



**Managing
Subcontractor Risks:**

**Ensuring Compliance and Mitigating
Disruptions in Complex Supply Chains**

Subcontractor Risk in the Supply Chain

Subcontractors have become more important than ever in today's complex supply chains. Subcontracting allows client organizations to complete projects more efficiently with specialization while engaging in local sourcing, diversity, and environmental initiatives. It is estimated that 60–70% of contract work is outsourced to subcontractors,ⁱ who handle most kinds of tasks.

Considering how vital they are, it is concerning that 32.4% of supply chain disruptions come from subcontractors.ⁱⁱ Some of the risks associated with subcontractors include lack of proper qualifications, unsafe work practices, illegal labor practices, and poor financial health. Unfortunately, two thirds of clients do not conduct the necessary due diligence for their primes' subcontractorsⁱⁱⁱ, while subcontractors often have little to no direct communication with the hiring client. This state of affairs is due to the fact that in subcontracting, one or more prime contractors always stands between the client organization and the subcontractor.

To maximize the potential of subcontracting, client organizations must maintain visibility into subcontractor management and be accountable to their investors for their decisions. Likewise, prime contractors and subcontractors can go a long way in reducing risks by mapping their practices to the hiring client's compliance standards, quantifying their ESG value proposition, and making compliance metrics visible to their supply chain network.

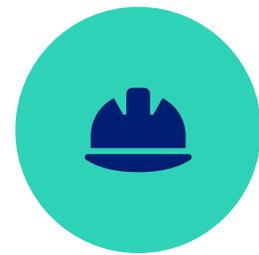
In this white paper, we will:



Provide an overview of subcontracting terms, responsibilities, and challenges



Discuss the major risks associated with subcontractors



Offer best practices for mitigating those risks

SECTION ONE

Subcontracting – Key Terms, Responsibilities, and Challenges

Key Terms in Subcontracting

Client *(ˈkli-ənt)*

: The company that hires and pays a direct supplier for work or materials.

Direct Supplier *(Də-rekt Sə-plī-ər)*

: A company hired by the client to provide materials or services. They may also subcontract work.

Prime Contractor

(Prīm ˈkän-trak-tər)

: A supplier who hires subcontractors to complete work for the client.

Subcontractor *(Səb-ˈkän-trak-tər)*

: Performs specific tasks or services as directed by a contractor. They don't have a direct relationship with the client.

Subcontractor Management

(Səb-ˈkän-trak-tər Ma-nij-ment)

: The process of hiring, training, and overseeing subcontractors. The more layers between the client and subcontractor, the greater the risk.

Roles and Responsibilities in Subcontracting

Managing subcontractors effectively means understanding roles and responsibilities within the supply chain network. Each organization is a "node" in the network, which itself is a shifting web with no single center point. Roles often change as a prime contractor may be a client in one agreement and a subcontractor in another. This fluidity means everyone must manage risks to maintain stability in the network.

One of the critical mistakes a hiring client can make is to assume that a subcontractor's risks do not affect them or that investing in subcontractor success does not help the client, prime contractors, or investors succeed. Without a dedicated strategy to manage these risks, liabilities can be easily transferred between the client, primes, and subcontractors, and remain unaddressed. These assumptions also fail to tap into the power of supply chain networks. By taking on more responsibility and gaining more visibility within the network, each entity will find more growth opportunities.

Responsibilities of Clients

- **Define Project Scope and Requirements:** Clearly outline project details, including technical specs, quality standards, timelines, and budget.
- **Vet Direct Suppliers and Contractors:** Prequalify all prime suppliers and contractors to ensure that they have the proper training, insurance, qualifications, safety systems, and processes to meet compliance standards.
- **Set Compliance Standards and Expectations:** Communicate compliance standards to the prime contractor and ensure they are applied to subcontractors.
- **Monitor and Oversee:** Regularly review and inspect progress to ensure alignment with compliance standards and work objectives.

Responsibilities of Prime Contractors

- **Act as the Agent:** Engage subcontractors and fulfill contractual expectations.
- **Maintain Licenses and Insurance:** Fulfill all legal obligations.
- **Vet, Train, and Monitor Subcontractors:** Ensure subcontractors are qualified and perform their functions to the compliance standards set by the hiring client.
- **Manage Relationships:** Keep clear communication with subcontractors and clients, manage performance, and keep projects on time.
- **Eliminate Hazards:** Implement safety measures and manage risks.

