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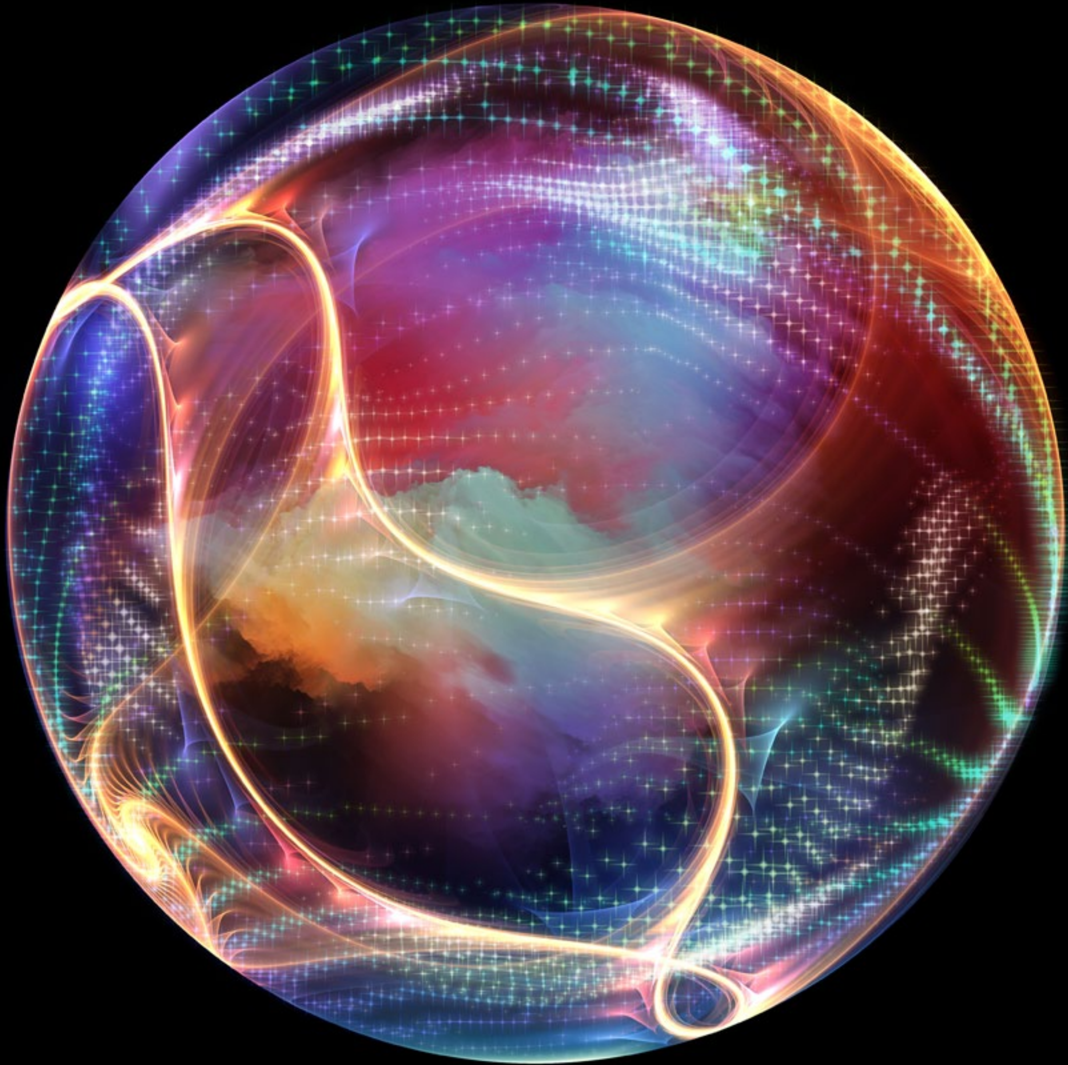

Managing the extended enterprise in Asia Pacific

New risks and opportunities for business in a changing world

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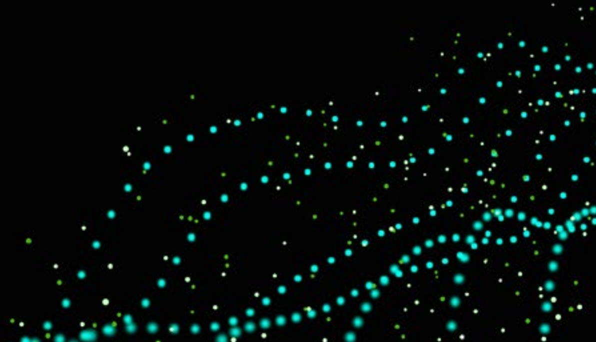


Foreword

The shape of the enterprise has fundamentally shifted.

Businesses rely on an entire ecosystem to succeed. In a globalised, digitally enabled world, their footprint extends well beyond a single factory or place of operation. A firm might make finished goods or occupy a critical supply chain niche. They may be headquartered in one location but possess offshore subsidiaries. Invariably, they are dealing with many different third parties further afield.

In short, a thriving business now depends on a web of alliances and relationships extending well beyond its perimeter. This extended enterprise includes vendors, suppliers, affiliates, and joint venture partners. It encompasses research and development (R&D) labs, technology incubators, retailers, distributors, and customers.

