



Supplier Classification

A Differentiator
in the Modern
Supply Chain
Landscape



Introduction

Over the past decade, supply chains have grown both in terms of length and complexity as companies ventured beyond borders in search of better margins. With increased outsourcing of non-core competencies, companies have become more reliant on suppliers for driving cost savings and innovation. The result? Strategic supplier partnerships today rank high in the corporate agenda. Additionally, Supplier Relationship Management (SRM) is seen as a priority procurement function that can make a huge difference.

Now, despite the criticality of SRM in the current market scenario, several organizations still struggle to initiate, develop, and nurture value-driven partnerships with suppliers. The primary reason for this is that companies often end up thinly spreading their attention across the entire supplier base which often comprises thousands of Tier-1 and Tier-2 suppliers or subcontractors. Clearly, not all suppliers in a network command the same level of spend, and hence every supplier represents a different level of value to the buyer.

Imagine a company X with 50 suppliers, 30 of which perform high-risk functions, and 20 which are lower risk and less involved. The company has a total spend of \$1 million, which is spread across these suppliers. Without knowing which suppliers belong to which category, the company can spend a greater proportion of its budget on Tier-2 suppliers. As they contribute less value or have less of an operational impact, this makes the spend less optimal.

This is where supplier classification or segmentation can help companies differentiate their supplier base in terms of the potential impact they can have on an organization, the risks they pose, and the value they can deliver. With supplier classification capabilities, the company X can allocate proportionate spending to its suppliers, based on their risk level, resulting in optimal spending. Supply chain managers can determine the level of engagement required by different supplier types and effectively assign limited resources while aligning specific compliance mandates depending on the requirements.

Classifying Suppliers to Drive Maximum Business Value

Modern SRM approaches often include processes for enterprise-wide interactions with suppliers to drive value depending on the nature of the relationship. The intrinsic nature of that relationship – be it structural (competitive dynamics, size of the company or balance of trade) or cultural – impacts the overall outcome across the value chain.

The ultimate goal of SRM is to facilitate robust supplier collaborations to respond to changing market conditions, reduce cost, drive innovation, and make internal processes more efficient. Therefore, it's critical for supplier management teams to closely understand company objectives and then determine whether their suppliers' capabilities align with these. To determine the right engagement model and necessitate the right engagement requirements, supplier management teams need to have a robust classification strategy. That way companies can create a tailored approach for every supplier – developing a targeted relationship strategy based on the level of risk and criticality determined by a standard set of criteria.



A robust supplier classification process can help contractor management teams allocate resources efficiently and most importantly, negate risks and manage time more judiciously. For instance, a company wouldn't essentially classify a welder and a janitor as the same risk level if they came on site. Putting them on the same level means the company would either lower the work requirements for the welder, which would be risky and dangerous, or it would increase the work and compliance requirements for the janitor, which would prove costly and time-consuming.

This is particularly important because often companies end up dumping all their contractors and suppliers into one bucket instead of designating specific requirements depending on the category or job requirements for each type of worker. This ends up making the onboarding process extremely time-consuming because suppliers will be asked to provide documentation in line with prequalification questionnaires that in many cases don't apply to them.

Why do you need to classify your suppliers?

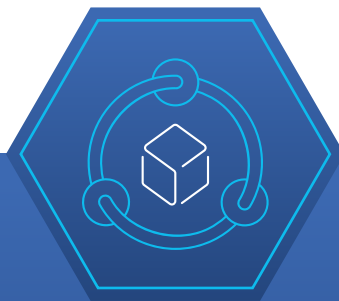
The bigger the supplier base, the more critical it is to identify the high-value suppliers. This can allow companies to:



Identify and nourish longstanding supplier partnerships, thereby enhancing visibility across the supply chain



Drive better cost outcomes and returns on investment with enhanced spend mapping



Align key supply chain activities with larger business goals and objectives by identifying suppliers who can drive innovation and continuous improvement



Motivate suppliers to deliver better service outcomes and improve standard compliance practices

Classification: Tier-Level Structure or Nomenclature

Supplier classification tier level and nomenclature often vary by organization and industry. However, it generally ranges between three or four selections or categories, such as:



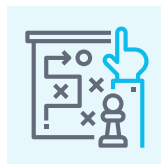
Strategic Contractors:

These contractors or suppliers play a critical role in the entire procurement value chain. In fact, they are often deemed as the “extended enterprise” or the extended arm of an enterprise. They are typically classified as high-value suppliers because they often act as a sole source of a particular value or service being delivered which provides the company with a competitive advantage. This category contains the least number of suppliers, but it also requires the highest attention from the decision-makers.



Business-Essential Contractors:

These are the contractors with whom companies have generally developed a good working relationship. These contractors can be counted on for relatively low-risk profile tasks and quality when it comes to service delivery. This category is also important in the entire supplier ecosystem, and they deserve attention with a little more oversight into their internal operations. They also require performance management and continuous improvement.



