

Acquirers spend weeks modeling revenue scenarios and adjusting discount rates, then get blindsided by a mundane reality: a single resin supplier missed two deliveries and gross margin collapsed. Supplier risk rarely ruins an acquisition on day one, but it can quietly erode cash, stress customer relationships, and trap you in a cycle of firefighting. A disciplined, practical review of the target’s supply base belongs alongside quality of earnings and legal diligence. It is not glamorous work. It is field calls, document hunts, and asking the same question three ways until the answers line up.

This guide draws on the patterns I have seen across industrials, consumer products, healthcare services, and software with hardware attachments. The core idea is simple. Treat suppliers like you would a concentrated customer base: quantify exposure, validate resilience, and link operational reality to the deal model. If your firm runs Business Acquisition Training or you are personally Buying a Business for the first time, consider this a working playbook, not just a checklist.

Start with a map, not a spreadsheet

Most data rooms begin with an AP aging and a vendor master. Those are helpful, but they hide relationships. Before you dive into cost variance and payment terms, sketch the supply network on paper. What are the five inputs without which shipments stop? Who converts those inputs? Who holds the tooling and where is it located? Are there upstream constraints like a single foundry or a regulatory license? This “map” clarifies where concentration and single points of failure live.

At a packaging company I reviewed, the AP report showed 230 vendors. The map revealed two bottle molds owned by a subcontractor who also sat on the customer’s change approval board. Lose that subcontractor, and change control alone added 90 days to any second source. The financials did not surface that dependency; the process map did.

Ask the target’s operations lead to walk you through one flagship SKU or service from order intake to receipt of revenue. Interrupt with questions that frame risk. If demand doubled next quarter, what breaks first? If the port closes for three weeks, what do we airfreight and at what premium? If the FDA requests additional testing, which lab has capacity? The objective is to surface friction you can quantify later.

Concentration beats complexity when it comes to risk

A business with 100 vendors can still be fragile if three of them drive 70 percent of material spend or control irreplaceable IP. Conversely, a shop with five vendors can be resilient if those vendors sit on commodity inputs and can be swapped in 30 days.

Compute supplier concentration first, but not just by spend. Use three lenses:

- Spend concentration. Top five vendors as a share of total COGS or operating expense. Break this into direct materials, contract manufacturing, logistics, and critical services like IT hosting or EDI.
- Dependency concentration. Which vendors supply unique inputs, own custom tooling, or have validation status that takes months to replicate? Tag these regardless of spend. A \$90,000 reagent can sit on the critical path as firmly as a \$4 million resin.
- Switching friction. Time and cost to validate a second source, including regulatory filings, customer approvals, retooling, and inventory burn-down. A high-friction vendor carries more risk than its spend implies.

You can approximate switching friction with a short rubric in interviews and document review. Low friction if alternatives exist and require minimal changes. Moderate if there are qualified alternatives but require testing or contracts. High if alternatives exist but require new molds, software interfaces, or recertification. Extreme if there are no viable alternatives for at least nine months.

One consumer product roll-up looked fine on spend concentration: the top supplier was 18 percent. What the numbers hid was extreme friction. That supplier owned four molds, held the only masterbatch formula that hit the client’s specific gloss target, and its quality system was embedded in the customer’s vendor qualification file. On paper, 18 percent. In practice, single-source critical.

Validate the paper trail, then confirm on the shop floor

Contracts, MSAs, and SOWs will not tell you whether a vendor answers the phone at 7 a.m. on a Friday, but they do set the rules of engagement. Pull the following, and do not stop when someone says, “We think legal has it.”

- Current contracts and term sheets, including term, termination rights, price adjustment clauses, lead time commitments, warranty, tooling ownership, and change control processes.
- Price history for top SKUs or services for at least 24 months. You are looking for step-ups, surcharges, and whether increases were passed through to customers.
- On-time delivery and quality metrics, at least by vendor, ideally by part number or service line. Even a basic three-column report (on time, early, late) over time can show if risk is rising.
- Inventory policies by item: min/max levels, safety stock assumptions, consignment arrangements, and any vendor-managed inventory contracts.
- Compliance certificates: ISO, IATF, SOC 2, GMP, FDA registrations, or industry equivalents where relevant. Gaps here can suddenly become gating items when a customer audits.

If the target cannot produce this material, that is its own risk signal. Still, people can work around weak paperwork. Walk the warehouse or service floor. Observe what is physically high and low. Ask to see any quarantine area and ask why those items are there. Spot check a few items in the ERP: Does the lead time in the system match the current PO acknowledgments? I once saw a system with 14-day lead times for a component that the vendor had been shipping at 42 days for a year. Sales promised two-week turns. The operation bled expedite fees.