With the extended enterprise comes an ever-widening universe of risk. Until recently, businesses making big decisions about their investments, products, and workforces could rely on domestic and global conditions to remain stable. This no longer holds true. The "new normal" approaching the mid-2020s involves operating amid constant volatility, even turmoil.

In this evolving environment, boards, CEOs, and other leaders must be finely attuned to geopolitical developments, changing economic circumstances, and cybersecurity threat landscapes. They must also monitor technological advances, market attitudes, national policies, and shifting regulatory requirements in areas such as environment, social and governance (ESG).

Nowhere is this challenge greater than in the Asia Pacific region. Anchored by China, the so-called "factory of the world," Asia Pacific rests at the centre of global production. However, it has experienced significant supply chain challenges in recent years. These include the COVID 19 pandemic, climate change, energy market disruption, cybersecurity attacks, intensifying trade tensions, and geopolitical instability between rival powers.

This unsettled landscape is changing the risk equation for businesses, all the way from major technology providers to foundries, retailers, and shoe manufacturers. The bigger the extended enterprise, the greater an organisation's vulnerability.

Traditional discussions of the extended enterprise have been based on American or European perspectives. This report is specifically targeted to large organisations operating in Asia Pacific or wishing to grow in the region. It draws on interviews with some of Deloitte Asia Pacific's leading specialists, reflecting engagements and feedback from clients,

Key trends and considerations are pinpointed that should be top of mind for enterprise leaders as they evaluate third-party ecosystems and seek to de-risk, while embracing new opportunities. This may involve taking decisive steps to manage different risk domains, diversify business locations, mitigate supply chain vulnerabilities and reform ESG practices.

Above all, managing the extended enterprise requires a whole-of-organisation approach and willingness to think dynamically about the future. Nations and businesses must be ready as the next upheaval could come from anywhere.

We hope that our perspectives on managing the extended enterprise in Asia Pacific provide you with helpful insights and considerations for a comprehensive business approach.

Jimmy Wu
Deloitte Asia Pacific Extended Enterprise leader

Asia Pacific in transition: Key trends

Business supply chains and operations are in flux in a volatile world.

Two major wars, in Ukraine and the Middle East, are realigning major power dynamics and testing the limits of international cooperation. The Asia Pacific region also faces intensifying strategic and economic competition amid rapidly urbanising populations, a digital revolution, and unfolding energy transition. While the push towards decarbonisation is being led by Europe, Asia Pacific nations and businesses have an opportunity to specialise in new industries and be part of global supply chains.

During this time of flux, many governments across Asia Pacific are moving to support local businesses, catalyse homegrown ecosystems, and upskill workforces. Partnering opportunities exist for global industries and corporations that wish to diversify their operating base, develop alternative manufacturing locations, and redraw supply chains.

For a long time, globalisation led business leaders to prioritise supply chain efficiency. However, the mindset of "just in time" is being replaced by "just in case."

Recent upheavals have prompted large companies to emphasise safer, more resilient supply chains and closer geographical proximity to third parties. Today's leaders must consider that the next trade disruption could be imminent—be it another war or pandemic, climate crisis, terrorist attack, or cyberattack on critical infrastructure.

Supply chain volatility the new normal

Disruption has proven a constant for Asia Pacific businesses in recent years. The outbreak of COVID-19 in 2020 led to border shutdowns and reduced workforce mobility. This resulted in historic losses in output and productivity. Nations were forced to develop greater sovereign capabilities. Companies also radically accelerated their digital transformations and developed new business models to survive.

Supply chain volatility has also accompanied the conflict between Russia and Ukraine from February 2022. Port logjams and airspace restrictions have combined with high oil prices to make transporting goods difficult. Ukraine produces 90 percent of the neon gas used to make electronic chips. Russia makes one-third of the world's palladium.[1] When war broke out, crucial Asia Pacific sectors such as semiconductors—the foundation of computers and other electronic devices—suffered supply shortages and delivery delays.

Shifting superpowers

Today, China and India are two of the largest powers in the Asia Pacific region. India has the world's largest population, but China's economy is about five times larger than that of its neighbour.[2] Looking forward, India has ambitions to develop a US$10 trillion economy by 2030.[3] It seeks to become an international business headquarters, lifting living standards and per capita income for its citizens.

For its part, a rapidly modernising China is expanding its sphere of influence through North and Southeast Asia. The Chinese economy is becoming more globally oriented and sophisticated, even as the country's population ages and reduces in size. Many Chinese companies are seeking to diversify their local businesses. This might combine establishing a headquarters in China while also aiming at the international market.

Investment from both the US and China is being welcomed by most countries throughout the region. However, trade tensions are escalating, particularly as the US and China reduce economic cooperation. American tariffs have been levied on a wide range of Chinese exports, including steel, agriculture, cars, and consumer goods. There is also growing concern about a Taiwan-related conflict, particularly given Taiwan's hub status in areas such as advanced chip manufacturing. This would have serious implications for global and Asia Pacific businesses with headquarters, supply chains, customer bases or other third-party relationships in Northeast Asia.

Any conflict would likely involve severe disruption to the availability of many rare earth minerals. As the world moves to decarbonise, rare earths are integral to a wide array of clean energy technologies. These include electric vehicles, solar plants, wind farms, battery storage, and hydrogen. Rare earths also play a vital role in the defence industry, as well as the production of computers, televisions, and smartphones.