Responsibilities of Subcontractors

- **Maintain Licenses and Insurance:** Meet all legal and regulatory requirements.
- **Complete Necessary Training:** Ensure workers are properly trained to reduce the risk of injuries or death.
- **Provide Work or Materials:** Deliver quality work per the contract.
- **Report Problems and Progress:** Communicate issues and updates to the prime contractor.



Common Challenges with Subcontracting

Subcontracting in supply chains has many benefits such as diverse sourcing, flexible responses to needs, access to expertise, and local benefits. However, it also brings challenges, often needing technological solutions. This is especially true considering the large number of subcontractors that might be conducting work under primes. In the Avetta network, for example, some primes oversee hundreds of subcontractors. Managing such large and complicated supply networks can be an extremely challenging endeavor.

Challenges for Clients

Clients face risks such as reputational damage from subcontractors without a direct contract. They may assume the prime contractor handles everything, but without subcontractor visibility, they can't manage these risks responsibly.

Major challenges for clients include:

- **Contractual Assumptions:** Assuming the prime contractor's responsibility protects clients from all risks and consequences is a dangerous risk prevention strategy.
- **Reputational Risk:** Clients may not be legally or financially liable for incidents but can suffer reputational damage.
- **Organizational Risk:** Without an integrated systems approach, cybersecurity, health and safety, and business risks originating with a subcontractor can impact the client. Such risks multiply across the client organization and can even spread to partnerships across the supply chain network.
- **Large Networks of Subcontractors:** Large numbers of subcontractors working under primes can be difficult to prequalify, manage, and oversee without strong technical solutions.

Challenges for Prime Contractors

Prime contractors require the same degree of insulation from financial risk and project disruptions as hiring clients. If primes do not prequalify subcontractors and remain accountable to their clients, they will be unable to protect themselves.

Major challenges for prime contractors include:

- **Prequalifying Subcontractors:** Difficulty in identifying and vetting responsible subcontractors makes it challenging to fulfill contracts and distribute liability properly.
- **Lack of Technology:** Many prime contractors lack technology to streamline subcontractor risk management. Without integrated tech support, communication lags and issues are more challenging to manage.
- **Meeting Client Standards:** Prime contractors often struggle to understand and implement client standards. This is exacerbated by the fact that clear channels of communication between the layers of clients, primes, and subcontractors usually do not exist.

Challenges for Subcontractors

Subcontractors do not have direct access to clients and may feel less accountable due to the lack of visibility. They may not meet high compliance standards, or even know what they are, due to signal attenuation.

Major challenges for subcontractors include:

- **Lack of Supervision:** Insufficient oversight from prime contractors and lack of access to the resources needed to problem solve and manage changes.
- **Signal Attenuation:** The further removed from the hiring client a subcontractor is, the more attenuation of accurate communication, expectations, standards, project information, and training.
- **Accountability Issues:** Not adhering to standards can lead to health and safety risks, rework, and lost contracts.
- **Lack of Technology:** Without integrated tech stacks and support, communication lags and issues are harder to manage.



SECTION TWO

The Hidden Risks of Subcontracting

Subcontractor Risks are Inherently Hidden

As mentioned, the key reason for increased risk around subcontractors is the lack of visibility for the hiring company (and sometimes even for the original contractor, as subcontracting can often go down multiple tiers). Many companies vet, prequalify, and require MSAs/contracts only with their prime contractors and suppliers, with no direct link or visibility to subcontractors. This hides the risk indicators associated with subcontractors, increasing the chance of an incident or violation occurring.

For many clients, the answer is to rely on prime contractors to properly vet potential subs, ensure adequate qualifications, and enforce compliance requirements. This expectation may even be written into strong contractual agreements with the prime, holding them liable for any damage caused by their subcontractors and releasing the hiring company from all legal or financial responsibilities.

