

Supplier Tiers: What's The Difference Between Tier 1, Tier 2, and Tier 3



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Supplier Tiers: What's The Difference Between Tier 1, Tier 2, and Tier 3
What You Need To Know About Classifying Suppliers

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As a procurement professional, you know how important it is to have a reliable and cost-effective supply chain.

One way to ensure that your supply chain runs smoothly is by utilizing supplier tiering.

But what exactly is supplier tiering, and how can it benefit your business? Let's break it down.

What is Supplier Tiering?

Supplier tiering is the practice of classifying suppliers based on their performance and importance to your business.

This allows you to easily evaluate which suppliers are performing well, which ones need improvement, and which are essential for your operations.

You can manage suppliers by breaking them down into different tiers more efficiently.

The Benefits of Supplier Tiering

Supplier tiering offers numerous benefits for businesses that use it.

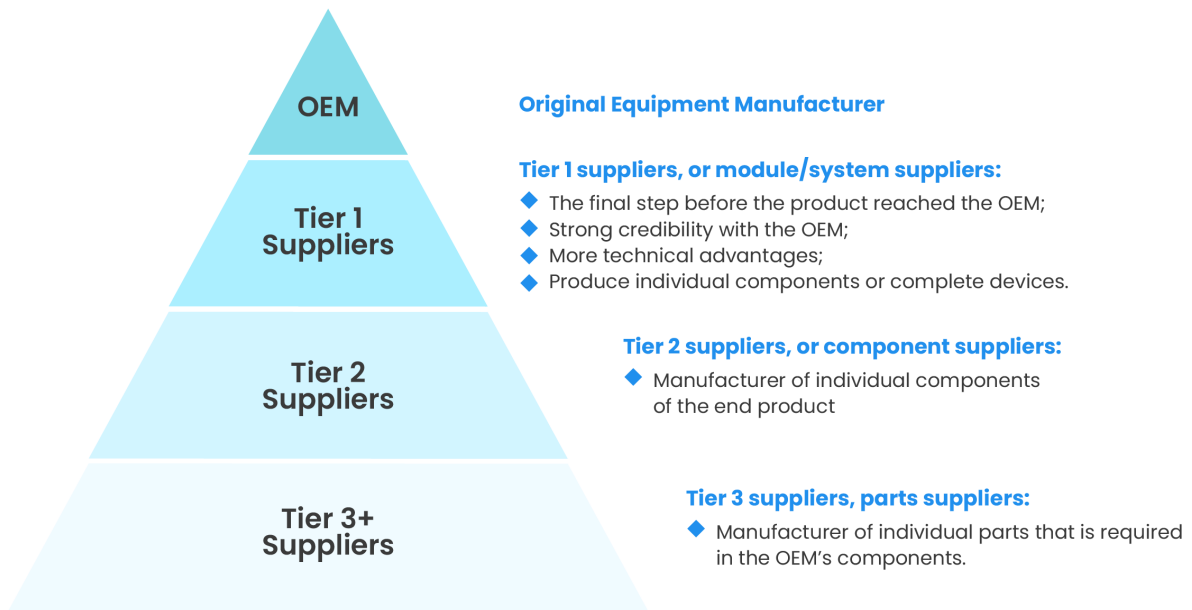
It allows companies to develop relationships with key suppliers who provide the best value for money and services, allowing for easier supply chain management and lower supply chain risk.

It also gives organizations greater negotiating power because they know what services they need and how much they should pay for them.

This process also helps create transparency within the supply chain so that everyone involved knows what's going on at all times, leading to better communication and collaboration between all parties involved.

Supplier tiering also helps reduce costs by eliminating inefficient or unnecessary processes in the supply chain.

Supplier Tiers



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What Are Supplier Tiers?

• Tier 1 Suppliers

Tier 1 suppliers are the top-tier suppliers within your supply chain. They provide high-quality products and services that meet strict specifications and are typically considered the most reliable options available.

Tier 1 suppliers are the most significant in terms of supply chain setup, they can also represent direct suppliers to the end customer or original equipment manufacturers (OEMs).

These suppliers tend to have long-term relationships with their customers and often provide additional consulting or technical services in addition to product delivery.