China currently extracts 60 percent of the world's rare earth minerals and processes nearly 90 percent. Its resources and expertise provide an avenue for leverage over other nations with limited capacity, including the US. For example, in December 2023, China announced major export restrictions on graphite, gallium and germanium, as well as rare earth extraction and separation technologies.[4]

"China Plus One" strategy

Post-pandemic, China remains an attractive place for international companies to locate subsidiaries or branches. However, as China takes on the characteristics of an aspirational advanced economy, it is becoming less suited to low-cost production. The government is moving to promote higher value industries, including high-tech, life sciences, and consumer brands. Following the example of Europe, China is also increasing ESG requirements on companies and their suppliers.

These factors, combined with growing geopolitical tensions, particularly in Northeast Asia, are prompting many businesses to consider a "China Plus One" de-risking strategy. This potentially involves keeping a large presence and base in China, but opening other premises such as manufacturing plants elsewhere. Multisourcing might occur from second and third locations. A prominent example is Apple supplier Foxconn, which has opened secondary locations in India, Vietnam, Cambodia, and Indonesia.

Such "China Plus One" or "China Plus N" strategies increasingly involve greater localisation, producing goods and services closer to home. More businesses are looking to "reshore," "nearshore" or "friendshore" to countries where production is particularly capital-intensive or can be automated. For example, many US manufacturers are relocating production closer to domestic markets in Canada and Mexico.[5]

According to a recent report by Morgan Stanley, India, Mexico, and Southeast Asia are best positioned to benefit from the transition to more localised supply chains.[6] The report forecasts that reshoring from China will progress slowly, with most tech hardware production flowing to India and Southeast Asia, not North America.

China currently accounts for 34 percent of global manufacturing GDP or US$4.9 trillion out of a total of US$14.2 trillion. Based on a potential loss of international production and exports from China, an estimated US$846 billion of manufacturing output could be at risk—6 percent of the global total.[7]

However, the Morgan Stanley report predicts some countries will see "significant growth gains." For example, it forecasts India's manufacturing base will triple by 2031 with its share of GDP rising from 16 percent to 21 percent. Mexico is estimated to have a potential net gain of 30 percent in exports to the US over five years. In fact, Mexico-US trade is now about level with China-US trade.[8]

India rises

Today, India sees a significant opportunity to position itself as a partner to global corporations that want to redraw supply chains. The nation is a global leader in software development for IT-enabled services and exports. Geopolitical instability has not affected this position. If anything, drawn by the dependability of India's business environment, offshoring to India has increased. For example, conflict in Ukraine has undercut hubs such as Krakow in Poland. This has traditionally been used by global corporations for their supply of IT professionals and proximity to Europe.

India has also created a "China Plus One" policy in the form of Production Linked Incentives (PLIs) to encourage companies to build manufacturing ecosystems with a larger local dependence. This has provided a significant boost to some sectors.

India at a glance

India's GDP is about US$4 trillion,[9] making it the fifth largest economy in the world behind the US, China, Germany, and Japan. Growing by more than 5 percent a year, it is a global outperformer. Projected economic growth in 2024-25 is 6.6 percent. While coming down from 7.8 percent the previous year, this remains well above the G20 average.[10] In particular, the country's banking and finance sector has been booming.

A significant uplift in exports is needed for India to meet its ambitious aspirations. Major investments are also needed to upgrade health and education infrastructure, and upskill the workforce. In particular, there is an opportunity for Indian firms to significantly scale manufacturing production.

For example, Apple's iPhone exports from India have nearly doubled from $6.27 billion in the 2022-23 fiscal year to $12.1 billion in 2023-24, as reported by The Trade Vision. This growth is part of a larger surge in total smartphone exports from India, which increased to $16.5 billion from $12 billion over the same period.[11]

Yet India has not been immune to global disruption. Losses in the electronics sector due to supply chain problems have included Taiwanese electronics company Wistron, one of three global contract manufacturers for Apple, which wound down its Indian operations in 2023.[12]

The life sciences and pharmaceuticals sectors have also been impacted. Active pharmaceutical ingredients (APIs) are the core of any medicine that is created. China used to be the fulcrum for this trade, accounting for significant supply to India as this was cheaper than manufacturing domestically. However, supply has now eroded due to import restrictions imposed by India resulting from geopolitical tensions. Deloitte understands that this is the reason large pharmaceutical companies have set up significant bases in India, including Sun Pharma, Glenmark, and Lupin Laboratories. All are manufacturing APIs locally rather than relying on imports.

Electric vehicles are another area of competition. Here, China has invested early and significantly to build a supply chain for the world's new electric vehicles ecosystem. China is now the largest maker of all automobiles in the world.[13] However, even in this area, India is offering PLIs as an initial incentive to encourage corporations to redraw their supply chain.

Japan rebuilds local capacity

Japan is responding to global events with a push to boost homegrown production and rebuild domestic supply chains. In December 2022, the Japanese government passed a major law known as the Act for the Promotion of Ensuring National Security through Integrated Implementation of Economic Measures (Economic Security Promotion Act).[14] This was designed to stabilise supplies of critical materials, uphold critical infrastructure, and support development of critical technologies.

Under the law, 11 goods have been designated as strategically critical materials and products. This is to protect against economic coercion by reducing their supply chain exposure. The goods include semiconductors, rare earth minerals, medical supplies, fertilisers, batteries, industrial robots, aircraft parts, storage batteries, and machine tools. In each of these cases, the Japanese government is committed to developing homegrown supplies and stockpiles. It is also prepared to subsidise or encourage onshore plant building. The alternative is to move plant and production offshore, or seek alternative suppliers, most commonly from Southeast Asian countries like Thailand and Vietnam.

