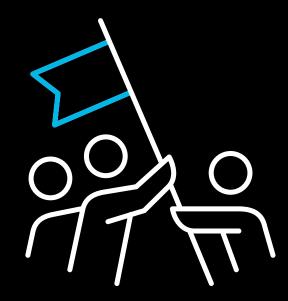
At Deloitte, our specialists predict that the approach to third-party resilience will become more proactive in orientation, more progressive in building organizational capacity for agility, adaptation, learning, and regeneration. This means that organizations are changing the way they respond to a third-party incident. Many are moving away from a knee-jerk reaction and towards a more holistic approach where they will plan for severe and plausible eventualities (a mindset shift from "what now?" to "what if").

A possible way forward, which is being explored with renewed vigor in some of the more regulated industries, is to identify systemically important third parties and drive consistent resilience standards. These will be aligned by geography or industry sectors/ sub-sectors, through sectoral or geographical communities. While providing a common standard or benchmark can be helpful, this approach will require organizations to undertake additional risk management activities to gain appropriate levels of assurance needed for their own specific relationships.

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The macro-economic and business headwinds and related uncertainties discussed in <u>section one</u> are forcing organizations to be more agile and better prepared in their response to unfamiliar or challenging situations.



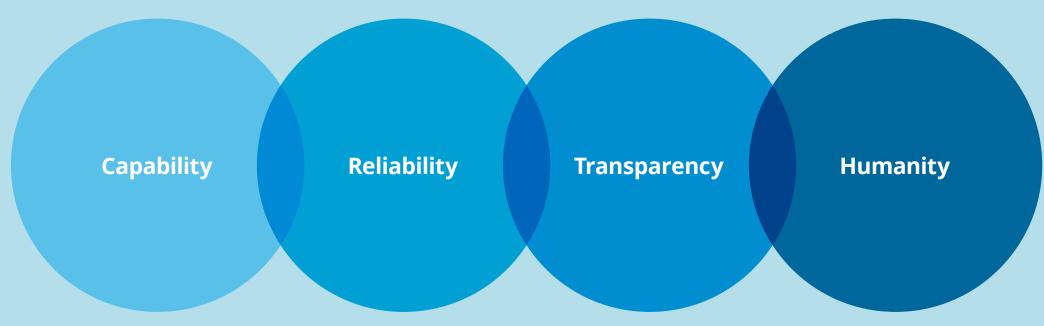


Astute organizations with mature TPRM practices aspire to deepen their trust with their third parties founded on transparency, reliability, capability, and humanity. This is shifting the focus of governance away from administering questionnaires to, for example, more collaborative conversations around innovation, strategic growth, and enhanced performance.

Summary



Building or enhancing trust in third-party relationships is becoming an increasingly significant consideration. Especially when managing critical suppliers and other third-party relationships. More organizations now realize the strengthening correlation that trust has with financial performance and resilience. Our previous research on this emerging interrelationship has identified **four key factors that build and enhance trust:**



These cover a wide spectrum of organizational activity.

There are three factors that organizations must consider when building trust. They are:

- 1. A consideration of all relevant **ESG areas that focus on responsibility and sustainability** as part of due diligence (as indicators of responsible partnerships).
- 2. **Strategic decisions** such as **relying more on regional and less on global supply chains**, ensuring **supplier diversity** and the perception of a more agile and timely response to incidents (potentially due to proximity to supplier leadership).
- 3. A willingness to **demonstrate resilience and a strong control environment enabled by technology** (ideally through a common digital thread that enables a transparent response) and provision of independent certifications/standards.

Our 2023 survey results suggest that only a small number of firms are prioritizing all the above when trying to enhance the level of trust around third-party relationships and provide them with more flexibility on oversight. Most firms are only using some of these strategies which enables them to achieve limited results.

Overall, we believe that further work needs to be done by many organizations to enhance trust as this topic continues to evolve. This will help organizations to realize the opportunities that higher levels of trust, particularly with the most material/critical third parties, can create for them.

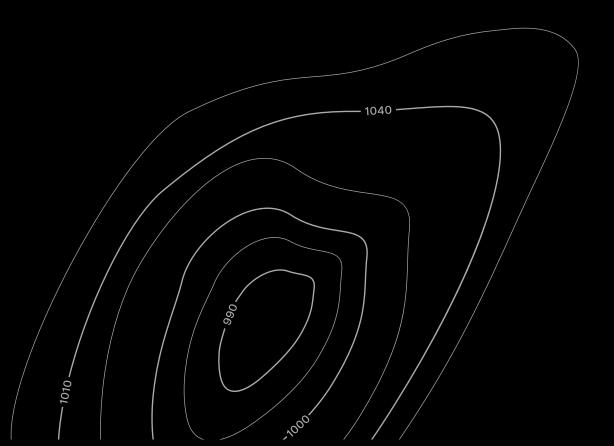
Key insights

Our survey shows that organizations are prioritizing their focus and investment on specific risk domains (Figure 12).

In <u>Figure 12</u>, we've identified the risk domains included in the TPRM programs of respondent organizations. We have then examined these against four key trust-enhancing factors (i.e., *capability*, *reliability*, *transparency*, and *humanity*).

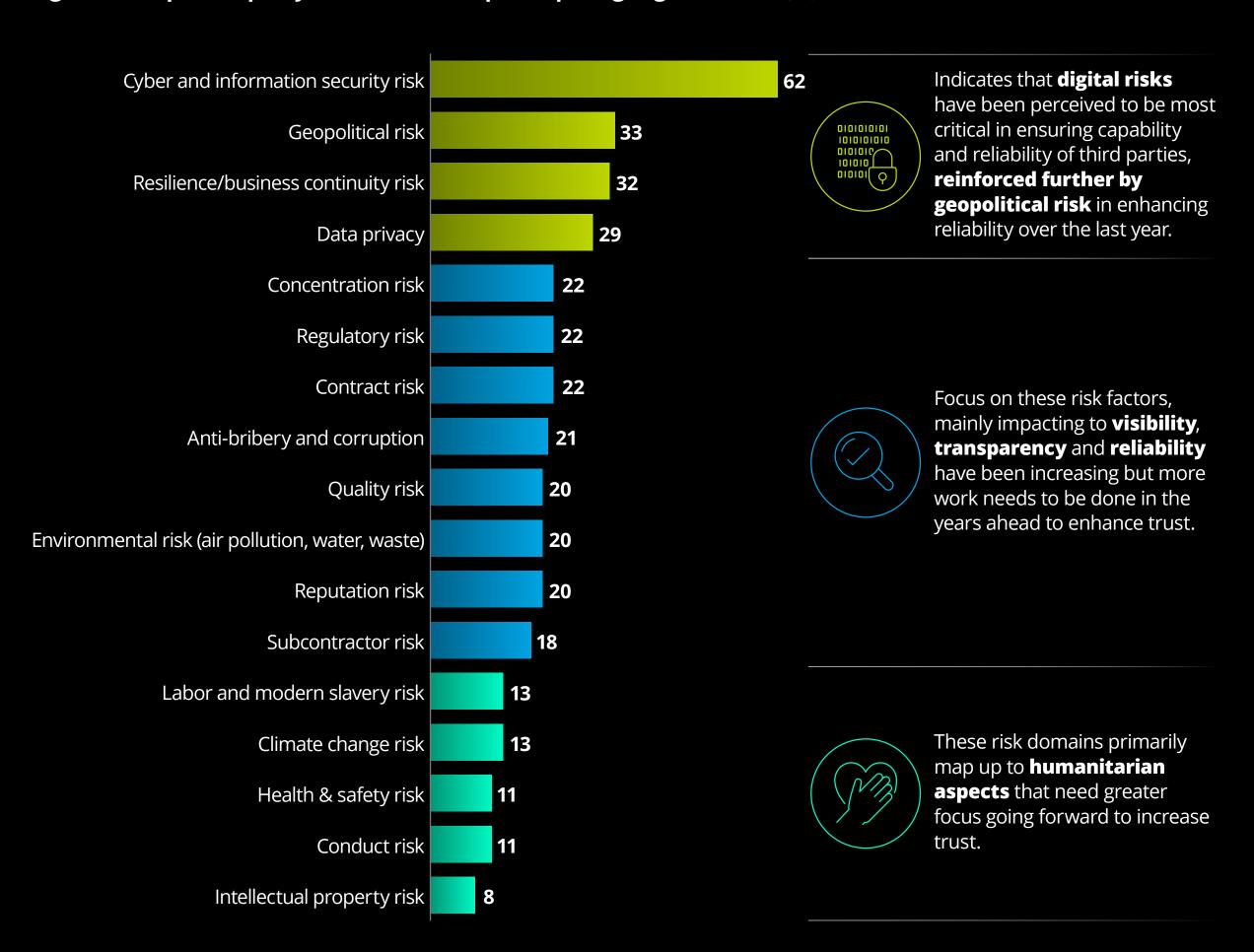


More organizations now realize the strengthening correlation that trust has with financial performance and resilience.