This type of supplier also has access to large volumes of resources, so they may be able to deliver goods faster than other tiers of suppliers.

Tier 1 can be the direct suppliers of your final product - like cotton t-

shirts - or the fully built components that will be combined to create the final product. This is true of any finished product.

• **Tier 2 Suppliers**

Tier 2 suppliers are known as secondary suppliers or second-tier suppliers. They supply components or assemblies derived from raw materials by Tier 1 suppliers.

Tier 2 suppliers provide the OEMs with sub-assemblies and basic parts to complete a final product, such as construction vehicles or mobile phones.

Both tiers play an essential role in supply chain processes. However, it is often the responsibility of tier 1 suppliers to guarantee quality products and services meet all requirements — both in terms of design and specifications.

Tier 2 suppliers are usually smaller companies specializing in specific supply chain areas.

They offer more cost-effective solutions than Tier 1 suppliers but may not have access to as many resources or the same level of expertise as those at higher tiers.

As such, they may be able to provide good quality products or services but may not be able to accommodate customers who require large orders or complex requirements.

In the case of the cotton t-shirt physical product example, tier 2 is the cotton fabric mill - the company that makes the fabric from the cotton plant.

Tier 2 suppliers are sub-suppliers or subcontractors of your tier 1 suppliers.

• **Tier 3 Suppliers**

Tier 3 suppliers are typically small businesses that operate on tight margins to keep costs low for their customers. They often focus on one

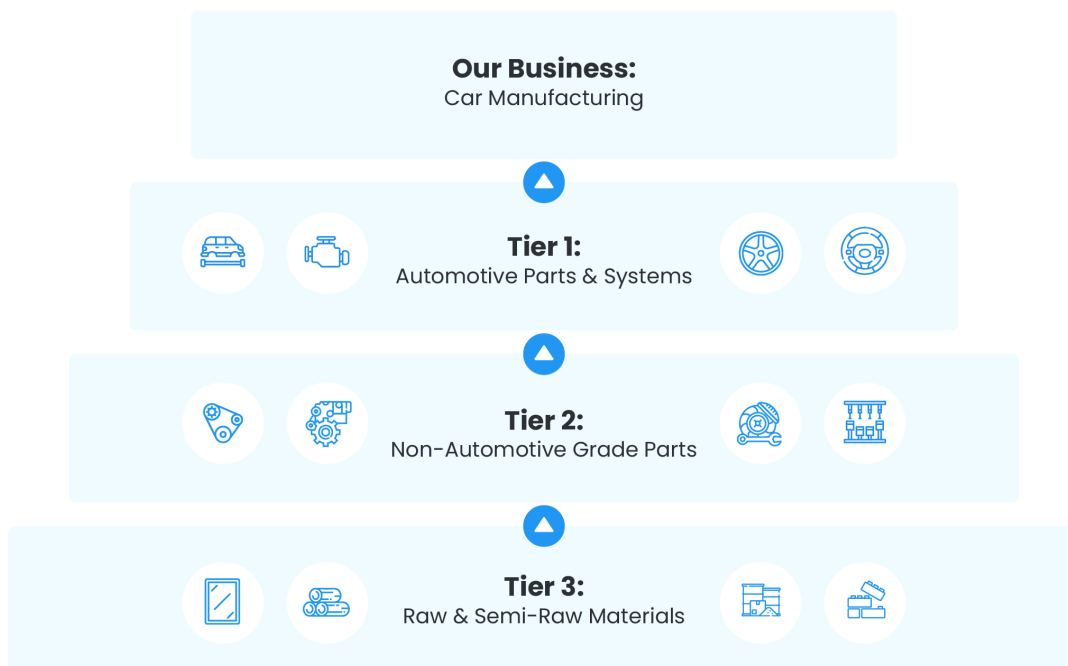
specific area and specialize in delivering certain goods or services quickly and inexpensively.

While these suppliers can provide cost savings for businesses, they typically don't have the same levels of expertise or resources as those at higher tiers and may not be able to accommodate larger orders or more complex requirements.

In the case of the t-shirt company, tier three is the raw material - cotton from a plant farm. Remember that tier 3 isn't always a raw material, but in this example, it is.

In any case, your tier 3 suppliers are suppliers or sub-suppliers for your tier 2 suppliers.