Tactical Vendors/Contractors:

Contractors under this category are generally entrusted to deliver volume-driven services and they compete for business often based on cost, service level, and scalability. These contractors are often easy to replace. They also need constant compliance monitoring and often require operational intervention.



Strategic Contractors



Critical to the entire procurement value chain



Deemed as the "extended enterprise"



Typically classified as high-value suppliers

Business-Essential Contractors



Companies usually have good working relationships with them



Can be counted on for low-risk profile tasks and service delivery



Require performance management



Tactical Vendors/Contractors



Generally entrusted to deliver volume-driven services



Often easy to replace



Need constant compliance monitoring and operational intervention



Figure 1: Tiers of Supplier Classification and Characteristics¹

Key Attributes Determining a Particular Category

There are several key attributes that determine a particular classification category. Each attribute may have several levers that influence the overall classification process.

The following are some of the major attributes that companies can use to classify their suppliers:

Overall Spend



An organization's yearly spending with a supplier becomes a key determinant of the category where the supplier should be classified. The organization may create spend thresholds for every segment based on factors such as overall demand and budget. It is extremely important for companies to consider the Year-Over-Year supplier spend growth because this can provide a futuristic overview of a supplier's engagement level. Companies should also be on the lookout for high-performing suppliers with low spending. Doing so can help identify strategic partners within their own supplier pool and increase their scope of work for more value creation.

Risk Profile

A supplier's risk profile works as a critical determinant for supplier category, and it also influences an organization's procurement plans and sourcing strategies.



The risk profiles of suppliers can be further segregated into



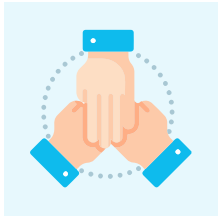
Actual Risks

A company should consider past incidents, history of supplier failure, and the impact the activities had on business continuity plans. The frequency of incidents and failures and the disruption level of each should typically determine the risk level of a supplier from high to low.



Potential Risks

In this case, a company needs to quantify the extent of disruption that a potential supplier failure may create and the impact it may have on day-to-day operations. Suppliers may be assigned a low to high risk profile depending on the level of potential risk to overall business operations.



Level of Collaboration

With this attribute, companies can classify suppliers based on the specificity of the service offering and innovation. For instance, suppliers can be placed in separate categories depending on their collaboration with the company to deliver a unique or customized service offering.

On the other hand, classification can also be done based on three things:



Strategic Advantages

(Creation of new segment, new market entry)



Competitive Advantages

(Innovation, market share)

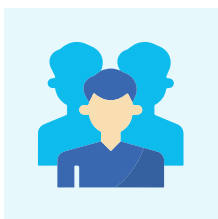


Operational Advantages

(Process enhancement or cost-benefit)

Knowledge Sharing

This attribute can help companies understand the operational and transactional connections they have with their suppliers and then assign them a specific category. For example, let us take two suppliers of a company. The first supplier shares strategic knowledge with the company because there's an exchange of intellectual property and/or confidential data. With the second supplier, there's only one-way sharing where the company simply provides the basic requirements. Taking the knowledge sharing attribute into account, it is clear that the first supplier is more important to the company than the second supplier.



End-User Impact

There may be instances where a product or service offered by a supplier may have a very distinct or direct end-user impact. Quite evidently, such suppliers must be categorized as strategic suppliers and placed in the top tiers of classification.

Streamlining Supplier Classification

How Can Avetta Help?

Traditionally, companies have been classifying suppliers purely based on business priorities, spending or risk exposure. The majority have often embraced proven classification approaches such as the Kraljic Matrix or the Pyramid approach which considers these attributes as key determinants for every category. However, considering how the market, the associated risk vectors, and regulatory requirements are evolving, companies need to look beyond traditional supplier attributes to understand their supply chain more closely and classify suppliers more accurately. This is where Avetta can simplify the classification process.

Built with complex supply chains in mind, the Avetta One platform comes with an advanced supplier classification engine that intelligently prequalifies all the suppliers based on diverse attributes and criteria set by the hiring company. The cloud-based platform allows companies to automatically collect and verify supplier documentation. Additionally, Avetta One helps organizations define their own compliance criteria and quickly see which suppliers are qualified, which are not, and why. Supplier management teams can leverage the platform to assign different classification criteria for each site and type of work.