When you talk to the purchasing lead, do not ask “Are suppliers stable?” Ask, “Which vendor do you watch on Sundays?” The name that comes out is your first call after close, even if spend is modest.

Financial signals that predict supplier strain

Suppliers telegraph stress long before a formal breach. Three patterns tend to show up in buyer data:

- Shortened terms on new POs or more pro-forma requests. If a vendor who used to extend net-45 now pushes for net-15 or payment upfront, they are protecting cash, not extending favors. This often correlates with covenant pressure at the supplier.
- An uptick in surcharges, especially energy, freight, and small lot fees. Surcharges might be legitimate. Persistent, poorly supported surcharges usually indicate the vendor is trying to patch margin problems quickly.
- Uneven quality credits or RMAs. More frequent quality issues combined with longer credit approval cycles point to either process control slippage or internal staffing cuts.

Your own AP aging with the supplier holds clues too. If the target consistently pays one vendor early while stretching others, assume that vendor has leverage. Early payments can be smart in exchange for allocation or price, but they also signal concentration risk.

On the supplier’s health, ask for publicly available financials if the vendor is public or part of a listed group. For private vendors, you will rarely obtain statements, but you can triangulate with credit reports, UCC filings, lien searches, and trade references. In regulated categories, the FDA inspection database or health authority warning letters can be telling. In software or IT services, check SOC 2 reports and any customer status pages for uptime history.

The hidden risks inside “services” and software vendors

Acquirers often underweight risk tied to non-physical suppliers. Two categories deserve extra scrutiny.

Cloud and software. If the target runs a critical workflow on a single SaaS vendor, map the failure modes. What if the vendor moves pricing up 15 percent next renewal? What if an outage lasts 24 hours during peak? Are there local backups or a manual fallback? Who owns the data and in what format can you extract it? Ask for and read the actual MSA, not the marketing sheet.

Pay attention to termination assistance, data export rights, and notice periods for price changes. If a reseller stands between you and the software publisher, confirm the reseller’s stability and whether you can contract directly.

Specialized technical services. Calibration labs, sterilization providers, specialized testing houses, or HIPAA-compliant providers look interchangeable until you need them on short notice. Verify capacity commitments and certification status. One device company built its production plan around a single sterilization slot at a third party. When that provider underwent maintenance, shipments paused for three weeks and carrying costs soared. The fix, negotiated post-close, required a modest standing capacity retainer. That would have been cheaper to secure before the deal.

Regulatory and geopolitical exposure

Some industries carry supplier risk that is primarily regulatory or geopolitical rather than operational. Even a domestic supplier may depend on upstream imports with exposure to sanctions, export controls, or tariff swings.

Work backwards from the bill of materials or the service flow and identify regulated touchpoints. Examples include:

- Dual-use electronics or software subject to export controls.
- Chemicals with evolving environmental restrictions.
- Medical inputs that require specific site registrations.
- Data residency rules that impact where and how data is processed.

You do not need to become a trade lawyer, but you should ask suppliers to attest to country-of-origin, HS codes, and compliance scope. A quick cross-check with a trade compliance advisor can flag categories with pending changes. In 2018 and 2019, small contract manufacturers with aluminum-heavy BOMs saw unplanned cost jumps of 10 to 20 percent due to tariffs. Buyers who modeled static input costs had to choose between margin compressions and rapid price increases to customers, which are rarely fully recoverable in-year.

Tooling, molds, and who actually owns what

Physical tools often sit at the heart of supplier risk. Molds, dies, fixtures, custom test rigs, and software integrations with vendor-specific code all raise the switching cost. During diligence, inventory these assets and confirm:

- Legal ownership and bailment terms. If the vendor holds the tool, ensure the contract grants you the right to retrieve it upon termination and clarifies maintenance responsibilities.
- Condition and remaining life. A mold two million shots into a three million shot life will need replacement soon. Ask for maintenance logs or at least recent repair invoices.
- Location and duplication. Is there a backup tool? Where is it stored? Can both run on different presses or only on a specific machine? I saw a case where the “backup” mold required a 500-ton press that only existed at the same supplier’s secondary site. Not a backup.
- Change history. Minor tweaks accumulate. If the only accurate drawing lives in the vendor’s head, you have a knowledge risk that magnifies during a dispute.

Do not rely on a line in the fixed asset schedule that says “Customer-owned tool” as proof of anything. Get pictures, tags, and serial numbers. If the tool supports a SKU that drives meaningful EBITDA, your post-close plan should include a second tool or at least a funded maintenance and inspection schedule.