Unfortunately, such an approach does not take into account the many severe consequences that impact a hiring company when a subcontractor is involved in an incident. These include project quality concerns, significant project delays, cyber threats, reputational fallout, and regulatory violations. It will not matter to shareholders, workers, customers, investors, and regulators whether the hiring company is “contractually liable” if there are labor violations, massive project delays, or devastating media coverage about an incident associated with that company. Additionally, countries such as Canada are starting to put laws on the books such as Bill S-211 that make companies responsible for the activities of their entire supply chain.^{iv}

Common Subcontractor Risk Scenarios

- **Safety incidents:** Without direct vetting, a hiring company is unable to know the qualifications of subcontractors working on a project. Untrained workers and unsafe work conditions endanger everyone on a job site, making accidents more likely.
- **Workforce and human rights issues:** When a hiring company lacks oversight into its extended network of subcontractors and lower-tier suppliers, workforce issues such as working conditions, fair wages, child labor, modern slavery, and more can hide beneath the surface.
- **Financial instability:** Subcontractors are often small businesses that tend to be more financially vulnerable. Without direct vetting, a hiring client is unable to know if a sub of a sub of a sub is on the verge of bankruptcy, which may lead to delays, labor violations, unsafe working conditions, or poor-quality work.
- **Quality:** When a prime contractor outsources manufacturing, production, distribution, or labor to one or more subs, the hiring company loses crucial visibility into the quality of all components that result in the end product.
- **Cyber threats:** Every member of a value chain is a potential vulnerability when it comes to cyber threats. A cyberattack on even the smallest subcontractor could have severe ramifications up and down the supply chain.
- **Subcontracting loopholes:** High-risk contractors may try to get around hiring client compliance standards and processes by signing up to work as a subcontractor to one of your primes.

Impact of Subcontractor Incidents

The above risk scenarios can have serious consequences for the hiring company if an incident occurs, regardless of direct financial or legal liability:

- Severe brand and reputation damage due to widespread media coverage of an incident, event, or violation.^v
- Project delays when a subcontractor becomes unable to fulfill a job due to bankruptcy, an accident, or other adverse event.^{vi}
- Business disruption in the face of cyber events^{vii}, recalls^{viii}, investigations, and more.
- Investor, employee, and customer displeasure.^{ix}
- Penalties, fines, and project shutdowns due to subcontractor regulatory violations.^x

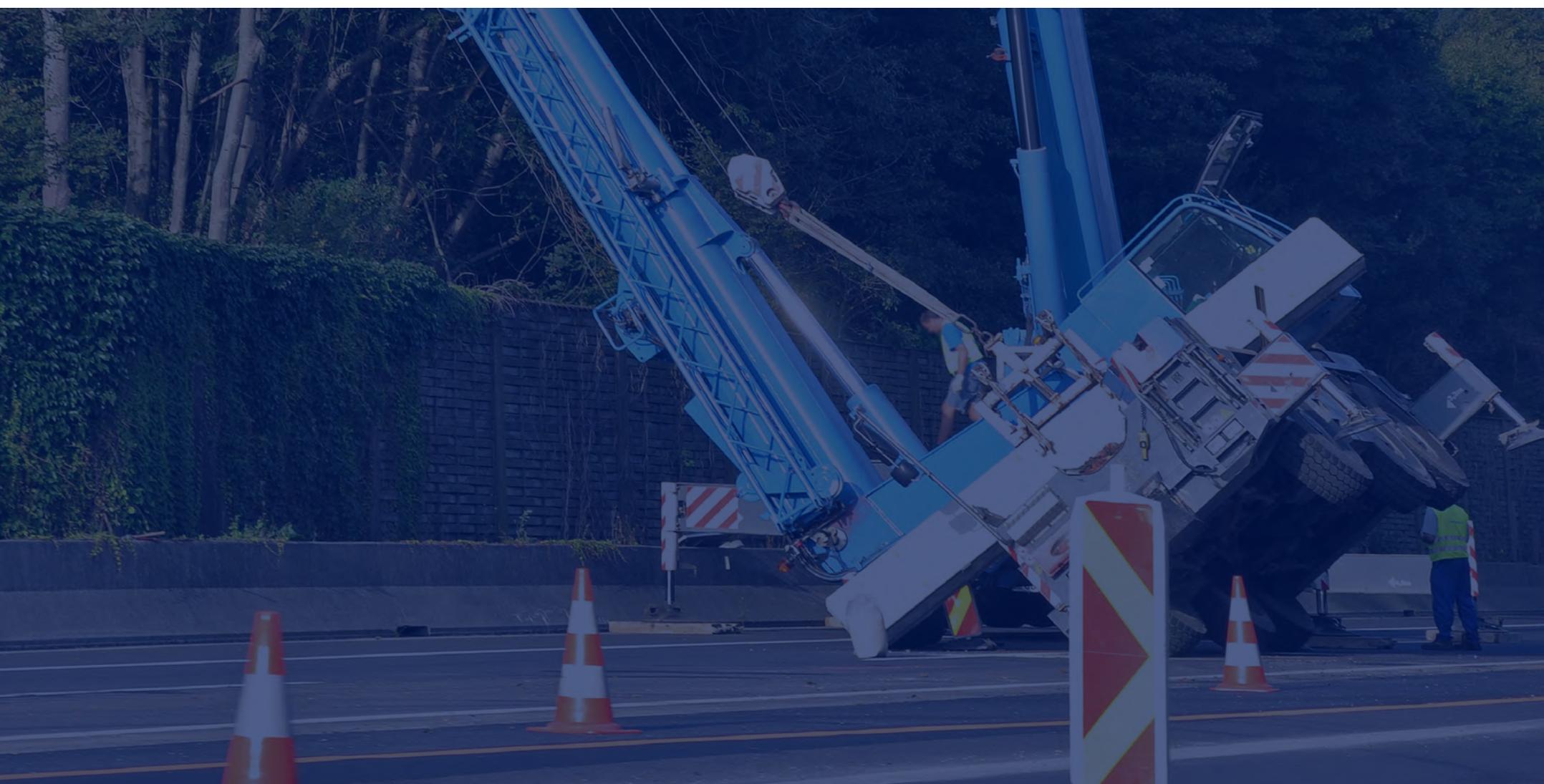
It is clear that relying on prime contractors to ensure subcontractor qualifications and compliance is a high-risk model of managing subcontractor risk. Instead, hiring companies should be proactive in applying the same rigorous vetting and compliance requirements to subs as they do to their prime contractors.