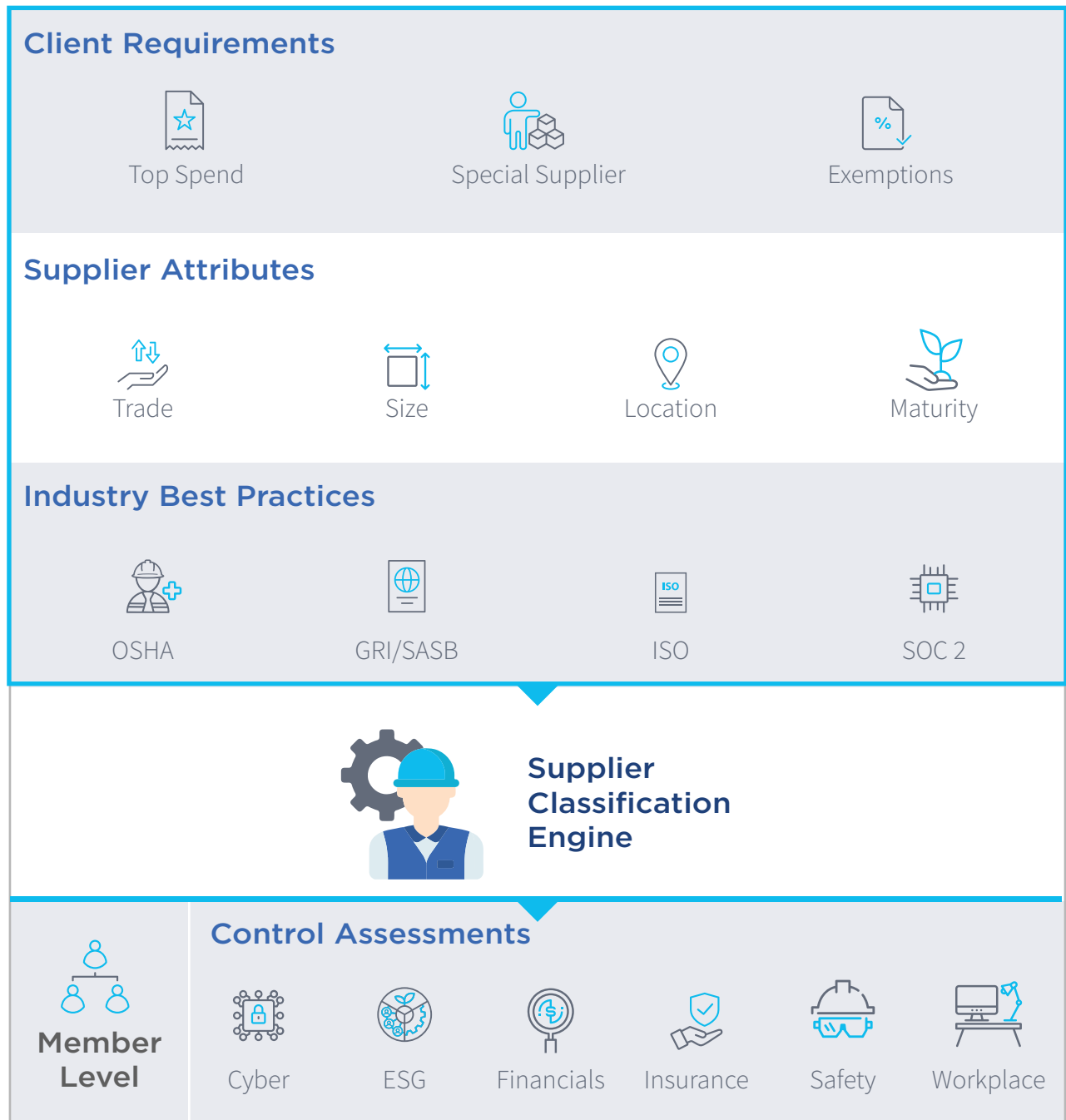


Figure 2: Avetta's Supplier Classification Engine

As is the case with other business transformation initiatives, establishing a robust SRM program can be a complex exercise. But with accurate supplier classification available in the Avetta One platform, companies can create a strong supplier network with end-to-end compliance and visibility – the cornerstone of forging successful and lasting supplier relationships.

References

Source: Supplier Segmentation Strategies Have Never Been More Vital;

<https://marketingassets.staples.com/m/5a0463421df87c1b/original/Supplier-Segmentation-Strategies-Have-Never-Been-More-Vital.pdf>



About Avetta

The Avetta SaaS platform helps clients manage supply chain risk, and their suppliers, to become more qualified for jobs. For the hiring clients in our network, we offer the world's largest supply chain risk management network to manage supplier safety, sustainability, worker competency and performance. We perform contractor prequalification and worker competency management across major industries, all over the globe, including construction, energy, facilities, high tech, manufacturing, mining, and telecom.

For suppliers in our network, our audit and verification services help lower their safety incidents rate by 29%. As a result, about 50% of members find additional job opportunities within the first year of joining. In addition, our suppliers receive privileged access to the Avetta Marketplace, where dozens of partners offer special discounts for business services like insurance and work gear. Avetta serves more than 500 enterprise companies and over 125,000 suppliers across 120+ countries.