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Pricing power and pass-throughs

Your deal model usually has a line for gross margin improvements. Before you bank on it, match price increase history against supplier cost increases. Ask the target for a log of supplier cost changes and the corresponding customer price actions. How fast were they passed through? At what hit to volume? Were increases applied evenly across customers or staggered? If the target sells into big-box retail or group purchasing organizations, they may face annual price windows and penalties for mid-cycle changes.

One practical test: pick three high-volume inputs, plot their last two years of price per unit alongside the customer price for the associated SKUs, include freight-in and handling if material. Where the lines diverge, dig in. If the business has historically eaten spikes in input costs because it lacked pricing leverage, your “procurement savings” thesis might be covering for commercial weakness.

On contracts, pay attention to indexing clauses. Some vendor contracts allow annual adjustments based on CPI, PPI, or specific commodity indices. Those can be beneficial if they normalize both up and down. Others bake in asymmetric ratchets: quick to rise, slow to fall. Your legal diligence should flag one-way clauses and identify negotiation levers.

Operational resilience: inventory, demand variability, and lead times

Inventory is often treated as working capital math. In supplier risk, it is insurance and a policy choice. A target that carries 60 days of safety stock on long-lead, single-source parts may look bloated on cash but resilient in service levels. Conversely, a “lean” operation with bare shelves can crumble under modest variance.

Map actual lead times from PO to receipt, not the ERP standard. Split that into supplier lead time, transit, customs or inspection time, and internal receiving. Now run a simple scenario: if demand is 20 percent above plan for two months, can you cover the gap from safety stock or expediting? If demand is 20 percent below, how much obsolescence risk sits on the shelf given shelf life or model transitions?

Some acquirers try to buy resilience with airfreight after the fact. Airfreight can work, but it often erodes the economics of a deal. A \$0.08 part, at high volume, cannot absorb a \$1.20 per unit rush shipment without noise. If the target has a history of frequent expedite fees, expect a cultural problem around planning that will take months to unwind.

Human factors inside the supply chain

Vendor stability is influenced as much by people as by contracts. Identify the one or two individuals at each critical supplier who make your target a priority. That could be a scheduler who slides your orders into a full week or a QA lead who signs off your lots first. Post-close, these are the people you need to meet, thank, and, if appropriate, reward through recognition or a small joint business plan.

On your side, assess the buyer’s bench. If the head of purchasing is a single point of failure, build a backstop. Review desk procedures. If purchase orders are issued via individual email templates rather than system-generated documents, you are exposed to absence and error. Small process fixes like shared [Buy a Business](#) inboxes, acknowledgment trackers, and vendor portals can cut risk further than a renegotiated discount.

People also carry tribal memory. During diligence, ask who remembers the last major stockout and what was done. If the answer is hazy, assume the lessons were not codified. Institutionalize supply risk reviews in the operating cadence, not just as a diligence artifact kept in a folder.

What to ask suppliers directly, and when

Direct supplier outreach before close is delicate. Customers worry about spooking vendors or tipping off sellers. But it is common and often necessary for material vendors, especially if the buyer is a strategic or a large sponsor. If you do engage, frame your outreach as continuity focused and avoid premature renegotiation talk.

A concise set of questions can reveal most of what you need:

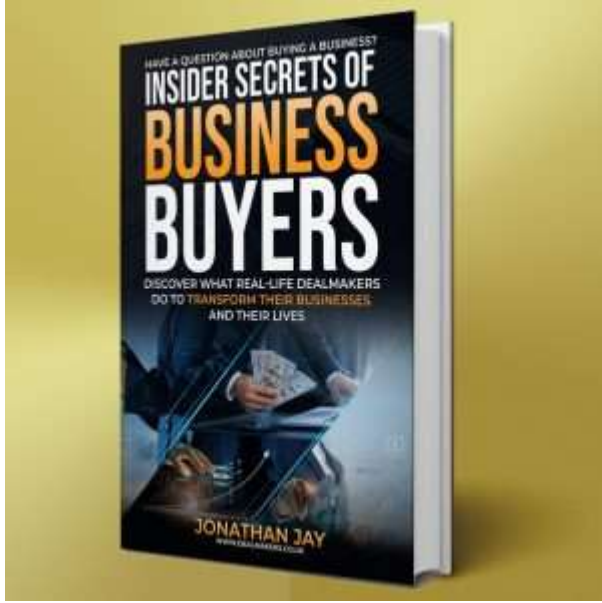
- Capacity and prioritization. How do they allocate when capacity is tight? What minimums secure priority? Have their other customers in your category grown or shrunk recently?
- Lead time trends. What were quoted and actual lead times last quarter and what do they expect next quarter? Any planned shutdowns?
- Price outlook. Which components of their cost structure are most volatile? How do they manage surcharges? What indices do they reference for changes?
- Quality and change control. What is their process for engineering changes and how much notice do they need? How do they notify customers?
- Financial stability indicators. Without asking for books, ask about recent investments, ownership changes, or bank support. Vendors are often surprisingly candid if you are respectful.