Examples of Subcontractor Incidents

In 1999, a massive crane collapsed in Milwaukee, WI, during the construction of a new baseball stadium for the Milwaukee Brewers. A subcontractor was operating the crane when the collapse killed three workers. The subcontractor and prime faced millions in lawsuits and OSHA penalties. The Milwaukee Brewers (the hiring client) were on the hook for \$100 million in repairs and significant negative media coverage, ultimately leading to a project completion delay of one year.^{xi}

In 2013, Nestle was forced to suspend product deliveries and issue recalls for all products that contained beef from a particular subcontractor. Traces of horse DNA were found in quality tests of these products. Though the quality issues came from a subcontractor, not a direct contractor, Nestle still had to endure the severe reputational and financial consequences of the recall and negative media coverage.^{xii}

In 2023, three workers were tragically killed in a deadly scaffolding collapse in Charlotte, North Carolina. North Carolina's department of labor found six violations against the subcontractor responsible for the scaffolding, including the fact that the scaffolding components hadn't been tested for 10 years and were not inspected for visible defects before each work shift. All parties involved in the project were later sued by one of the workers' families.^{xiii}



SECTION THREE

Section Three: Best Practices for Managing Subcontractor Risk

To properly manage subcontractor risk and compliance, hiring companies must take a proactive, deliberate approach. In this section, we'll explore best practices for managing subcontractor risk, including:



Compliance Requirements



Prime and Subcontractor Communication



Monitoring and Enforcement

Compliance Requirement Strategies and Tactics

Compliance and Safety Should Start at the Top

Developing a company-wide compliance and safety strategy should involve high-level decision-makers across the organization to ensure consistent application across all projects. As with any major initiative, a company's stance on subcontractor risk and compliance must start with the C-Suite. Achieving consistent standards is nearly impossible without cohesive and well-communicated buy-in from the top. Clear policies and practices should be communicated across all levels of the company, from corporate leaders to field supervisors.

Subcontractors Must Follow the Hiring Client's Compliance and Safety Requirements

The most effective approach to subcontractor risk management is to ensure that all safety and compliance requirements apply to both prime contractors and subcontractors, at the company and worker levels. Doing so ensures that risk practices flow consistently throughout the supply chain, and are easier to manage, monitor, and enforce by the hiring company (as opposed to unique rules for primes versus subs).

Enforce Company-Level Requirements

Just as with any direct contractor, subs should be comprehensively vetted at the company level, including safety history and statistics, safety and sustainability practices and policies, financial health, and potential cyber vulnerabilities. Directly vetting every subcontractor ensures that the hiring company has the visibility and control to ensure the same standards of quality and compliance applies to everyone working for them.