The Japanese government views regional geopolitical tensions as a high supply chain risk. Businesses are considering potential developments. Local companies have strong ties with Taiwanese suppliers in areas such as manufacturing, chemicals, consumer electronics, and semiconductors. Many Japanese companies also source rare earth metals in and around China.

In particular, Taiwan manufactures 90 percent of the world's advanced semiconductors, including those used by Japanese industry. A conflict that disrupted supplies would strike a direct blow to the economy.[15] As part of an effort to reshore production back to Japan, the government is supporting Taiwanese chipmaker TSMC to build a second Japanese manufacturing plant that would begin operation by the end of 2027.[16]

Finally, large organisations in Japan are working to map or visualise their supply chains, which are often complex and multi-layered. This is primarily driven by concerns over potential disruptions caused by lower-tier suppliers (where intermediate products are sourced from subcontractors). By doing so, firms can take proactive actions to mitigate risks, such as mulitisourcing their supplier base.

Indonesia leverages natural resources

As Southeast Asia's largest economy, Indonesia is responding to geopolitical disruption with an increased focus on domestic production. It is also seeking to attract large inflows of foreign direct investment, pursuing a middle orientation between the US and China.[17] As such, Indonesia is becoming a destination for international companies to secure market access and new opportunities.

For example, Indonesia's potential to become a global battery superpower comes from holding the world's largest supply of nickel ore.[18] This crucial input has major strategic value to China, as it does to any nation seeking secure global electrical vehicle and battery supply chains. As a result, there is a rapidly growing ecosystem in Indonesia anchored by nickel mines.

In 2021, the government took a significant step by instituting export bans on unrefined ore to force investment into higher value-added downstream activities such as nickel smelting and refineries.[19]

Other technology-intensive sectors with potential include clean energy and data centres. In addition, Indonesia is a provider of raw materials such as rubber and coconut oil.

Indonesia is already home to large Chinese construction interests, as the government moves to decentralise bureaucratic and business opportunities away from the capital city, Jakarta. Indonesian state-owned enterprises are also engaging with Chinese companies in joint venture arrangements. Tsingshan has ploughed significant investment into the nickel-rich island of Sulawesi and built large industrial parks to domestically process ore.[20] Battery makers such as CATL have invested billions in Indonesian domestic battery production facilities. South Korean and Japanese carmakers and battery companies are rushing to catch up.[21]

Another trend is Chinese investment in Indonesian startups and other opportunities in Southeast Asian markets. For example, the Chinese electric vehicle leader BYD is negotiating with the Indonesian government to set up its own factory in Indonesia.[22] The US government and major American companies are also active. Ford has announced it will be part of a US$4.5 billion nickel investment project with a Chinese partner.[23] Tesla is also involved in several initiatives.

Vietnam as a manufacturing alternative

Vietnam is transforming into a global manufacturing hub and effective "China Plus One" relocation destination.[24] Key advantages include its strategic location close to international shipping routes and well-developed transport infrastructure, including international airports, seaports, and rail links. Production costs are also competitive, with Vietnam's labour costs being about half those of China's.

While benefitting from US-China trade tensions, Vietnam has challenges ahead to fully leverage its manufacturing capabilities. Chief among these is finding skilled labour. With only 56 million people, its workforce is 14 times smaller than that of China. Other areas of risk for companies that wish to engage with suppliers and other third parties include the lengthy time taken for projects to be approved, land use limitations, and the impacts of environmental laws.

Corruption is a concern in many Southeast Asian countries. With a lack of regulatory oversight and institutional strength, business is often conducted on the basis of personal relationships. There is a tradition of the state being involved in commercial arrangements. Businesses may also need to assure themselves of the integrity of labour practices within Vietnamese suppliers.

The changing enterprise risk equation

ESG issues require risk management across the ecosystem.

Imagine establishing a high-tech factory in northern Vietnam. Or sourcing suppliers from a remote part of the Philippines, or another location without a long history of supporting global commerce. For corporations that are considering diversifying their bases of operations or redrawing supply chains, successful execution is not simple.

Invariably, it requires responsible engagement with not simply an extended enterprise but a new ecosystem. This goes beyond the company's direct labour force to encompass third-party contractors, suppliers, and service providers. Examples include cooks, cleaners, truck drivers, IT specialists, and lawyers. Recalibration of the business also means operating in a new local community and environmental context. As such, it is essential to consider compliance requirements amid an ever-widening zone of risk.

ESG and the extended enterprise

ESG is an umbrella term for issues that affect a company's reputation, standing, or social licence (see examples below compiled by Deloitte). These include environmental responsibilities such as limiting carbon emissions and upholding biodiversity protection, fair treatment of workers, occupational health and safety, and ethical sourcing and supply chain management, just to name a few. As digital technology and AI transform supply chains, firms also need to protect sensitive data and guard against cyberattacks. A breach anywhere in a supply chain can potentially compromise all participants.

