



Procurement & Supply Chain

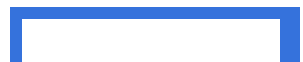
# Financial Insights Your Supplier Intelligence Platform Should Track (& Contextualize)

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Supplier intelligence is essential for understanding suppliers and your entire supply chain ecosystem. But data alone isn't helpful. It's the types of data and the insights you draw from them that make the difference. When you're tracking the right metrics and contextualizing them in one unified platform, you can leverage key information to:

- Improve predictability in your supplier network (remember: risk mitigation and stability go hand in hand).
- Uncover areas of opportunity that improve supplier and business relationships.



- Bolster negotiation power.

So what kind of data should you be paying attention to?

There are countless indicators you can use to understand and mitigate your supply chain risk, but a few metrics stand out.

## Top Metrics & Indicators to Monitor

What metrics you monitor will depend on your industry and whether the company is public or private. For instance, more information will be readily available for publicly traded companies than for private ones. However, if possible, include the following metrics in one centralized platform that automatically updates you with real-time alerts.

Real-time monitoring is essential for achieving an agile risk management posture. After all, the sooner you know something, the sooner you can act. With active monitoring, instead of relying on quarterly financial reports or subjective supplier surveys, you can understand your supply risk in the moment and take appropriate action to prevent or mitigate the impact.

### Revenue

Tracking revenue helps firms understand the growth trends of their supplier. While revenue alone does not indicate positive or negative financial health, it is a good baseline to understand how large a firm is, potential opportunities, and your share of business with them.

Pay attention to see how a company's revenue is trending, how it is concentrated (e.g., location), and benchmark that against their margins. The relationship between revenue and margins can help you contextualize these metrics and see if the company is trending positively overall.

For example, if the company is growing revenue but the margin is shrinking, that indicates the customer base is increasing but products are being sold for less.

This can be a potential red flag, because if the margin is shrinking, that means the supplier isn't translating revenue into earnings that will grow the company.

***“Earnings are what get invested in future research and development to keep the company ahead of the rest of the competition long-term,” explains Steven Tinkey, Director of Portfolio Management at United States Air Force. “If you’re not investing in the next great thing for your sector or improvements to your existing processes to drive down costs and increase margins, you’re not getting any better.”***

# Profit Margins

Profit margins aren't just important in the context of revenue metrics. Having a supplier intelligence platform that can show the most updated profit margins on your suppliers gives you:

- **A good indication of financial stability and performance:** For example, if a supplier is showing strong profit margins and overall growth, they may be looking at expanding their operations or investing in new areas.
- **Overall leadership and management competency:** Navigating the right level of operational efficiency and quality alongside sound financial management indicates strong leadership and alignment.
- **Negotiation leverage:** A strong profit margin means the supplier may be open to expanded contracts or new investment opportunities together. Identifying this position early can help you leverage the opportunity faster and potentially before other competitors reach out.

# Credit Ratings

You need to know that you will be paid on time and won't have to dedicate inordinate resources chasing down payments from your suppliers. When large, long-term deals are on the line, having confidence that the supplier will be able to uphold its end of the contract — financially and production-wise — is critical.

That's where credit ratings comes in. Credit ratings are one of the best signals of how fiscally responsible a company is and provide an approximate but important measure of credit risks.

But keeping a pulse on your suppliers' credit ratings is difficult. You can't rely on ratings provided directly from a supplier, because they are only incentivized to disclose what is in their best interest.

That's why [gathering this data from third-party sources](#) that can also alert you when there is a sudden change in rating is essential, particularly when evaluating private or smaller companies where revenue and margin information is difficult to track. Your supplier intelligence solution should monitor metrics like Dun & Bradstreet scores to assess suppliers' financial health and stability over time.

# Altman-Z Score

The [Altman-Z score](#) measures the probability that a company will go bankrupt within the next two [years](#) (e.g., the lower the score, the higher probability of bankruptcy). It combines five

financial ratios to assess a company's financial stability, taking into account factors like profitability, liquidity, and equity.

As a result, the score has become a reliable metric for predicting insolvency with a 72% accuracy in predicting bankruptcy two years before it occurred. These scores are particularly useful for manufacturing companies who rely on a wide array of global suppliers and need to understand where potential diversification for certain goods or services is necessary.

On its own, the Altman-Z score is important for risk mitigation and predictability. But it's also valuable when evaluated in conjunction with other factors, such as labor and hiring trends. For example, if there is a small but not eye-catching drop in an Altman-Z score at the same time as a sudden drop in employee headcount, that might be cause to dig into what's going on with your supplier.