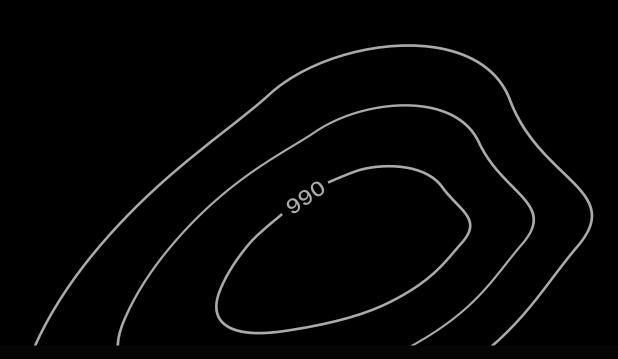
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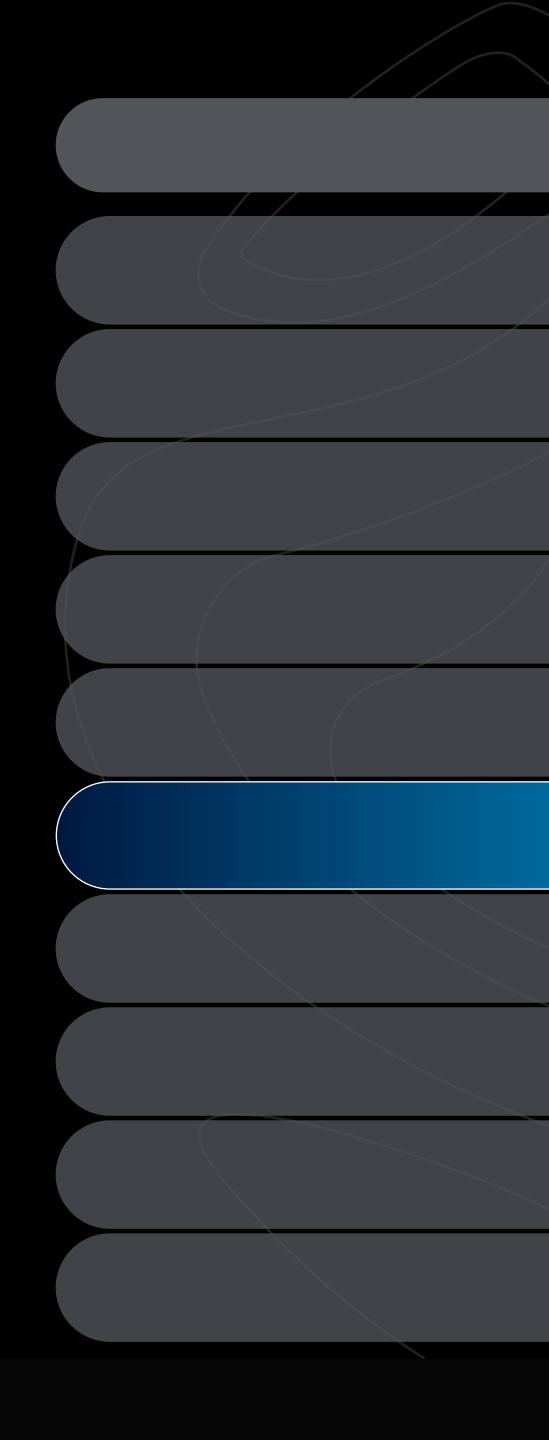
Figure 12. Top third-party risk domains in participating organizations (%)



Relationships with complex subcontractor dependencies are more likely to experience challenge when attempting to build trust. This is due to the fundamental lack of visibility and transparency, as risks tends to hide away in the lower rungs of the relationship ladder. That's why establishing a higher level of trust is so important. Especially in organizations who have material or critical relationships with third parties that are an integral part of complex supply chains.

These third parties – which are directly engaged by the organization – must ensure that standards are being met by the next layer down on the supply chain, and so on. Some tangible examples of this include data privacy (e.g., General Data Protection Regulation (GDPR) requirements) and labor rights (multiple legislation emerging around the world) where the relevant compliance requirements are pushed down the third-party chain while still remaining the responsibility of the primary organization, which is the challenge.





Organizations with more complex supply chains must work harder to build trust in the standards and behaviors being applied across their extended enterprise. The level of trust is informed by both and can influence the nature of assurance activities that might be necessary in the oversight of these relationships. Figure 13a provides an illustration of how this can work.



Efficient oversight of trusted third-parties that are not too critical or material

These third-parties represent those which are relatively less critical/important members of the extended enterprise, but those that have developed high levels of trust. There is an opportunity here to explore cost-efficient tools in the assurance toolkit and embrace data driven techniques (e.g., risk intelligence, adverse media reports etc.) alongside less frequent point-in-time activities (e.g., a periodic assessment program). The strong trust position and relative lower importance provides greater flexibility in this approach.



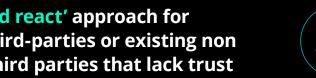
'Track and react' approach for newer third-parties or existing non critical third parties that lack trust

This approach is likely to work efficiently and effectively with newer third-parties who have recently been onboarded, depending on their Over time, if greater trust develops between the third-party and the engaging organization, more flexible assurance techniques associated with a higher trust quadrant of the grid may over time the nature (rigor and frequency) of the assurance activities would evolve again. Tracking and reacting to future events and ongoing evolution will determine any future



Strategic growth with highly trusted critical/material third-parties

Due to the material nature of these third-parties, a robust level of oversight and assurance will always be necessary. However greater levels of trust can enable strategic growth and greater reliance on Third-Party Assurance (TPA) reports and responses provided to questionnaires about controls activities or incidents. This needs to be accompanied by a stronger belief in the follow through of remediation activities, which can in turn help alleviate some of the comprehensive oversight requirements. Exploring opportunities to innovate e.g., leveraging greater access to executive leadership or greater transparency into strategic initiatives, could impact the risk posture of the relationship to inform the frequency/ timing and rigor of assurance activities.



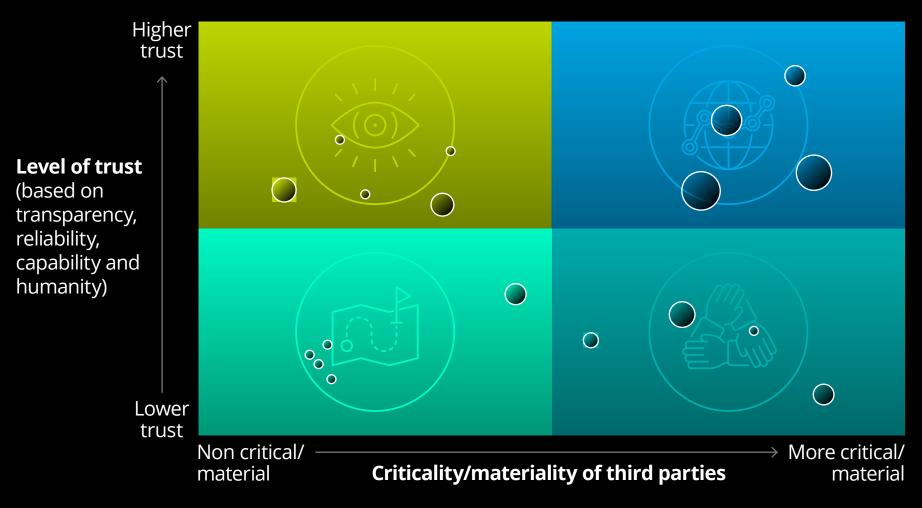
current materiality to the engaging organization. apply. Should a third-party become more critical movement(s).