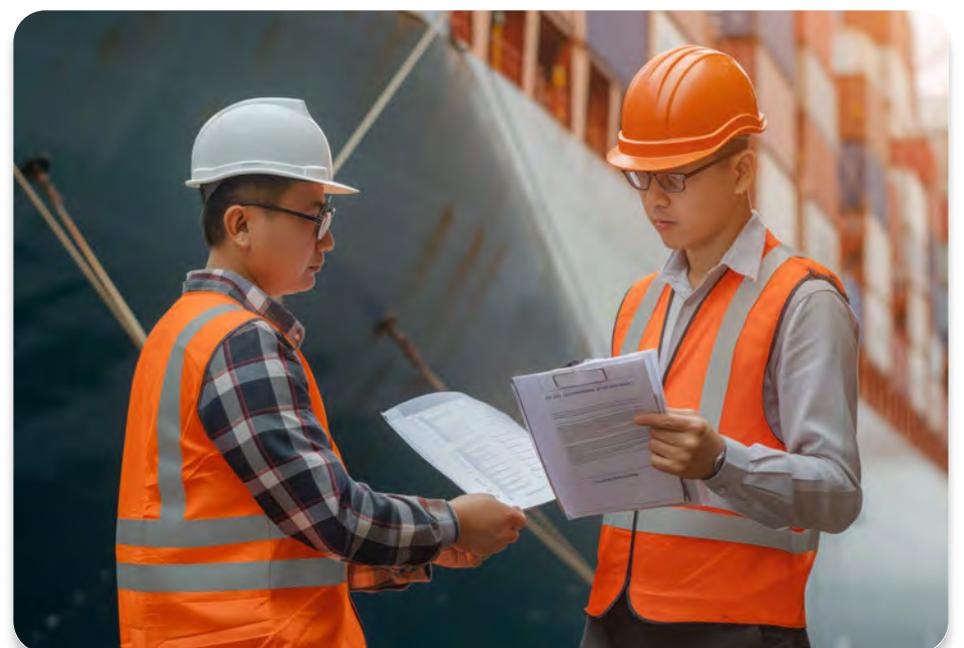
Enforce Worker- and Site-Level Compliance

Robust worker compliance is especially critical for subcontractors, as a large amount of risk exists at the job site where the work is performed. Any worker on a job site, whether employee, prime, or sub, must meet the same training and compliance standards for entering a site and performing work. Even one exception for a worker immediately makes everyone else on the job site less safe.

Site access controls and security can effectively maintain proper worker qualifications and training, especially when paired with on-demand mobile worker training^{xiv} and on-site hazard management tools.^{xv}

Ensure Proper Insurance Coverage

Insurance is one element that may not be consistent from primes to subs. Prime contractors typically handle most insurance requirements, with liability for work performed by subcontractors remaining at the prime contractor level. However, every subcontractor must have verified workers' compensation coverage to protect the prime and hiring company.



Prime and Subcontractor Communication

If your current subcontractor management practice is hands-off, the transition to a more proactive, direct program will require clear expectations and communication to all primes and subcontractors.

Once you've determined what subcontractor requirements will be and how you will obtain and manage subcontractor information,^{xvi} consider these steps:



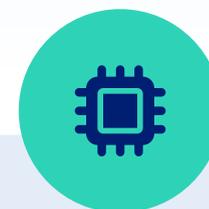
Communicate clearly to your primes:

To effectively shift your subcontractor compliance program, your primes must be informed and on-board. Consider multiple communication channels such as in-person town hall meetings, webinars, and emails to help your direct contractors understand the new subcontractor program requirements.