Growing pressure on the extended enterprise in each of these areas is being driven by changing customer and stakeholder expectations. Another factor is regulation, either in the country where the business is headquartered or in the home country of the subsidiary. Recent legislation in countries such as Japan places stringent obligations on organisations to report and implement strategies with respect to upholding human rights, while managing supply chain environmental impacts.[25]

In Deloitte's experience, many Asia Pacific businesses are only beginning to view ESG as a board-level concern. Compliance and disclosure obligations generally lag those in Europe and parts of North America. However, it is likely that international reporting standards such as IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information will increasingly inform regulatory approaches in the region.[26]

Overall, it is the responsibility of the engaging organisation to ascertain how its third parties conduct business. As a result, setting and enforcing standards on partners and suppliers is a major issue.

The company may face a positive duty of care to act in accordance with ESG principles. Individual board directors may be personally liable for failing to act in the company's best interests. Businesses are also increasingly aware of the need to represent their ESG credentials honestly or face action for "greenwashing" or "social washing."

Examples of ESG issues

Environmental

- Minimising carbon footprint and managing climate change vulnerabilities
- Water, waste and pollution management
- Transition to a circular economy
- Renewable energy and clean technology
- Consideration of rights of First Nations peoples to access, maintain, and protect their lands

Social

- Human capital development
- Health and safety
- Ethical supply chain and sourcing
- Human rights
- Privacy and data security
- Community engagement, including focus on First Nations peoples
- Labour standards
- Ethno-racial equity
- Gender equity
- Diversity

Governance

- Board oversight
- Corporate reporting, including ESG-related matters
- Risk mitigation and management
- Diversity and inclusion
- Executive pay, including remuneration linked to ESG-related key performance indicators
- Tax transparency
- Business ethics, including anti-bribery and corruption and anti-money laundering risk management processes

A continued challenge for business leaders

Recognition among businesses of the need to develop resilient, sustainable supply chains was identified as part of Deloitte's 2022 Third-Party Risk Management Survey.[27] The 2023 edition, based on more than 1,350 responses from organisations across 40 countries, confirmed that businesses worldwide are making progress to manage third-party risks within their extended enterprise. However, the growing complexity of these relationships continues to present challenges.[28]

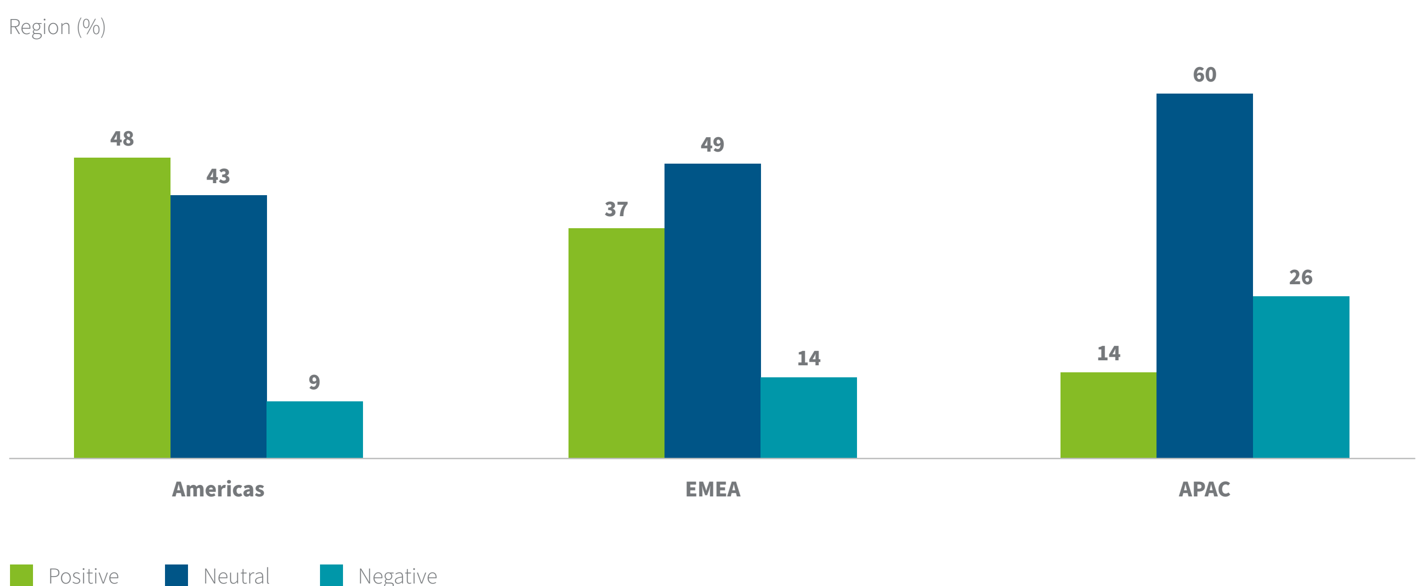
For example, more than 40 percent of respondents expressed concerns about their company's ability to meet increasing expectations around ESG. Ongoing geopolitical challenges were identified by 61 percent of respondents as the main headwind in managing supply chain and other third-party relationships. This was followed by continued multi-year inflationary trends, identified by 46 percent of respondents.

Nonetheless, 56 percent of respondents said their organisational cultures had become much more supportive in understanding and managing ESG risks in their extended enterprise (third-party ecosystem). Sixteen percent disagreed with this proposition, while 28 percent remained neutral.