Build trust with critical/material third-parties (currently lacking trust)

These third-parties can be more of a concern as they represent critically important constituents of the extended enterprise. Yet the level of trust developed with these organizations is lower. This in turn is likely to necessitate a significant level of assurance activity with these organizations which is more rigorous and frequent in nature. Incidents or a deteriorating risk posture/performance at these third-parties requires a robust investigation and response. A key objective over time will be to increase the level of trust with these organizations, that can help reduce the intensity of assurance activity and increase some reliance on less invasive techniques. Where this does not prove possible, regular reporting and monitoring remain key.





Size of circle is indicative of volume of spend

Indicative Assurance Techniques

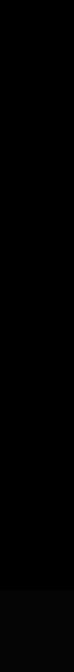
- Questionnaires/ Certification/ TPA reports
- 2-5 year remote audit programmes
- Remediation attestations
- Annual performance reviews (reporting more regular)
- Adverse media

- Certifications/ TPA reports
- Ad hoc assessment activity
- Remediation attestations
- Annual performance reviews (reporting more regular)
- Periodic risk intelligence
- Adverse media

- Questionnaires
- Annual remote/ onsite audits
- Remediation audits
- Monthly reviews focused on risk, control and performance
- Daily risk intelligence
- Adverse media

- Questionnaires/ certification/ TPA reports
- 12-24 months remote/onsite audits
- Remediation evidence
- Monthly reviews more strategic in nature
- Daily risk intelligence
- Adverse media





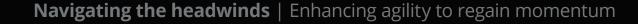


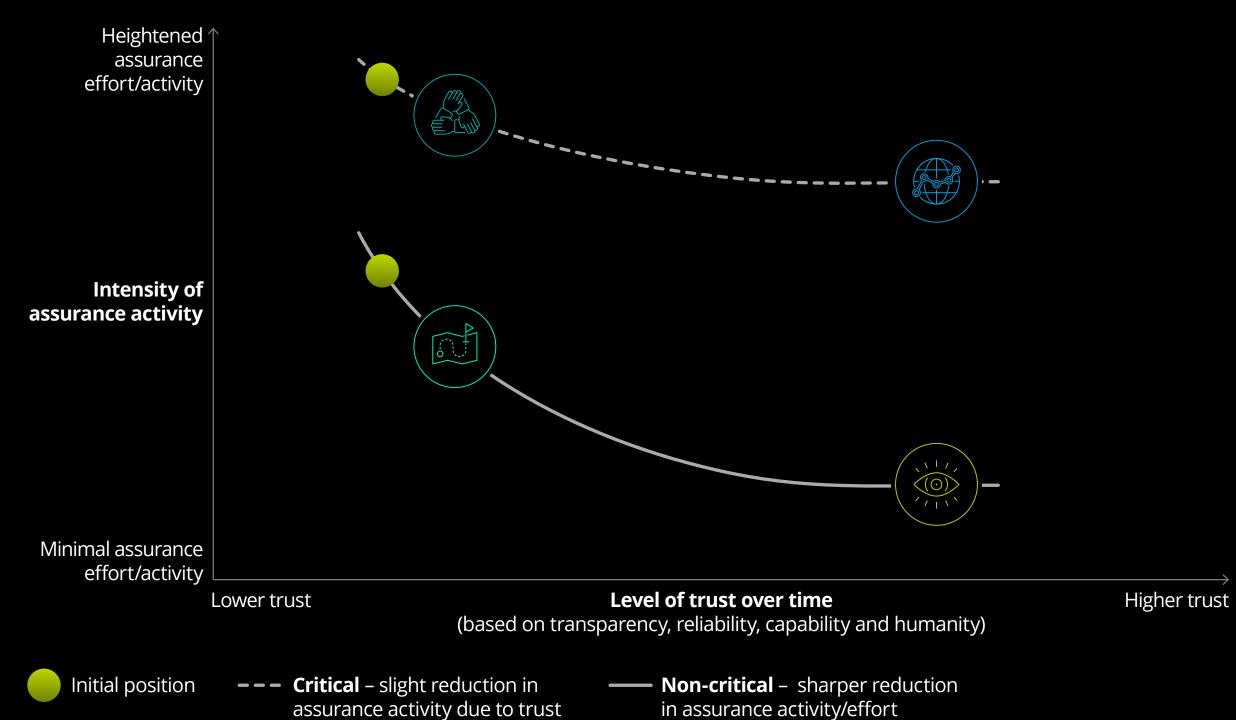
Figure 13b shows how the cost of assurance is likely to be impacted over time as trust increases.

This impact will be different depending on the criticality/ materiality of each third-party relationship:

- For critical/material third parties (top line on the graph), increasing levels of trust are likely to have a smaller impact on reducing assurance activity; and
- For non-critical, or non-material third parties (second line on the graph), there may be greater opportunity to reduce assurance effort as trust increases (as shown by the steeper drop in the curve).

Indicative assurance techniques are outlined on the **previous page**. As an exception to the above, trust and criticality may not increase much over time for some third-party relationships. Therefore, they may remain in their respective (original) grid position **(Figure 13a)** with assurance activities identified at the initial stages.

Figure 13b. Impact of increasing third party trust on level of assurance activity/effort





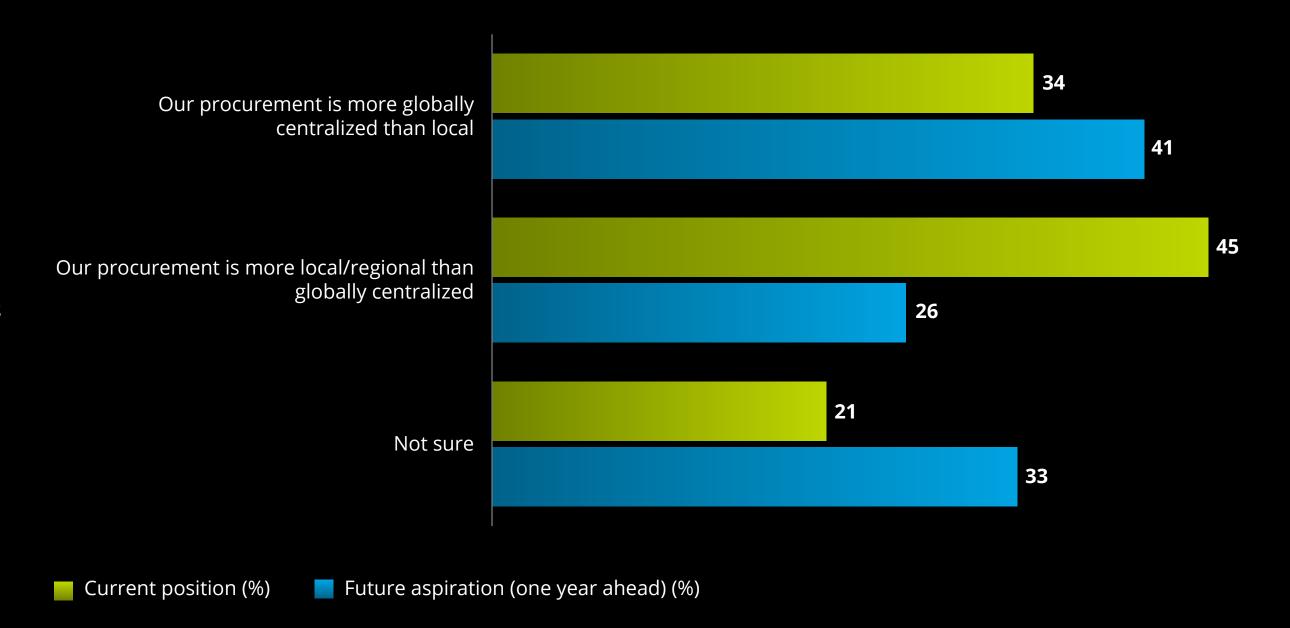
Another key area impacted by trust considerations is the decision to progressively increase local sourcing as a strategy. This comes with a higher inherent level of trust, as it reduces dependence on more distant (and often at times inherently distrusted) sources of supply.