## Funding Rounds

Similar to the benefits of tracking profit margins, monitoring a private company's funding details helps you understand your supplier's rate of growth and likelihood of expansion. In turn, that informs conversations around new deals and avenues of growth for your own firm.

From a risk management perspective, strong funding might alleviate concerns around financial viability and health as well. However, having a full picture of a supplier's funding history is critical. Just because your supplier raised a certain amount of money does not necessarily mean explosive growth is around the corner.

Consider additional context clues to better assess financial health, such as

- The amount raised in the past
- How long it has been since their last funding round
- Who their investors are
- Whether they are pre-revenue or post-revenue

These are insights you won't always get from supplier surveys or press releases, which are designed to portray suppliers in a better light. So it's important to track these independently where possible.

## Debt-to-Assets & Debt-to-Equity Ratios

Solvency ratios, like debt-to-assets and debt-to-equity ratios, measure the ability of a company to pay debt obligations, thus providing insight into its long-term financial health. This makes them useful for assessing predictability and stability of your suppliers. By reviewing a supplier's solvency ratios, firms can better contextualize the magnitude of the supplier's liabilities or, conversely, the strength of its assets.

Solvency ratios deliver a more holistic picture of the supplier's financial health, as they encompass additional assets other than cash (i.e., inventory). While liquidity-focused ratios provide more short-term insight, the long-term nature of solvency ratios gives a better picture of how a supplier might fare if economic conditions take a downward turn. These insights can be particularly useful when approaching a new supplier contract.

***“Let’s say the relationship we’re looking for with this supplier is more than a 3 to 5 year contract,” says Tinkey. “We need to know the long term viability of the company. Are they going to make it long enough to supply the things that we’re buying?”***

Solvency ratios can help answer those questions so companies can move forward with confidence.

## Cybersecurity

How strong are your suppliers' cybersecurity postures? Do they have best-practice standards in place? What are their security controls and risk mitigation plans? Supply chains are a [growing target](#) for hackers, and with the average cost of a data breach reaching an all-time high in 2022, companies can't afford to ignore cybersecurity standards within their supply chain.

***“While it’s not a direct financial metric, cybersecurity has a direct financial impact on a company’s performance when something goes south,” Tinkey explains. “Cybersecurity is also a leading indicator of future financial performance. As any CEO will tell you, it’s not when you get attacked; it’s about how that attack is able to penetrate and destroy your value.”***

That's why it's important to review your [suppliers' cybersecurity](#) postures and conduct a cost-benefit analysis on the value of their cybersecurity standards. For instance, cybersecurity can impact the supplier's costs as they invest in tighter controls. This can mean higher prices for you (and slightly lower profit margins), but better protection for you upfront. Cybersecurity will cost you either way—it's up to you decide the value of prevention over the risk of mitigation after a breach.

## Intellectual property

Another helpful indicator is how your suppliers handle their intellectual property. Pay attention to their research and development practices. How are they investing their funding and profits? Are they taking control of markets over time through the creation of protected technologies?

Depending on how you view it, patenting technology could be viewed positively or negatively from a financial standpoint. On the one hand, patents protect the supplier's technology. On the other hand, patents are public, which means they can expose the very technology the supplier is trying to protect for everyone to see. This can introduce potential financial risks for companies targeting leading edge markets.

# How to Use these Indicators for a Proper Analysis

None of these metrics are useful unless you without proper analysis.

## Look at the company's historical trends

Evaluating data in a single point in time won't give you accurate insight into a company's true performance. That's why it's important to gather and review data over time to understand how those metrics are trending.

For instance, the direction a metric is trending can tell you if the company is aware of and addressing a problem, explains Tinkey.

***“If the metric is trending positively, you can infer the supplier has focused attention and resources on actively managing that measure of their operations. But if its trending the other way, you can assume the company, or maybe the market as a whole, is struggling to correct whatever is impacting their performance.”***

## Contextualize the information

In addition to analyzing data trends, it's important to contextualize the information against similar companies. In some cases, it's not the supplier's fault that there is a downturn in performance.

For example, if you looked at one airline's performance during the pandemic, you'd think they were doing something wrong. But in context with the rest of the market during that time, it would be clear that the entire airline sector was in recession due to external factors.

## Bring it all together

While these financial metrics are important, they don't replace taking a holistic view of risk. This means incorporating these data with additional supplier intelligence metrics such as cybersecurity scores, labor trends, and more. As you manage your supplier data, make sure your metrics are updated regularly and that your platform can immediately notify your team of any sudden changes.

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