Interestingly, respondents from the Americas and Europe, the Middle East and Africa (EMEA) were far more positive about their ability to manage third-party relationships into the future. For example, 48 percent of American business leaders and 37 percent in EMEA were positive, compared with just 14 percent in the Asia Pacific region. This may be due to the greater focus and investment in ESG issues elsewhere around the world. As the report noted, larger and more mature organisations that have invested in third-party risk management for years tend to better understand the interconnected nature of risks and opportunities.

Another challenge for businesses is developing metrics to measure ESG performance. Environmental metrics like carbon emissions are relatively straightforward to quantify. However, social metrics often lack clear definitions or standards. According to Deloitte's 2024 Global Human Capital Trends research, only 19 percent of business leaders say they have very reliable metrics for measuring the social component of ESG. And only 29 percent strongly agree that they have a clear understanding of how to achieve them.[29]

Figure 1: Sentiment of respondents in measuring third-party relationships going forward



Source: Deloitte's 2023 Third-Party Risk Management Survey

Examples of regulatory approaches

India moves to regulate ESG

Corporations based in India are becoming more aware of their obligations across the different dimensions of ESG, particularly where these involve the extended enterprise.

The Reserve Bank of India brought in guidelines in October 2023 that compel all banks and non-bank financial companies to assess third parties.[30] These guidelines ensure they are meeting norms around cybersecurity, financial solvency, and employee health and safety. In specific sectors, such as insurance and IT, new regulations require corporations to assess their supply chain and vendor ecosystems to meet mandatory reporting requirements. Among smaller companies, awareness is rising of the need to adopt supply chain best practices or risk not being able to work with larger companies.

Environmental regulation is complex in India. The nation is one of the world's top five carbon emitters (though ranked lower on a per capita basis). Its dependence on significant coal deposits and use of fossil fuels is unlikely to reduce significantly in the future due to cost. There is increasing investment in renewables, including wind and solar, as well as a push to adopt cleaner gases. However, this is likely to take a couple of decades to significantly change the energy mix.

The Securities and Exchange Board of India (SEBI) has also made it mandatory for the top 1,000 listed entities by market capitalisation to include a business responsibility and sustainability report (BRSR) in their annual report. This describes the initiatives taken by the listed entity from an ESG perspective. ESG-related disclosures across the value chain are required by the listed company under the BRSR Core framework. These shall become applicable to India's top 250 listed entities (by market capitalisation) on a comply or explain basis from 2024-25 and 2025-26, respectively.[31]

A hot topic in China

China is focused on regulating the environmental and climate change impacts of doing business and what companies need to do to meet regulatory requirements. Listed companies are being encouraged to take measures to reduce carbon emissions.[32] This impacts both Chinese multinational companies operating externally, as well as local businesses providing manufacturing supplies for many industries. It also imposes additional costs on industry, adding to growing labour and operational costs.

In the next couple of years, more of these requirements will become mandatory. Measurement of Scope 3 emissions is currently voluntary in China, however more detailed standards could soon emerge. Hong Kong has mandated ESG reporting since 2016.[33]

Indonesia in the starting phase

In Indonesia, the concept of third-party risk management is only starting to receive attention. In Deloitte's experience, this is creating risks for international companies from countries with high ESG requirements that may seek Indonesian suppliers. The government has committed to an ESG agenda with discussions about setting up a new carbon tax law. The financial services industry is leading the way in setting criteria for distributing loan credit. Companies dealing with Europe are also having to pay more attention to measuring carbon emissions.

However, the ESG disclosure requirements on major mining companies are limited. This is because Indonesia is often treated as a base of operations, leaving the central headquarters located in another jurisdiction with responsibility to look at policies like ESG.

Cybersecurity vulnerability moves to third parties

Across the Asia Pacific region, there is a growing awareness of cybersecurity risks. These include the threat of ransomware attacks and need to protect customer data. The extended enterprise is also becoming the main attack surface, rather than parent organisations. This is leading some firms to become more proactive and broader in their cyber risk management.