Our survey showcases some interesting data points (Figure 14). We found that **45% of respondents** currently procure as locally as possible. This is because of their specific efforts to identify sourcing options from available and local supplier(s) which in turn result in smaller pockets of suppliers distributed in regions where organizations have market presence. We believe this is due to a perception that it's easier to build trust and manage local third parties, than those in relatively more distant geographies. The other reason for doing this is to reduce the risk of any significant geographic centralization, or concentration, of third parties, in the more distant geographies. However, it must be kept in mind that such approaches can also create localized concentration risks in the primary geography that could be equally dangerous.

On the other hand, 34% of respondents said that procurement continues to be more globally centralized than locally. The fact that this is not an easy decision to make is reflected in the remaining 21% of respondents not being clear of their overall strategy yet.

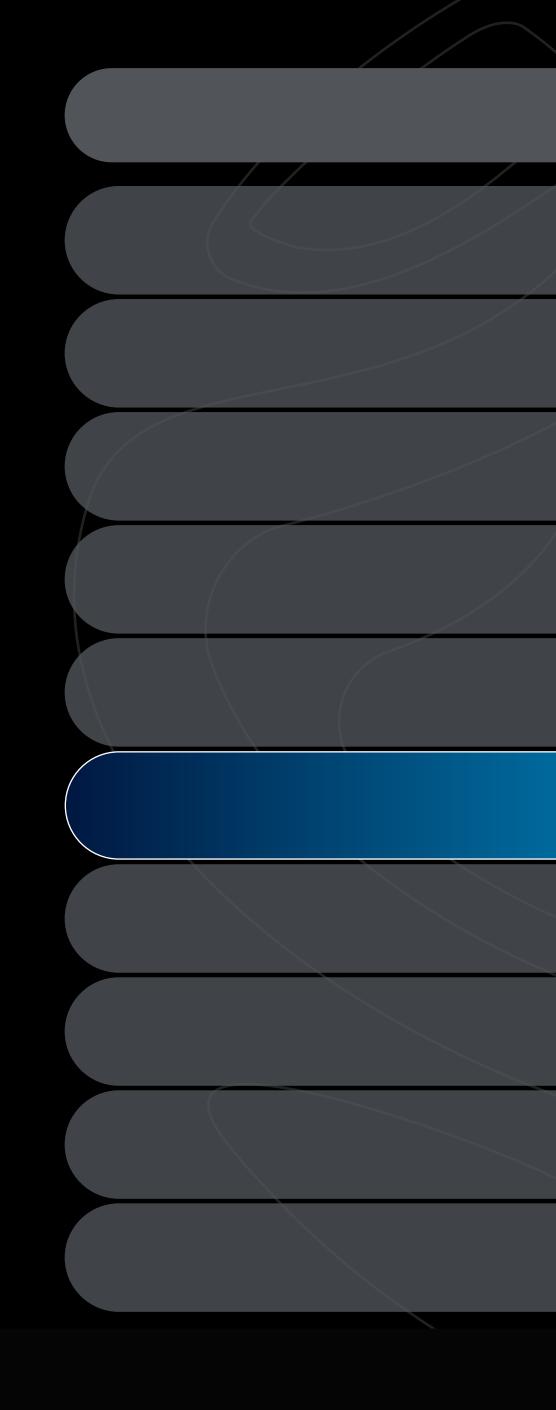
Our survey also found that globally centralized procurement is likely to swing back in favor in many organizations in the next one to three years. We expect this to go up to 41% vs 26% of companies who plan to continue to procure locally.

Figure 14. Centralized global sourcing vs regional and local procurement, current position, and future aspirations



This suggests that the desire to realize the benefits (efficiencies, price points etc.) of a globally rationalized supply base is very strong. It also tells us that it's crucial to enable and build trust in such third-party portfolios, to minimize time and cost associated with the management of these third parties. However, we must be conscious that, at this stage, 33% of respondents are unclear about their future strategy. If the uncertainty in the macro-environment continues longer than expected, it may create a further delay in any change in strategy given the relative ease of building trust locally.

Unsurprisingly, the survey data also shows that only 28% of respondents have a high or very high capability to manage global contingencies related to their global supply chains, including export controls, sanctions etc. While this powers the shift in regional and local procurement at this point in time, this could also be a plausible explanation for the swing back towards unified and integrated global procurement in the future, by which time this capability is set to improve.



Organizations are able to leverage an independent controls assurance report or similar certifications as part of an "assurance toolkit" to reinforce trust (e.g., System and Organization Controls (SOC) style reports).

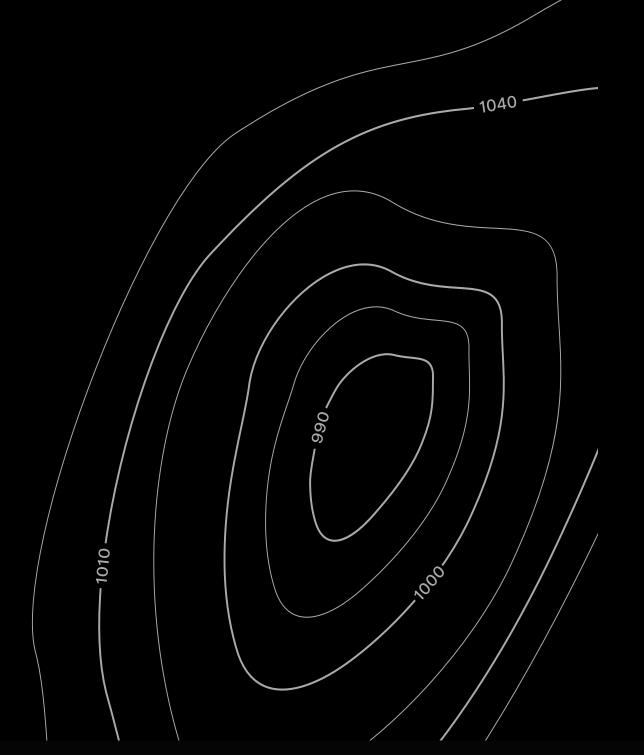
These reports are typically prepared by reputable audit firms at the request of a service provider and can be leveraged by multiple organizations who consume goods and/or services from that same third party. Another Deloitte survey, The Future of Third-Party
Assurance: Insights from our 2022 Global TPA Survey, February 2023, found that the use of these reports is on the rise.

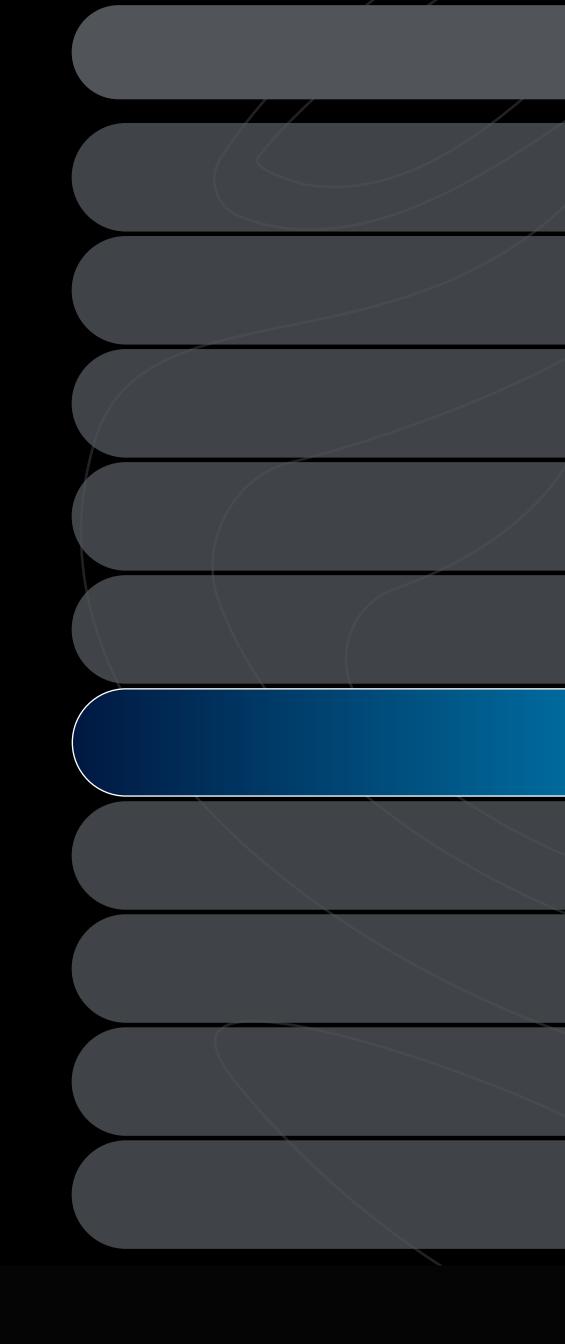
The report also found that the degree to which key risk domains can potentially get in the way of building trusted third-party relationships is increasing as **new threats continue to emerge.** An example of this is cybersecurity. It's a prominent trend that respondents in this survey reported cybersecurity as requiring the strongest assurance by an independent third party or otherwise, to support trust and transparency in third-party ecosystems. This was followed by privacy and ESG considerations. As discussed in section five, an increased desire for real-time risk intelligence that accurately mirrors the risk posture of a third party is another mechanism organizations are using to establish or enhance the level of trust in a third party, which informs the downstream due diligence and monitoring activities. However, the key to this being achieved is to be able to trust the data being provided and interpret it appropriately.