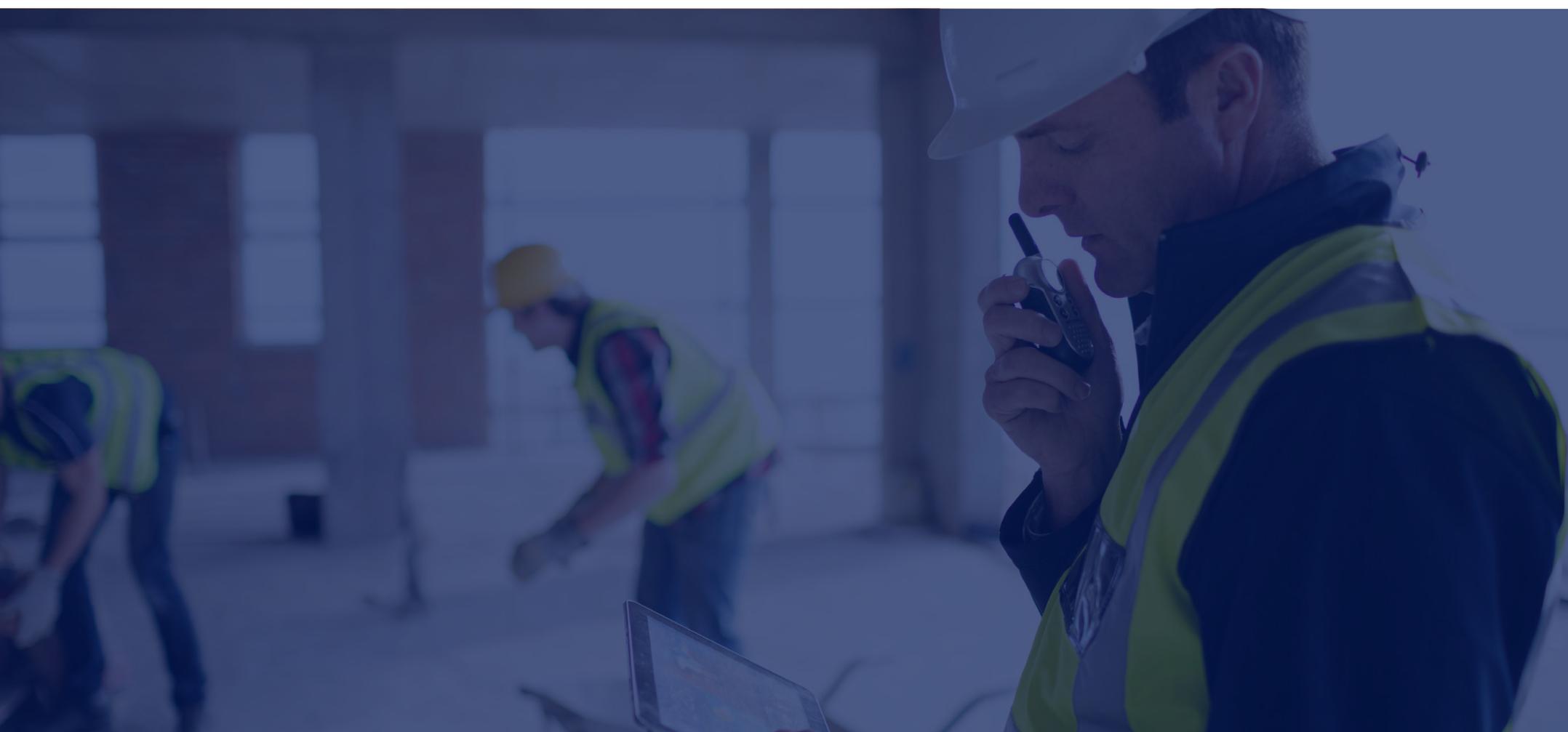
Re-examine your contracts:

Ensure your contracts specify the relationship dynamics between you, the primes, and their sub-contractors, including provisions for direct interaction as needed.



Use technology to prequalify, hire, and monitor sub-contractors:

Take advantage of modern tech solutions for prequalifying, hiring, monitoring, and communicating with your subcontractors. Make sure that your primes are on-boarded and trained to use these systems.



Monitoring and Enforcement

Even with the best risk management strategy, field leaders may be tempted to make small compliance exceptions to keep projects on track (such as telling a worker they can enter a site without proper training, if they take the training within the next week). Likewise, primes may want to circumvent your new requirements to get a sub hired quickly in a pinch. As such, monitoring and enforcing subcontractor compliance is crucial to maintaining your safety and sustainability standards throughout your supply chain.

Conduct regular compliance audits, site visits, and inspections to ensure proper qualification and compliance by your primes and subcontractors. This is especially critical in disconnected and global operations, to ensure visibility and avoid safety hazards, child labor, quality concerns, and other risks lurking within your extended supply chain.