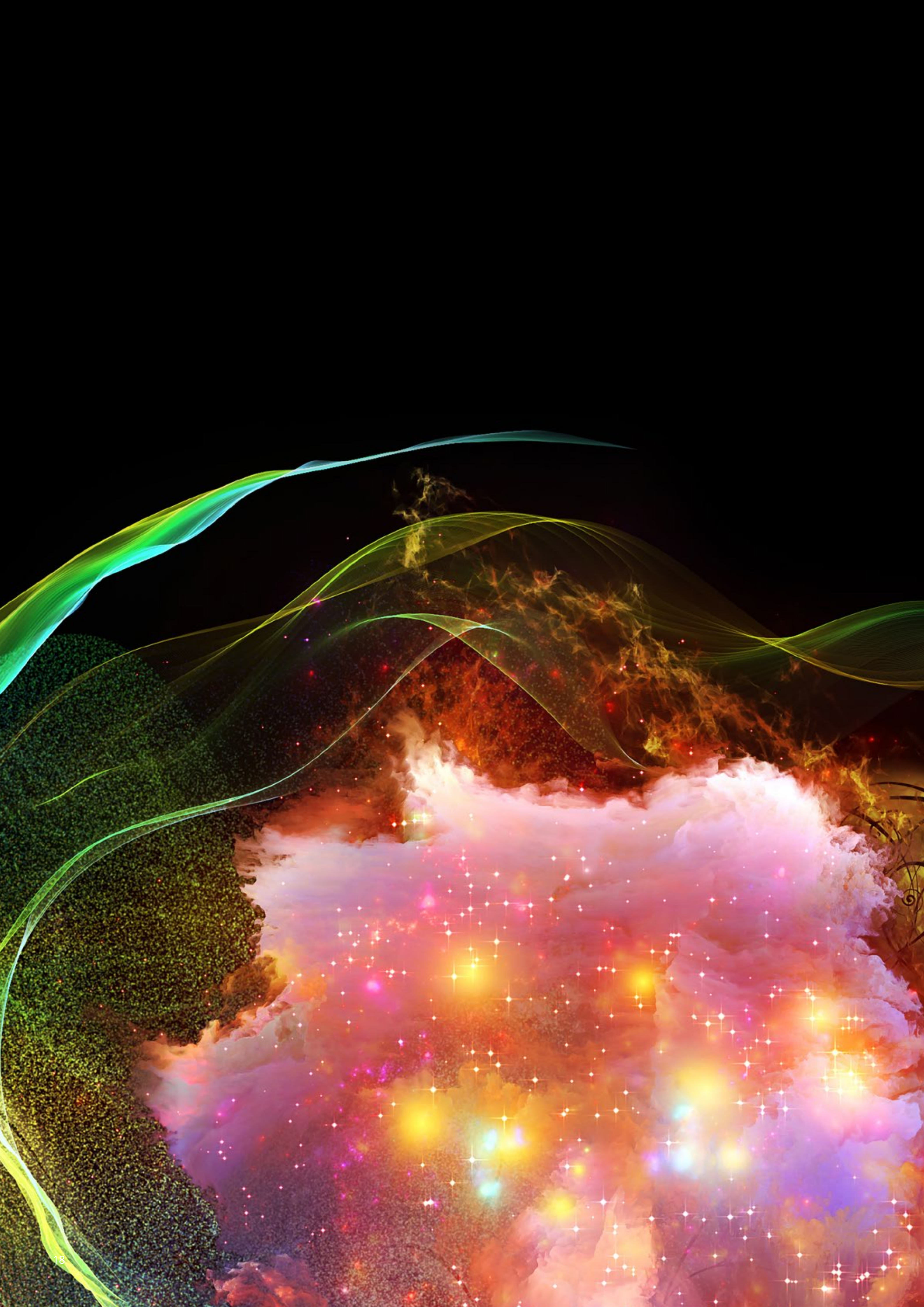
For example, in Deloitte's experience, the first line of cyber defence among Japanese companies is very strong. Now, more Japanese companies are starting to examine cybersecurity beyond their first tier of suppliers. Another example is the financial services industry, where discussion of vulnerability is particularly intense. Given significant investments by banks in securing their own perimeter, cyber criminals often target supply chains to access bank systems as the third parties are easier to compromise.

Modern slavery and labour laws

The need to comply with labour laws is a growing risk for global companies with supply chains, particularly in Southeast Asian countries.

Local regulation may not be so much the issue as laws in the country where a business is headquartered. For example, an Australian company doing business in Southeast Asia will be subject to the requirements of Australia's *Modern Slavery Act*, introduced in 2019.[34] In Japan, there is growing attention to third-party labour risks, particularly given the high degree of outsourcing of back-office roles within shared services and IT functions to third parties, and temporary and part-time workers. Regulations have also been introduced in Japan to cover issues such as overtime limits and how long people work.[35] These changes will not only affect business operations but also have cascading effects on all business partners and third parties involved. Adapting to these regulations is critical to ensure a reliable supply chain.

Extended enterprise labour risk management is also subject to growing international scrutiny. For example, in February 2024, the US and Japan held the first round of government and stakeholder dialogues as part of the Task Force on the Promotion of Human Rights and International Labor Standards in Supply Chains. This is a bilateral initiative to uphold internationally recognised labour rights, including by prohibiting the use of forced labour in supply chains through trade policy. It draws on laws, policies and guidance that already exists, including the United States-Mexico-Canada Agreement Rapid Response Mechanism and methodologies for developing lists of goods produced by child labour or forced labour.[36]



Managing the new extended enterprise

A comprehensive business approach is needed to meet changing risks.

It should be clear from the first two chapters of this report that the extended enterprise is here to stay. More sophisticated third-party risk management has become a necessity of doing business, as Asia Pacific organisations reassess their operations and supply chains, while coming under renewed regulatory scrutiny. There once was a time when enterprise risk largely involved the organisational perimeter. However, rapidly expanding ecosystems require a completely different risk framework. Having a well-developed business approach that is structured to identify and assess risks can ensure organisations are not hitting major speedbumps as they seek to expand.

The need for clear visibility

Clear visibility of the extended enterprise is the first step to astute third-party risk management. This starts with mapping where a company's supply chain is most vulnerable. It involves identifying any overdependencies that could be affected by a geopolitical or climate crisis, or other business interruption. Overdependence on one country can pose risks (such as relying on minerals from Eastern Europe). Artificial intelligence and analytics can help pinpoint key geographical clusters and trends.

Having visibility into suppliers can help a business stress test its response to disruption in advance. For example, the company could devise how to react to a sudden port closure. It could prepare how to change technology solutions in response to a data breach, or deal with fluctuations in customer demand. To boost its flexibility, a business might decide to make greater use of automation in factories and distribution centres or make changes to its product range.