Given the need to enhance trust across third-party relationships, we believe organizations will increasingly explore new forms of independent TPA across a growing number of risk domains. These will be underpinned by newer frameworks/ approaches that can deliver this. For example, SOC2+ is a key reporting mechanism that collates a wide range of assurance requirements into a single report. One-third of respondents said they already used such reports, and the remaining two-thirds of respondents were already aware of such reports. 54% of those who aren't currently using this report anticipate leveraging such a report in the future - it's worth noting that these reports are popular in more than 90% of service organizations. In theory, the reports can be used by TPRM teams, as they continue to fine-tune and streamline their approach to risk management.

One-third of respondents said they already used such reports, and the remaining two-thirds of respondents were already aware of such reports.

However, these reports or certification do have their limitations, with a key challenge being that service providers typically issue their TPA reports in six or 12-month intervals. Many reports are released months after the financial year-end. While these reports can help to establish trust in third-party providers, the timeliness of their content is a clear limitation. In addition to this, these reports in isolation are unlikely to help organizations in more material or high-risk relationships. They may need more bespoke assurance, given the nuances of their specific relationships.





What can you and your organization do differently?

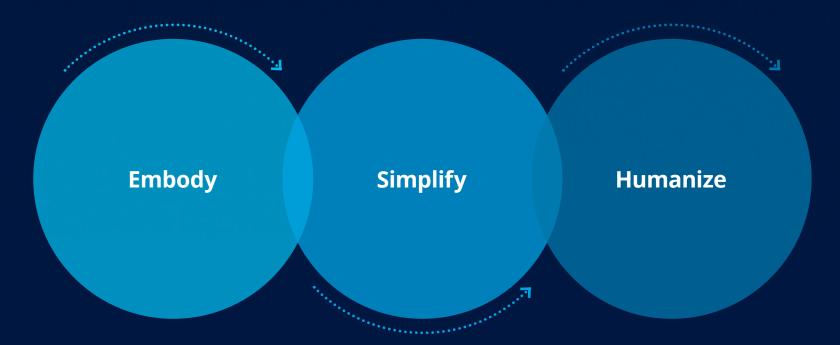
Trust takes years to earn, but moments to lose.

What steps can your organization take to establish trust and maintain it with third parties? According to the Deloitte publication Third-party trust management:

Elevating risk to reward, 2021, highly astute organizations must ensure that trust remains to be a critical component when managing critical third-party relationships, while covering more traditional and emerging risk domains. This is particularly true for organizations that establish more combined, integrated operating models, and relationships with critical third parties.

To build this trust, these organizations need unprecedented **visibility and influence** over their supply chains and other third-party relationships. This will help to supplement their approach based on third-party questionnaires and other tools or artifacts. Our experience has shown us that this will then shift **the focus of governance** away from such administrative activities to, for example, more **collaborative conversations around innovation, strategic growth, and enhanced performance**.

It's also important for sourcing and procurement teams to build trusted relationships to ensure that their organization is positioned as a preferred customer, whom a supplier will prioritize over others in times of headwinds and disruption, when allocating scarce supplies and logistical bandwidth. Organizations can establish trust with third-party risk management in three steps:



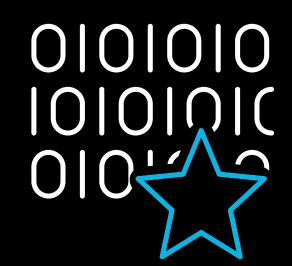
Embody a trust-based mindset in TPRM frameworks and related methodologies to segment third parties on their level of inherent risk, spend, performance, strategic value, and on the level of trust needed to operate collaboratively;

Simplify existing risk management programs within the organization that may be unilateral, administrative, or overly complex, to create capacity and space to establish trust; and

Humanize digital solutions that make interactions between buying and selling organizations more efficient and automated. The most trusted relationships can be amplified with human-centered design that's bolstered by bi-directional third-party engagement.

In addition, <u>Figure 13a</u> can potentially be leveraged by organizations to realize opportunities and increase efficiencies through better alignment of third-party assurance techniques to levels of trust.





Rapidly evolving and interconnected third-party risks are compelling organizations to continue to pursue digital transformation for achieving operational excellence in TPRM.

These are further enabled by automation and smarter segmentation, due diligence, and monitoring by harnessing the power of internal and external data. This also ensures that the level of oversight is proportionate to risks involved.

Summary



In this section we reflect on **significant shifts taking place around the enhanced use of TPRM tools and technologies (including the use of AI)** and provide our perspective on what we believe lies ahead for organizations to maximize this opportunity while mitigating risks. As shown at the very start of this report, the **challenging times we live in require the development of capability through smarter, real-time, and agile approaches**, underpinned by the innovative use of technology. This will help organizations to continue to be **"brilliant at the basics"** by intelligently refreshing fundamental TPRM processes such as due diligence, ongoing monitoring, and data required for better decision-making related to third parties, while ensuring a proportionate effort to risk management.

Our survey data indicates that the pace of adoption of smarter, digital TPRM mechanisms remains slower than expected in the areas of real-time due diligence and monitoring of specific third-party segments. This is due to: (a) risks becoming more inter-connected; (b) limited availability of budgets required for technology investments and concerns around getting it wrong; and (c) shortage of organizational knowledge/skills around cultivating intelligence in a meaningful and actionable manner.

As already seen in <u>section two</u>, strengthening the role of the Board and executive leadership in TPRM is one of the top three areas of priority action to address current TPRM challenges. **Boards and leadership have** a significant role to play in accelerating AI adoption which holds the key to successful third-party management going forward. There is clearly no time to waste as organizations that do not keep pace with ongoing digital transformation, including AI, will rapidly find themselves falling behind the evolving definition of good practice.

Key insights

The rise of Al-enabled tools for efficient and effective third-party management.

Our earlier surveys have clearly highlighted the need for real-time information that encourages proactive or timely decision-making processes related to supplier and other third-party management. Continually sharpening TPRM tools and improving the quality of related data remains an ongoing endeavor, to smartly balance and innovate organizational third-party management capability with growing expectations from TPRM teams.

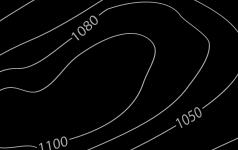
It'll also be important for all organizations to revisit their fundamental TPRM processes in the context of ongoing digital transformation.

One of our respondents said:

"Our focus is not just to improve risk management by investing in technology tools but to create a much leaner and more efficient TPRM organization. We propose to achieve this by refining oversight/governance practices and digitizing/automating TPRM processes."

The opportunities in this area continue to increase. For example, the role of generative AI in supplier management is the latest addition to this ongoing list of opportunities available to organizations with large and complex third-party ecosystems. The impact can be cognitive, behavioral, and physical. An example of this is "decision-support automation".

This method shortens procurement cycles or incident response times by piecing together intelligence from various sources that can enable risk-related decisions operationally and strategically in a manner that's more effective and efficient. It does this by offering more and quicker alternatives or potential options, that consider the impact of dynamic scenarios against organizational appetite.



Generative AI can also help enhance user experience by communicating in their spoken language instead of machine language. This allows AI to potentially act as an assistant, or a more knowledgeable tutor, or even a co-pilot in the future for those managing third-party risks. Further support could be made available with other generated content such as spreadsheet-based analyses, charts, and diagrams. These would help users manage logistics, routes, load-consolidation, and potentially concentration risk.