Areas that should be monitored and enforced include:

- **Safety Manual Audits:** Conduct comprehensive audits of subcontractor safety manuals and documents to make sure their processes align with your compliance standards, as well as to uncover important gaps.
- **Implementation Audits:** Leverage deeper, evidenced-based audits that require paperwork, certificates, and other documentation to ensure that subcontractors properly implement and follow their written procedures as outlined in their safety manuals.
- **Field Inspections:** Put boots on the ground to observe worksite practices and behaviors. This will allow you to verify onsite compliance with your requirements, safety regulations, and local laws.
- **Insurance Verification:** Review and validate that your subcontractors' insurance coverage meets your specific requirements. Identify liability limits and indemnity of their insurance policies. Make sure to monitor and follow up on insurance coverage expirations.
- **Business and Financial Risk:** Conduct business due diligence of your subcontractors by investigating their financial health, legal troubles, sanctions violations, and adverse media and negative press.
- **Cybersecurity:** Protect your business from data breaches and disruptions by monitoring the cyber health of your entire supply chain. Work with your subcontractors to identify potential threats over time and strengthen their cyber resilience.

Conclusion

Clients, prime contractors, and subcontractors share the responsibility for a strong, efficient supply chain network. Managing subcontractor risks is crucial for everyone's success and stability, as each node in the network has both a part to play and something to be gained. Successful and sustainable outcomes are the goal for everyone involved.

That said, clients play a central role in setting and communicating clear expectations for their contractors and subcontractors to ensure each level of their supply chain adopts responsible practices and answers for them. Hiring companies must ensure direct vetting and oversight of all subs in their extended network, applying the same comprehensive compliance requirements as they have for prime contractors. Clear, top-down standards, strong communication, and monitoring and enforcement are key building blocks to creating a strong subcontractor compliance program.

Lastly, hiring companies should take advantage of state-of-the-art supply chain risk solutions. Modern tech platforms support prequalification, audits, business reviews, financial risk analyses, cybersecurity monitoring, and insurance verification for subcontractors. Such solutions reduce paperwork, improve communication between the various supplier tiers, provide real-time monitoring of various leading indicators, provide onsite worker training capabilities, offer a centralized location for all prequalification and compliance documentation, and much more.

Avetta is a software-as-a-service (SaaS) company providing supply chain risk management solutions. Avetta's platform is trusted by more than 130,000 suppliers in over 120 countries. Visit [Avetta.com](https://www.avetta.com) to learn more about their subcontractor management tools, prequalification services, and marketplace offerings.



Appendix:

Additional Subcontractor Risk Management Resources

Industry Resources

OSHA Multi-Employer Citation Policy: This Occupational Safety & Health Administration (OSHA) directive provides guidelines on how OSHA enforces penalties in situations involving multiple employers on a single worksite (such as prime and subcontractors on one site).

ASSP: Managing Safety on Multiemployer Work Sites: This article from the American Society of Safety Professionals (ASSP) discusses best practices for managing worksite safety when multiple working entities are present, like primes and subcontractors.

ASSP: Understanding the Contractor Management Paradox: Another article from ASSP reviews the challenges of contractor management and provides comprehensive best practices for hiring companies to ensure safety and compliance.

AGC: Preventing and Managing the Risk of a Subcontractor Default: “This comprehensive checklist is designed to enhance your risk management strategy, covering key areas such as prequalifying subcontractors, using contracts to manage and reduce risks, and monitoring contract performance to mitigate defaults. It offers practical tips and actionable insights and was written by AGC’s Risk Management and Specialty Contractors Committees.”

American Subcontractors Association (ASA): ASA provides a variety of resources focused on subcontractor risk management. They offer best practices, educational materials, and guidelines designed to help subcontractors and general contractors manage risks effectively.

More From Avetta

9 Ways to Manage Hidden Subcontractor Risk: This Avetta blog provides additional recommendations on how to manage subcontractor risk within the supply chain.

Avetta Insights for Subcontractors: Busting the Myths: Created with data from Avetta’s own network of 130,000+ contractors and subs, this Avetta Insights Report examines common myths associated with subcontractors along with the realities seen in the real world.

Avetta’s Subcontractor Risk Management Solution: Learn how Avetta’s comprehensive contractor risk management solution uniquely extends visibility and compliance down to subcontractors for streamlined risk management.

Subcontractor Management for Primes in Avetta’s Platform: This Help article explains Avetta’s Subcontractor Management feature and how to use it, specifically for primes.

Best Practices for Managing Subcontractors: This Avetta whitepaper provides a guide for organizations to navigate the unique challenges and responsibilities that come with each subcontractor profile. Gain insight into common subcontractor risk factors, workplace safety, legal and regulatory violations, the digital security of supply chains, knowledge-building exercises to build resilience, and best practices for supply chain governance.

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