Always ask for references to a second qualified [company acquisition steps](#) source, even if you hope never to use it. Good suppliers do not fear informed customers and will often recommend peers they respect. Keep the conversation practical and schedule a follow-up within 30 days post-close to set a joint plan.

Modeling supplier risk into the deal

Translate qualitative findings into numbers the investment committee cares about. Do not just flag “single-source.” Tie it to cash and P&L.

- Probability-weighted continuity costs. Estimate the annual cost of mitigations like second-tool build-outs, minimum stock commitments, or capacity retainers. A \$120,000 annual retainer that de-risks a \$6 million SKU can be a bargain.
- Downside scenarios. Model a 10 to 20 percent cost increase on top three inputs and stress gross margin. Add a 2 to 4 week disruption and simulate expedited freight and overtime. If customer contracts cap price increases, note the lag.



- Working capital swings. If inventory policies must change, quantify the cash impact and recovery timeline. Lenders care about this as much as EBITDA.
- Capex for resilience. Tool duplication, alternate validations, or small warehouse expansions compete with other post-close projects. Put them on the same capital plan with IRRs grounded in service risk reduction.

Once you convert risk to numbers, you can decide whether to adjust price, add a holdback tied to a supplier condition, or set post-close covenants with the seller if they are staying on. Sometimes the right call is to walk away. A business that relies on a supplier under regulatory investigation with no viable alternate and an 18-month recertification path is not a timing problem, it is a thesis problem.

When the seller is the supplier

In some carve-outs and founder-led companies, the seller supplies components or services to the business after close. That can work, but it demands clean arms-length terms. Get a real contract with pricing, service levels, audit rights, and a sunset or renegotiation path. Price discovery is tricky if the seller's operation has commingled cost pools. Insist on transparency or an index-based price adjustment. I have seen deals fail not from malice but because the post-close shared-service price drifted while the buyer assumed stability.

If the seller is key to short-term continuity, consider an escrow or price adjustment tied to delivery or quality metrics. Everyone stays honest when incentives point the same way.

Post-close: first 90 days to harden the supply base

Diligence gives you a head start, but the first quarter after closing sets the tone. Three practical moves pay off.

- Build tiered supplier segmentation. Tier 1 are revenue-critical with high friction, Tier 2 important but replaceable within 60 to 90 days, Tier 3 transactional. Review Tier 1 monthly with clear metrics and a named executive owner.
- Launch two second-source projects. Even if you never switch, the process will flush out undocumented specs and weak drawings. Pick one high-margin SKU and one high-volume item. Time-box the work and close or continue based on evidence.
- Normalize data and cadence. Align ERP lead times with reality, set up PO acknowledgment tracking, and standardize scorecards. Short, consistent routines beat heroic recoveries.

Anecdotally, companies that schedule quarterly business reviews with their top five suppliers, share rolling forecasts, and pay on time see better allocation and earlier heads-up on trouble. It is not complicated. It is discipline.

How this fits with your broader acquisition process

Supplier risk assessment should not be a siloed workstream. Fold it into commercial diligence, legal review, and integration planning. When you test price elasticity, align with what you have learned about supplier price pass-through. When legal flags ambiguous tooling ownership, connect it to operations for remediation. When integration identifies system migrations, ensure vendor EDI or portal migrations are timed to avoid purchase order blackouts.

For teams running formal Business Acquisition Training, teach associates to start with the map, press for evidence, and translate operational findings into financial impact. It is better to deliver a grounded, even unglamorous supplier risk memo that says, “We need \$450,000 in year one to de-risk two molds and move safety stock to 45 days,” than to wave at generic “supply chain headwinds” and hope. Buyers who practice that habit rarely get surprised by a factory that suddenly stops answering.

A final word on judgment

No playbook replaces judgment. Sometimes the “risky” single-source vendor is a 30-year partner with spotless delivery even in chaos, and the right move is to lock in a multi-year agreement with thoughtful indexing and a capacity floor. Sometimes the “diversified” supply base hides a chokepoint two tiers upstream that no contract can fix quickly. Call three to five customers of your suppliers, not as auditors but as peers, and ask how those vendors behaved in stress. People do not change their stripes under load.

The best acquirers treat supplier risk as a strategic lever, not merely a hazard. They cultivate suppliers, invest in the boring backbone of data and process, and price deals with clear eyes. When a storm hits, they are the accounts suppliers keep shipping. When opportunities appear, they are the customers suppliers prioritize for new capacity. That is not luck. It is preparation paid forward.