While the growing use of Al creates many opportunities around third-party management, it can also pose newer risks to organizations. These risks could be realized in an organization's own use of Al but also through third-party services delivered using Al techniques. We've already seen the emergence of risks to data quality using inaccurate sources of data, privacy, cybersecurity, legal and regulatory compliance, and intellectual property. Organizations should undertake appropriate assessments to ensure they only use trusted partners in their Al ecosystems and to ensure these Al systems and services don't enhance or extrapolate biases.

Leveraging technology and real-time data to focus on critical/material third-party relationships.

Given the increasing scale of third-party ecosystems, it's important to concentrate efforts (e.g., allocate limited resources) on the most important and/or high-risk third parties. This requires the effective segmentation of the third-party population that needs to be revisited periodically as circumstances change. As a result, many organizations have been digitizing their approach to segmentation using tool-based questionnaires combined with risk intelligence, that incorporates real-time data based on the nature or location of services being delivered.

However, despite the growing importance of segmentation of the third-party population and increased availability of real-time data for this purpose, we found that:

- only 50% of respondents said they formally segment their third-party population based on risk (Figure 15);
- 32% said that they do not do so at all; and
- the remaining **18%** are **not sure**.

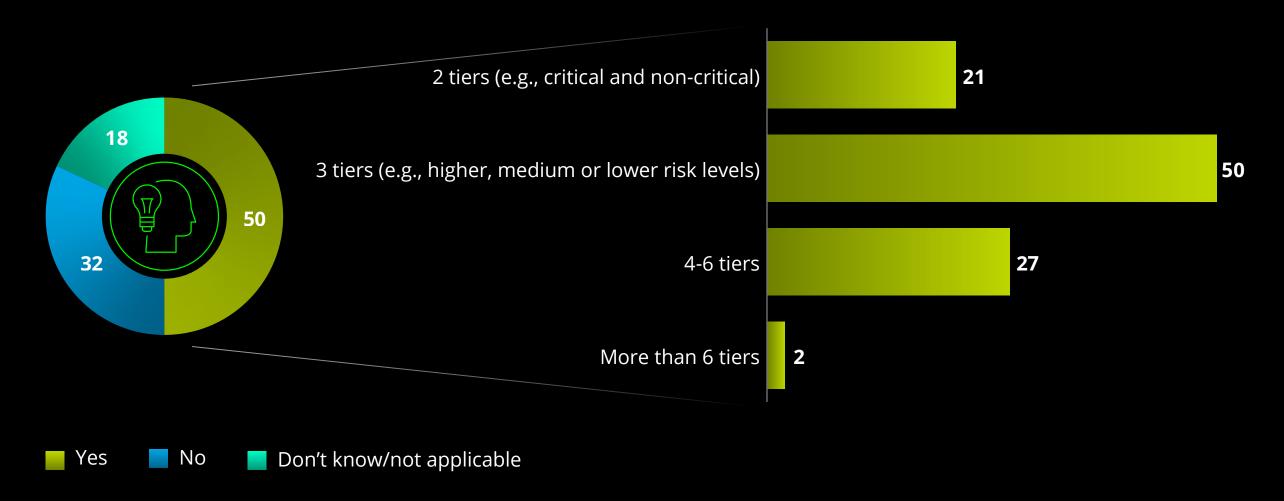
Those who segment their third-party population tend to categorize based on a **three-tiered** approach. This appears to be the **most popular approach** for 50% of respondents. In contrast, 21% use two tiers while 27% use four to six tiers for this purpose. The remaining 2% use more than six tiers.

The percentage of an organization's third-party population estimated to be in the highest risk category (i.e., those requiring the highest focus from a risk management perspective) tends to vary across respondents. 26% of respondents believe that such high risk third parties are not more than 5% of their third-party population, while 32% believe this is somewhere between 6-10% with some interesting variations by industry shown in Figure 16.

Responses to this survey suggest that there's no one-size-fits-all approach in such inherent risk assessments. However, those with better mechanisms to segment third parties are more likely to be able to operate in a proportionate manner.

Figure 15. Current practices in segmenting the third-party population in organizations





Impact of digitization on due diligence and monitoring activities

- Another area impacted by increasing digitization is the proportion of organizational due diligence or monitoring activity (related to managing third parties) that will be done in a real-time or digitized manner (i.e., based on access to a continuous feed of information that provides alerts to events and access to current trended data on third-party control environments typically supported by advanced analytics). As shown in Figure 17, being able to carry out due diligence and monitoring activity in real-time extensively (i.e., for 10-25% or more of the customer base) represents the inflection point that defines the future aspiration of 84% of respondents. Out of this 84%, the top 18% want to go all the way to cover 76-100% of their third-party base. A further 27% aspire to reach a coverage of 51-75%.
- At the moment, 62% of organizations use real-time techniques on less than 25% of their third-party population. This may be by design at the moment, but it also represents an opportunity for progress. This includes:
- » 17% at the bottom level where no such activity is carried out in real time;
- » a further 10% that now cover 1-5% of their third-party relationships in real time; and
- » the corresponding percentages for those who cover 6-10% and 10-25% of their population is an additional 17% and 18% respectively, totaling 62% referred to above.

Figure 16. Proportion of third parties in the highest risk category, overall and by industry (percentage of respondents)

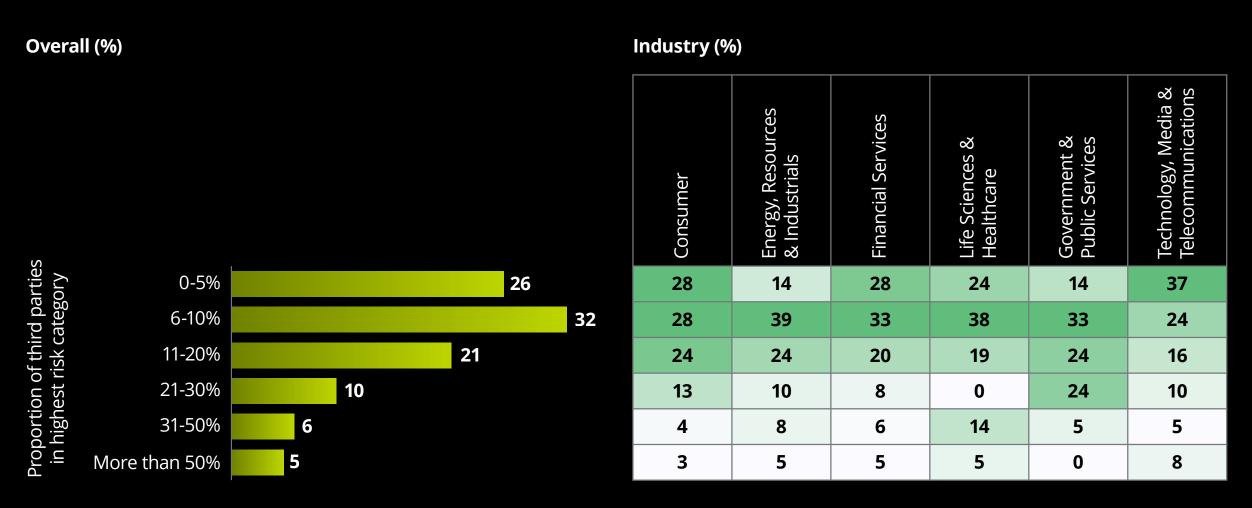
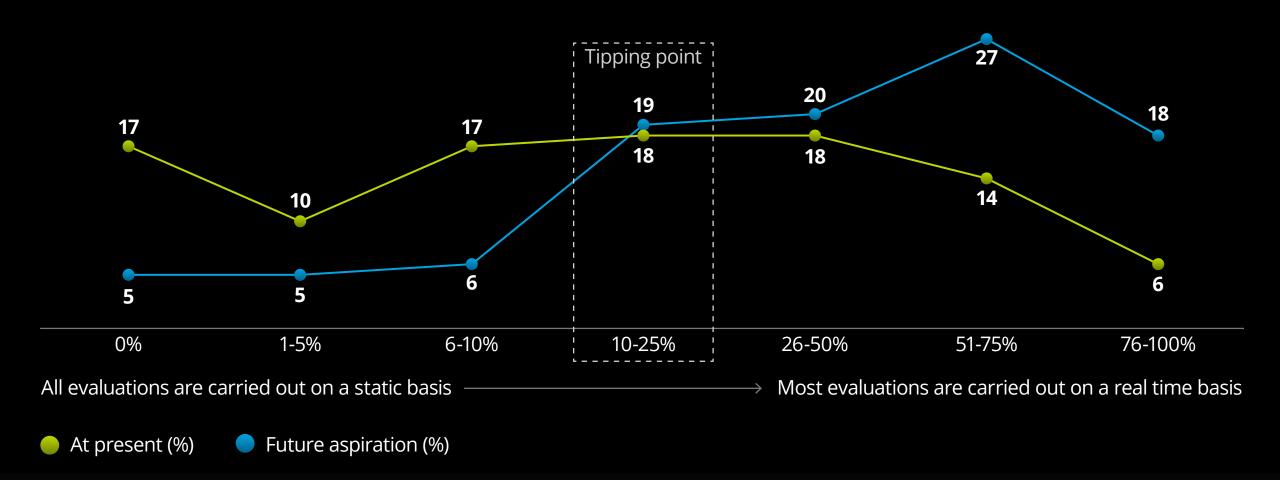