Supplier Tiers Example



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Why Do Supplier Tiers Matter?

The main reason why supplier tiers matter is because it helps you prioritize which suppliers should be managed first.

For example, if you have limited resources available for managing your supply chain, then it makes sense to focus on your tier 1 suppliers since they're providing products and services that are critical to your operations.

It also helps when deciding which products or services to outsource—you may outsource a product from a lower-tier supplier simply because it's not as important as something supplied by a first-tier supplier.

Why It's Important to Know Your Different Suppliers

Companies need to know who their suppliers are and what services they provide. Knowing your suppliers can have far-reaching implications for a business, from quality control to legal ramifications and ethical concerns.

First and foremost, knowing your suppliers helps to ensure product quality. If you're working with multiple faraway vendors, it isn't easy to maintain control over the materials being used or processes that take place in manufacturing.

Quality assurance is especially important when it comes to food safety.

Ensuring that all ingredients are sourced from reputable suppliers is vital for maintaining a product's health and safety standards.

Another key consideration is how ethical a supplier's practices are, especially because today's consumers are focused on social responsibility.

Does the supplier employ fair labor practices? Are there any cases of human trafficking or other unethical activities associated with them?

Companies should aim to form relationships with suppliers that uphold ethical standards and regulations to avoid becoming complicit in any wrongdoing by association.

Legal issues can also arise when dealing with suppliers if they fail to comply with relevant labor laws or other regulations related to their business operations.

Companies need to have an understanding of their liabilities regarding third-party contractors so as not to be held responsible for any infractions on their part.

Considering environmental sustainability is another factor when vetting potential vendors.

Companies need to determine how much energy suppliers use, whether they produce waste responsibly, and whether they commit resources toward reducing emissions or developing renewable energy sources like solar power or wind energy generation.

Additionally, businesses should look into a prospective supplier's ESG Index score, which measures its ESG performance across different industries—an important metric when selecting partners who subscribe to sustainable practices and values.

Cybersecurity is another point worth mentioning here: no matter how secure your internal systems may be, if you're working with an insecure third-party vendor, you could still be at risk for data breaches that could damage your reputation or lead to financial losses due to stolen information or ransomware attacks.

Suppliers must have robust security protocols that meet industry standards for companies to feel safe working with them digitally.

Understanding who you work with as a company is essential for ensuring compliance with legal regulations, maintaining ethical standards, protecting against cyber threats, and contributing toward more sustainable business operations—all while maintaining high-quality products and services according to customers' expectations.

To ensure these aspects are taken care of properly, businesses need knowledge of their supplier networks to properly vet potential partners before engaging in any contracts or agreements.

Defining Your Supply Tiers

The first step in categorizing suppliers is to define your tiers according to your specific needs. Each company will have different criteria for what makes a tier 1, 2, or 3 supplier based on their unique requirements.

Some factors that should be considered when defining levels include price points, quality standards, delivery times, customer service ratings, and payment terms.

It's important to define these criteria upfront so that all stakeholders know what they are looking for in each tier.

Depending on your industry and end product, it's possible to have more than three tiers.

No two businesses are alike, so supply tiers should be customized your needs.

Evaluating Your Suppliers

Once you have defined your tiers, it's time to evaluate your current suppliers against those criteria.

This is where data analysis comes in handy - collecting the right data, and running reports can help you make informed decisions about which suppliers should move up or down a tier based on their performance over time.

Ensure you gather information from multiple sources, such as customer surveys and financial statements, to get an accurate picture of each supplier's performance.

Creating Strategic Partnerships

Once you have categorized all of your suppliers into tiers, it's time to start creating strategic partnerships with them.

Tier 1 suppliers should be highly prioritized - focus on building strong relationships with these key partners so that you can get the best possible pricing and terms without sacrificing quality or delivery times.

For Tier 2 and 3 vendors, establish clear guidelines for working together but don't forget about them altogether - they may be able to provide valuable services at lower prices or with shorter lead times than Tier 1 vendors.

Understanding how to classify suppliers into different tiers is essential for effective procurement category management.

By understanding how each tier works and what criteria should be used for

assigning them, you'll be able to manage your supply chain better to ensure maximum efficiency and cost savings for your organization.

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