End-to-end visibility is required for organisations to maintain control. In many cases today, third parties now also outsource some business activities that are contracted to them, creating fourth-party relationships. This chain of subcontracting can go on and on, with the operations of the prime organisation impacted by the actions of distant parties. Some Japanese carmakers, for example, conducted supply chain visualisations up to 10th parties to gauge potential disruptions after the devastating 2011 earthquake and tsunami.[37] While this would be difficult for most companies to replicate, there are solutions that now visualise supply chain to 'Nth' parties, one example being Deloitte Australia's Illuminate tool.[38]

Of course, supplier visibility is only as good as the information being captured and reported. The key finding of Deloitte's 2023 Third Party Risk Management Survey is poor availability of, and trust in, the data needed to make third-party management workable and trace the actions of suppliers. Companies need good data analytics to forecast, diagnose, and fix supply chain issues. They need to be able to pivot quickly. This is one reason that manufacturers have accelerated the adoption of emerging technologies, as greater digital maturity is increasingly seen as leading to greater resilience.

Incorporating ESG

Disruptions such as climate events and ransomware attacks can bring a company to a standstill. The reputational stain from doing business the wrong way—polluting the environment or being linked to exploitative or unethical suppliers—can be impossible to wash away. It follows that ESG risk management needs to be a prime responsibility of CEOs, boards, and senior management.

Deloitte has worked with leadership teams to offer a host of professional consulting and other ESG advisory and strategy services. In our experience, these can help clients, for example, to design decarbonisation roadmaps across their various business units and departments. It is also important to examine the full range of ESG-related risks and identify supply chain management gaps.

More sophisticated third-party risk management is prudent for any businesses looking to shift headquarters or set up in a different jurisdiction with local suppliers and outsourced labour. The pressure to adopt sustainable practices and disclose ESG risks itself requires a re-examination of supply chain practices. Even if a business is the maker of the finished product, it has to think about the layers of suppliers involved.

Yet it is important to emphasise not just risks but opportunities. Legacy companies seek to retrofit ESG into their existing processes. However, businesses embracing new ecosystems and locations can incorporate ESG considerations into their ethos from day one. A tech firm contemplating a move to a new factory in India is unlikely to settle for the same building as 10 or 15 years ago. Rather, it is more likely to be an eco-friendly green building demonstrating the company's true values.

Role of international standards

Effective from January 2024, international standards such as IFRS S1 and S2 provide guidance to businesses on best practice governance over the entire extended enterprise. All companies in Asia Pacific can start applying them from today. They will become mandatory if and when regulators integrate them into financial reporting frameworks and other requirements.

IFRS S1 provides a set of overarching disclosure requirements designed to help companies communicate to investors about the sustainability-related risks and opportunities they face over the short, medium, and long term.

An entity is required to disclose information about sustainability-related risks and opportunities that could reasonably affect cash flows, access to finance or the cost of capital. The standard sets out general requirements for the content and presentation of these disclosures. These include setting out the entity's overall strategy and processes used to manage sustainability-related risks and opportunities, as well as progress towards any targets.

Under IFRS S2, an entity is required to disclose information about climate-related risks and opportunities that could reasonably affect cash flows, access to finance or the cost of capital. Climate-related risks to which the entity is exposed include both physical and transition risks.

A centralised rather than siloed approach

While firms have increased their reliance on third-party networks, approaches to management have not kept pace. Many different approaches have been tried and found wanting. Ultimately, what is needed is an integrated framework for ESG-aware risk management and oversight.

The goal should be to move from a siloed, piecemeal approach to a systematic one that covers the entire business relationship lifecycle. This starts with identifying ESG risks and obligations, including cybersecurity, the environment, and other dimensions of social responsibility. These should be incorporated into initial processes such as sourcing, procuring and contracting, all the way through to monitoring, financial processing and executive decision making. In Deloitte's experience, when one company engages another, they need to agree on roles and responsibilities early on.

An integrated approach involves aggregating performance improvement opportunities in each individual third-party process. This is the best way to increase efficiency, reduce costs (including third-party spend), and meet ESG commitments. Corporate headquarters need to centralise compliance, not simply leave this to regional operations and subsidiaries.

Japan modernises corporate governance

In Deloitte's experience, firms in countries such as Japan are deepening audit and compliance functions that were traditionally seen as "presentation only," or of administrative rather than strategic importance. The same can be said about corporate governance. As more Japanese listed companies expand their operations and become global companies, they are increasingly embracing an audit committee system over the traditional Kansayaku (statutory auditor) system. One reason is to align more closely with western corporate governance standards, improving the company's reputation among international investors and stakeholders.

Getting started

Any business that is considering moving into new geographies and engaging new third parties needs to manage risks proactively. A basic approach should involve the following:

1. **Create an inventory of third parties:** it is important to identify all third parties, from vendors to alliance partners and customers.

2. **Define your organisation's risk profile:** the classic risk management philosophy is that it is impossible to monitor everything all the time. Therefore, businesses need to prioritise. Not all parties pose the same level of risk. Conducting a risk assessment of the inventory of third parties is needed to understand which parties are the largest risk.

3. **Set a baseline for compliance:** this involves providing a standard by which third parties can meet a company's requirements. It will vary depending on what the third party does.

4. **Assess compliance:** make sure the third party remediates as required.

5. **Automate the process:** ideally this should involve a Corporate-as-a-Service Platform rather than haphazard management via Excel or email. Deloitte offers its own platform but there are commercial tools available in the market as well.

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