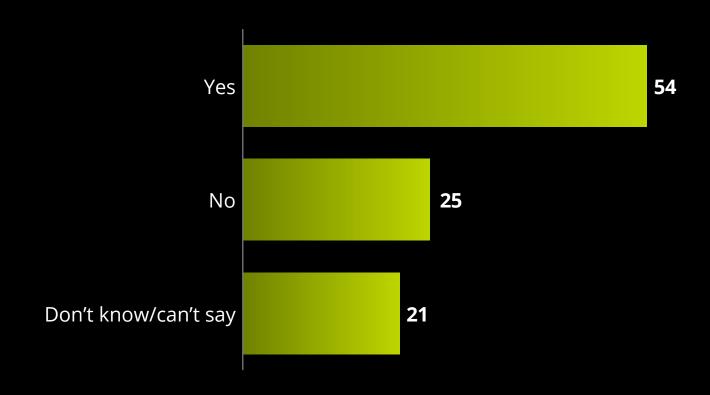
Figure 17. Percentage of due diligence or monitoring activity done in real time at present compared to future aspiration

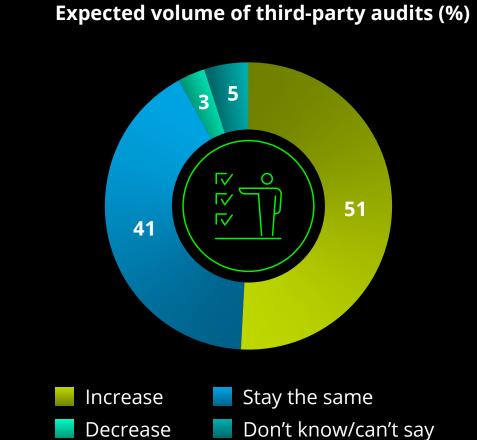


- It's inevitable that the use of evolving technology using real-time information will also help organizations to pinpoint and determine where deeper dives into specific aspects of third-party risk domains may be required. 54% of organizations consider a "deeper dive" or "third party audit" to be a necessary activity. This leads to key decisions on: "Who to audit?", "What to audit?", and "How much to audit?" This introspection helps organizations to diligently plan and complement other risk-related activities in their TPRM toolkit (e.g., inherent risk assessments, completed questionnaires, data-led risk sensing etc.) where appropriate or gain a higher degree of assurance for crucial, material or high-risk third-party relationships.
- 25% feel that third-party audits may not be necessary if real-time digital tools evolve to such an extent that they can elevate their status from co-pilots to autopilots. 21% of respondents said they aren't sure (today) what the future could hold with technology evolution and were unable to express their view at present.
- 51% of respondents believe that the overall volume of third-party audit activity will increase. A further 41% believe it will stay the same but with smarter targeting (particularly given developments in technology to help pinpoint where such deep dives will be required) when selecting third parties as well as scope. Only 3% believe this will decrease in the year ahead, but 5% said they didn't know/aren't sure what could happen (Figure 18).

Figure 18. Uptake of third-party audits

Organizations consider third-party audits a necessary activity to complement other risk-related activities (%)





Managed service solutions in digital transformation in TPRM going forward.

Our earlier surveys have shown that more and more organizations are leaning on external assistance to supplement their internal TPRM capabilities. The nature of the external assistance can vary in shape and size, but our survey indicates an increasing number of organizations exploring TPRM target operating models (TOMs) informed by and/or leveraging assistance from trusted advisors. That's also true for transformation (design and implementation), in addition to certain aspects of day-to-day execution of TPRM activities. Especially in relation to activities that represent the main pain points in organizations. These areas tend to offer the greatest opportunities for improvement and collaboration.

By embracing external assistance, these organizations get faster, more efficient access to readily trained workers and specialist technology. With further digital transformation, managed service solutions are now expected to evolve into more comprehensive and tailored, end-to-end, insights-driven services largely enabled by technology and only supplemented by focused staff deployments.

Our current survey shows that 36% of respondents are working more closely with managed services providers using integrated technologies, compared to 33% who aren't. The remaining 31% don't know/can't say. We believe the proportion using managed services will grow over the coming years. We expect organizations to give more focus and attention to closer collaboration and integration of effort between internal and external teams. This will help them to progress and develop their digital transformation journey.

What can you and your organization do differently?

What can your organization do to integrate technology better and harness the power of digital transformation in TPRM? The need to optimize TPRM tools and technology has consistently dominated our surveys since 2016, when a **three-tiered technology structure** for TPRM started to emerge. This three-tier structure comprised of:

- Tier 1: Enterprise Resource Planning (ERP) or other backbone systems. For example, procurement platforms acting as the foundation for TPRM activities supported by tier 2 and tier 3 (explained below).
- **Tier 2**: **Generic** or **specific** platforms addressing diverse risk management requirements which can be used for third-party risk management.
- **Tier 3**: Other niche packages (**feeder systems**) for specific TPRM processes or risks, providing feeds from specialized risk domains.

Ongoing refinements, as well as integration, across these various components over the years in the more progressive organizations has set the stage and established an intelligent third-party risk management and monitoring capability. This has been further enabled by streamlined third-party management processes including online real-time management information to support strategic decision-making, targeted deep-dive due diligence and proportionate ongoing monitoring of third parties.

The role of this underlying TPRM architecture is to coordinate activities across the depth and breadth of the organization to provide a single, up-to-date picture, rather than inconsistent and outdated information from static sources. The strategic aspiration is to reduce the sole reliance on questionnaires and increase the proportion of credible and actionable intelligence provided in real time. This is all accessible on the integrated platform that allows users to understand their total risk, from individual third parties and operations, to ensure that these operations can be managed effectively in a manner proportionate to the risk exposure.

However, the data from the current survey shows that not all organizations are there yet. Interconnected risks (in the current uncertain macro-economic environment) require internal data to be consolidated from across the enterprise, and from external sources, to gain a holistic view to understand connections and triggers. It also involves ongoing sensing across the various risk domains. As seen in our Deloitte report on The case for integrated third-party management, 2022, breaking silos between various functions (such as sourcing, procurement, purchasing, financial accounting, risk management, contract management, and resilience management) is key to understanding and managing these evolving and intertwined risks.

Going forward, the desire to focus on activities such as real-time ongoing monitoring and risk sensing continues, using emerging technologies such as robotics automation and Al. Organizations have experimented with classification, prediction, summarization, and intelligent process automation over the last few years. So, what's new with generative Al? It's the ability of this new technology to interpret and create content and analysis including charts, diagrams etc. that's expected to open several new avenues to offer:

- an enhanced user experience making third-party management tasks efficient and effective;
- collectively making notable enterprise-level impact in terms of cost savings; and
- transformational changes of the strategic business model or at the value-chain level.

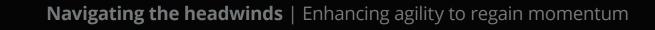
However, as always, newer opportunities will continue to create newer risks which must be carefully managed.

Apart from the above areas of applying AI, our experience shows significant potential to digitally transform **control** and prevention activities (CAPA) from initial due diligence to the ongoing monitoring stage and potentially beyond (e.g., setting, reviewing, and monitoring risk appetite). These activities can help leverage insight and input from domain experts more efficiently and effectively to review the red flags and other content produced by generative AI systems. Our survey suggests that many organizations are making progressive changes to be ready to adapt to this new era.





