

Supply Chain Fraud: The Next Battleground

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Five strategies can help procurement professionals avoid being victimized by companies willing to cheat.

How can you trust that your suppliers are sending you what they promise? There is plenty of recent evidence that companies, including major ones, are willing to cheat for financial gain even when the consequences are potentially severe:

- In 2013, horsemeat was processed and sold in beef products by two meat-processing companies, Spanghero and Silvercrest Foods.
- In 2017, Volkswagen admitted it cheated emissions testing with software that turned off emissions controls while driving.
- Earlier this year, Sapa Profiles admitted it falsified certifications on its aluminum used by NASA, which claims the faulty materials caused two failed satellite launches.

Are such examples rare? Or are they precursors to a world where combating supply chain fraud is the norm rather than the exception? The evidence consistently points to a worsening situation — in frequency and potential impact — making combating fraud the likely new front in the battle for supply chain integrity.

HOW TO WIN THE WAR

When working to reduce supply chain fraud risk, one of the challenges organizations face is that the “enemy combatant” is not bound by traditional rules of engagement, so it is willing to take advantage of existing expectations and processes. To deal with this as well as lessen the likelihood and impact of fraud, five actions can help: (1) reduce the need for war, (2) maintain clear battleground lines, (3) know the battleground, (4) avoid hostage situations and (5) bring allies together.

Reduce the pressures that prompt fraud. One of the key drivers of supply chain fraud is the competitive nature of an industry. Competitive bidding, short-term contracts and cut-throat buyer-supplier interactions are frequent, but organizations should be careful with an aggressive cost-based focus. Suppliers that feel shorted by buyers or face increasing pressures to reduce costs might find alternative means to remain profitable by cutting quality and service or through such deceptive means as fraud.

As pressures — such as high competition between suppliers, industries with small profit margins, suppliers at risk of bankruptcy and competitive bidding — facing an industry increase, so will the likelihood of a supplier cheating to get ahead or simply stay in the fight.

Supply chain managers can reduce pressures to engage in fraud by focusing on (1) long-term relationships, (2) profit-sharing contracts, (3) supplier development, (4) trust building and (5) relationship management. Remember, short-term savings by sourcing the lowest-cost option isn't always better in the long run.

Avoid transactional complexity. Supply chains often have complicated systems for managing the flow of product, information and money between companies — often with limited communication between groups. The more confusing, complicated and siloed the transactions, the greater the risk that opportunistic suppliers might take advantage of the chaos to cover up fraud.

Are there several quality levels for raw materials or inferior substitute products that look the same in a finished good from a supplier? Is it difficult to visually verify the quality or legitimacy of products? Examples include grades of olive oil, tensile strength of aluminum, and potency of pharmaceutical products. Is each transaction a unique transaction, without pre-established controls in place?

If the answer is yes to any of these questions, the likelihood of fraud is higher, demanding an appropriate response from supply management professionals. Higher transaction complexity provides the means that fraudsters use to cover up their illicit actions, so greater scrutiny is necessary.

Know the battleground: Understand the supply chain and develop supply chain transparency. Among the most important aspects of limiting supply chain fraud is awareness of the supply chain structure from start to finish, as well as knowledge of where product is coming from and organizations involved in the process. For example, consider the 2013 European horsemeat scandal, where complex order routing was used to hide the source of fraud. Simple product flows are much harder to circumvent via fraudulent means.

Companies need clear plans for effective supply chain fraud prevention that monitors the product flows, digital information and finances. Establish clear strategies for supply chain oversight and integration using a variety of tools and relationship-management approaches.

Don't become a hostage to your supply chain. Avoid relationships with asymmetric dependence, where one organization has a great advantage over another. Situations involving a single supplier or buyer, or a contract with steep exit penalties, can allow suppliers greater flexibility to cheat without fear of penalty. Relationships where one party has a great power advantage over another are likely to end in more negative relational outcomes for both parties.

Do not be dependent on suppliers to verify that the products they are selling are legitimate — and don't rely on their reports for quality assurance. Ensure that independent quality checks are performed on products and avoid relying on supplier quality or performance data, as it could be easily manipulated. Trust is an effective tool for reducing the cost of managing relationships, but it's also necessary to make sure your firm isn't overexposed.

Bring allies together. In the war against fraud, the more eyes watching, the easier it will be to catch and prevent fraud. As supply chain transparency and monitoring are established, involve multiple tiers of the supply chain in a joint effort to identify and prevent fraud.

One effective tool to prevent fraud is connecting end consumers with manufacturers to verify that the product was sourced legitimately, for example, by using authentication codes that can be checked against the manufacturer's website. Manufacturers also might establish authorized distribution channels with approved distributors or digital-tracking systems.

Incorporating these measures can help organizations lessen the impact of what's likely to be the next battle in the war on supply chain integrity: fraud. [ISM](#)

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