Using Supplier Segmentation To Maximize Supplier Relationships

Supplier segmentation refers to the process of dividing suppliers into distinct groups so that you can allocate your resources to better manage them. It is one of the core pieces of a supplier relationship management (SRM) program.

Supplier segmentation is important because organizations must build sustainable partnerships with their most strategic suppliers to achieve the most value.

Suppliers that you know are key to your business operations require a high level of engagement and more focus than others.

Through segmenting your suppliers into groups based on a level of criteria such as how critical they are to operations or how much you spend with them, it is easier to decide on the level and type of attention they need.

It's simply not practical to give every supplier the same level of attention because if you're closely monitoring the fires that have little or no impact on your business, then you risk running into issues with the critical suppliers and ultimately, wasting your manpower.

Why is developing collaborative relationships with your most strategic suppliers crucial to your success? It helps to make process improvements, reduce costs, and continues to encourage innovation in the products or services you offer.

To achieve innovation, it’s necessary to be transparent with your key suppliers and build trust.

Generally, it’s accepted that your strategic relationships with critical suppliers provide a competitive advantage and a positive ROI. It’s especially critical for companies that have limited resources.

Segmenting your suppliers can also help you identify your level of risk for instance if you have a single source of supply for your product or service.

If a supplier fails, it can lead to a major disruption in your supply chain and cause a negative customer experience because you aren’t able to provide the products or services your customers have come to expect.

Beyond cost reduction, improved processes, and continuous innovation, segmenting your suppliers also allows you to gain new insights into your current situation.

Simply working through the exercise could help expose weaknesses or risks in your supply chain so that you can fix issues before they arise.

Ultimately, you’ll have better visibility across the entire supply chain which equips you for better supply chain management.

By building relationships with your most critical suppliers who are those that are likely to provide products and services across multiple categories, you’ll have better visibility and transparency.

You’ll also be able to better manage your time and allocate resources. You won’t gain much if you nurture meaningful relationships with suppliers that are low-risk but also have minimal impact on your organization.

You’ll also be able to align procurement with your business and objectives by assessing which suppliers contribute the most value and how that aligns with your company’s values and priorities.

The Kraljic Matrix

The Krajlic matrix, named for Peter Kraljic, plots the volume of spend alongside value and separates your suppliers into four distinct quadrants.

Value is based upon how important a particular supplier is in terms of business continuity.

Using this approach, you place your suppliers into the following buckets:

- Where you have high value and high spend, you have your strategic partners.
- Where value is high but spending is low, you have leverage. you can use this to your advantage to negotiate better deals, for a stronger profit impact.
- Where both value and spend are low you have your non-critical suppliers. The company that provides your office supplies will most likely fall into this category.
- Where your spend is high but your value is low you have your potential for a bottleneck. These can cause any number of issues, so look closely at your bottleneck items to come up with a solution.

You can use this classification method to customize your approach based on your specific business so that you can get more detailed subgroups within each quadrant.

To get the most benefit from this exercise, first, define what risk and impact look like for your company.

Risks may be things like compliance records, financial stability, performance record, etc. The impact could be how much money you spend with different suppliers, the volume a supplier provides for you, etc.

After you’ve assigned value to each factor, it’s easier to calculate who your most important suppliers are, and then focus on ways to improve buyer-supplier relationships.

The Pyramid

The pyramid provides a different way of looking at your supplier database with the same priorities: strategic, important, and transactional.

This is usually how medium and small companies choose to segment suppliers.

With this approach, you can expect the pyramid to typically have three or four tiers, depending on whether partners are split into their own group at the top of the pyramid or grouped into the strategic category.

As you move from the bottom to the top of the pyramid, the supplier value increases, and the number of suppliers in that category decreases.

The ones at the bottom are the least priority because they are low-value and low-impact, whereas the ones in the middle, matter, but don't matter as much as the ones at the top. The top-tier suppliers are the ones with the strategic items.

> *Focus on eliminating high risk suppliers, worry less about non-critical items, talk to your suppliers with leverage items, and regularly review strategic supplier segmentation.*

Factors Influencing Supplier Segmentation

Several things play a role in how your company approaches supplier segmentation. Your industry and the type of business you're in should influence your approach.

As you decide what method to use, consider:

- Your total volume of annual spend and your projected growth
- How complex the products or services you purchase are
- The value each supplier brings to your business
- The supplier's location – regional or global – and how many businesses purchase from them
- The total number of active suppliers in your database

- Supplier risk such as financial stress, failure to supply, delivery issues, past supplier performance, and so on.
- The potential of each supplier. For instance, a smaller more diverse company or a local supplier may be more valuable than your current spend suggests.

Supplier segmentation's main goal is to identify where you need to focus your attention to maximize the potential of your supplier relationships.

There is no single approach to supplier segmentation that is better than the other. The key is to choose the one that best suits your organization.

Best Practices to Use While Segmenting Suppliers

Use the Pareto Principle, aka the 80/20 Rule.

This means focusing your attention and effort on the top 80% of the spend which usually accounts for 20% of your supplier database. If you have a supplier you use once every couple of years, don't spend a lot of energy on this relationship.

Think about both objective and subjective input as you said meant your key suppliers.

Consider things such as responsiveness, quality, and delivery performance in addition to your overall spend.

Once you've chosen your segmentation model, share it with all the internal users so that all touchpoints within the model are covered.

This also ensures consistent messaging which promotes that our relationships.

Talk with your key suppliers about Innovation and continuous improvement. Relationship-building has financial rewards and it needs to be beneficial for all parties involved.

Review your segmentation at least once a year. Because of economic changes, risk files also change. Your company's fortune can fluctuate year-over-year, and new suppliers hit the market all the time.

The Strategic supplier this year may not remain a strategic supplier next year if you have a product or service that is no longer fit for purpose.

When you are able to segment your suppliers effectively, you give your organization a competitive advantage.

Don’t be afraid to use technology to make things easier. Spend analysis tools are widely used in procurement and can make it easier to preallocate your suppliers automatically based on your annual spend.

You can divide them into strategic, important, and transactional as a starting point and then reallocate them as required by the user based on other information you have available.

Using supplier segmentation tools ensures that all of your suppliers are allocated to a group and are not duplicated.

Supplier Collaboration Efforts Matter

There is a limit to the amount of value your procurement department can generate when you focus solely on the price you pay for goods and services.

The most successful procurement organizations understand that by working collaboratively with your supply base you can find ways to unlock new mutual value.

By working together, buyers and suppliers can develop new products, which boosts revenue and profit for everyone.

Taking the initiative to design new processes together to remove redundancies and reduce waste, or purchase raw materials together, or collaboratively planning, forecasting, and more, it’s possible to mitigate risk, improve service levels, and untimely strengthen the combined supply chain.

At PLANERGY, our software is designed to help you keep track of spending, budgeting, and purchasing.

With the data in the platform, you can better manage supplier relationships and make supplier segmentation easier.

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