Respondent profile



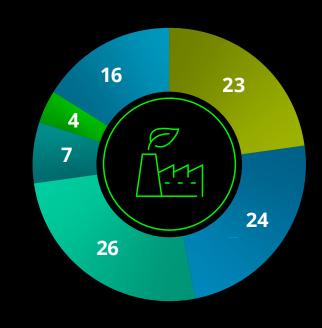
Respondent profile

For the 2023 survey, Deloitte received a total of **1,356** responses from a wide range of organizations from **40** countries.

The responses were from people accountable for TPRM activities within their organization.

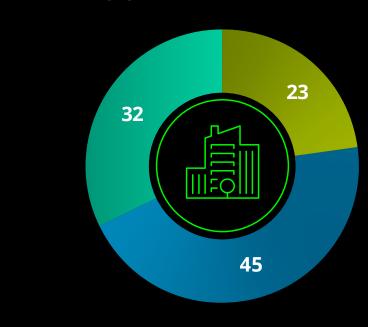
The survey was conducted between February and April 2023.

Industry (%)



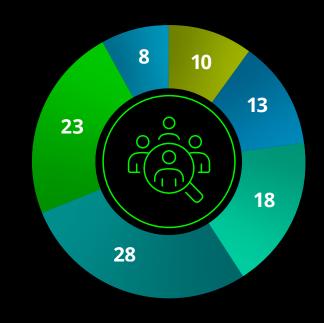
- Consumer
- Energy, Resources & Industrials
- Financial Services
- Life Sciences & Healthcare
- Government & Public Services
- Technology, Media & Telecommunications

Organization size (%)



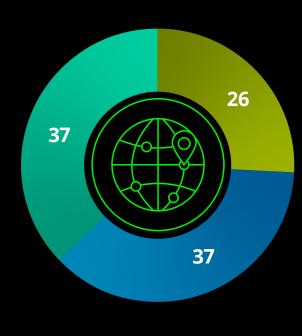
- Small organization (less than 250 FTE employees)
- Mid-size organization (250 or more FTE employees and turnover less than US\$5 billion)
- Large organization (250 or more FTE employees and turnover more than US\$5 billion)

Respondent position (%)



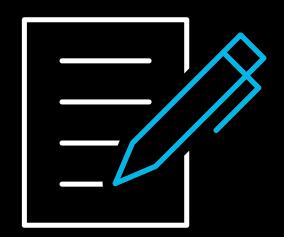
- Board member
- C-suite
- Senior management
- Head of specific functional area
- Middle management
- Others

Geography (%)

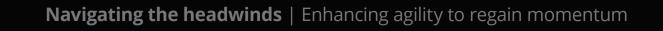


- Americas
- EMEA
- APAC





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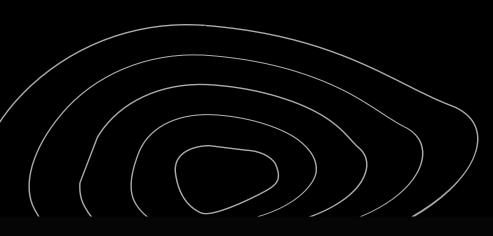


Kristian Park
Partner and Global Leader, Extended Enterprise

Kristian Park is the global leader of Deloitte's Extended Enterprise practice. Based in the UK, Kristian works with clients on a variety of different Third Party Risk Management topics – including designing and revising TPRM frameworks, implementing technology solutions and brining our operate offerings to clients e.g., screening and monitoring, third party questionnaires, etc.

Kristian also leads the UK and NSE firm's Strategic Risk offering, this includes Extended Enterprise as well as Deloitte's ESG and Resilience offerings. The intersect between these services has been clearer in recent years and is evidenced in the latest survey results.

He covers all industries, with significant experience in Financial Services, Life Sciences, Energy & Resources, Technology, Media and Telecoms, as well as Consumer products.





Danny GriffithsPartner, Extended Enterprise

Danny Griffiths is a Partner in our Extended Enterprise (EE) team, with over fifteen years of experience providing assurance and advisory services on Outsourcing and Third Party Risk Management (TPRM) to his clients. He has assisted clients on all aspects of TPRM across a wide variety of industry sectors but primarily works with organisations operating in the Financial Services sector. Danny specialises in advising clients on their interactions with, and management of, third parties against regulatory expectations and good industry practice. He has supports his clients to benchmark their existing TPRM practices and challenges them to establish new practices that will enhance their TPRM maturity. Danny also helps his clients to understand the technology landscape for TPRM and how to 'tech-enable' their TPRM practices or unlock the benefit of external assistance (such as managed solutions).

Danny is a leader within our international network for TPRM services and has worked extensively with clients throughout Europe, the Middle East and Africa (EMEA). He also has experience working with international organisations operating globally and engages collaboratively with international colleagues to provide insights for his clients. Danny is a regular participant and contributor at TPRM forums and hosts TPRM roundtables for Deloitte in the UK and internationally.



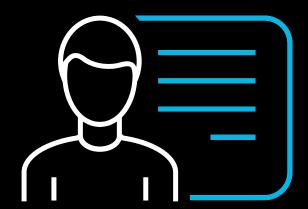
Dr Sanjoy SenHead of Research and Eminence, Extended Enterprise

Dr Sanjoy Sen is the head of research for Extended Enterprise at Deloitte and co-director for Aston University's recently-introduced MSc programme in Al and business strategy. Sanjoy's pioneering research and thought leadership in the area of third-party management has earned him a doctorate from Aston University in 2019 and the prestigious global research impact prize awarded by the Association of MBAs (AMBA) in 2021.

Since 2014, Sanjoy's work has been cited in various academic and professional journals including the Academy of Management, as well as the Wall Street Journal and other frontline newspapers.

Sanjoy has extensive experience advising boards, senior leadership, head of risk, and internal audit on strategic governance and risk management of the extended enterprise, outsourcing and shared services. He is a chartered accountant (FCA), cost and management accountant, and certified information systems auditor (CISA) with over 35 yeas of experience, including 17 years of partner-level experience at Deloitte and another Big Four firm.





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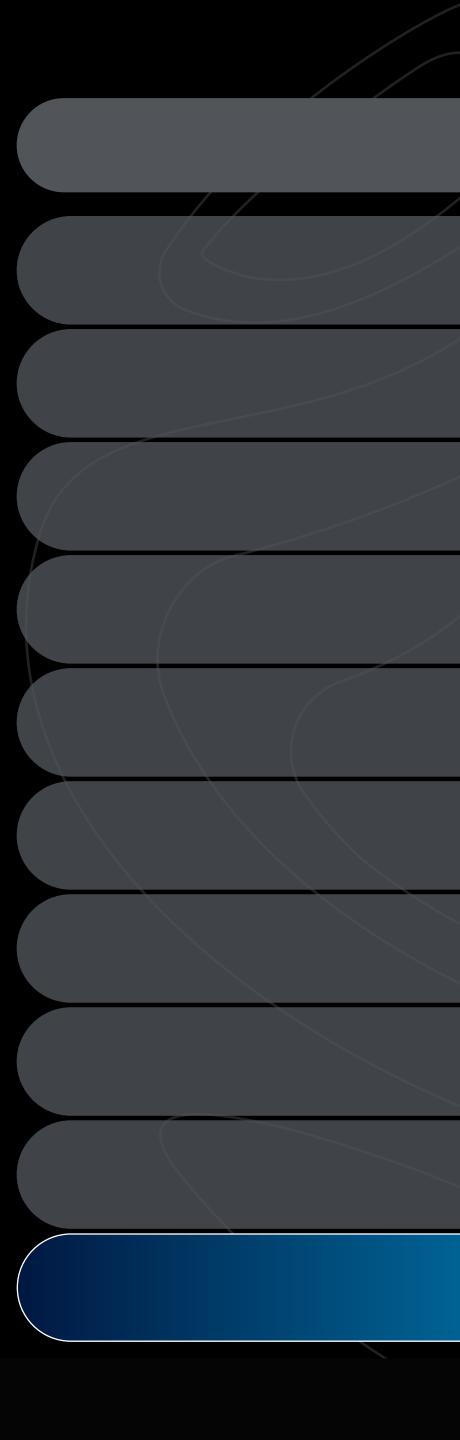
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