Stop wasting valuable time and energy on the wrong suppliers

Focus on the right suppliers, the right way
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About the authors

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Duie has more than 20 years of experience in IT consulting and business process outsourcing across multiple industries, from consumer packaged goods and manufacturing to energy and pharmaceuticals.

With a structured, analytical approach to solving risk-related challenges for companies and service providers alike, Duie works with global organizations to develop and implement all aspects of outsourcing management and governance, including organization design, process development, transition support, and relationship remediation.

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With a wide corporate IT background, Jerry brings an extensive range of experience to his engagements, from acting as a buyer of sourced services to helping companies on both the buy- and sell-side of sourcing services.

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Jerry is a member of KPMG’s Shared Services, Outsourcing Advisory (SSOA) practice specializing in ITO management, assessment/remediation, and sourcing strategies.
“Our smallest suppliers seem to take up an inordinate amount of management’s time. We need a smarter way to manage them.”

“We continue using some of our weakest suppliers just because they have relationships with our executives.”

“We tend to measure a supplier’s value by how much they reduce their prices to compete for our business—not the value they actually deliver to our business.”

“We have a handful of absolutely critical suppliers. We need a way to hedge that risk while incenting those same key suppliers to continue to invest in our business.”

Sound familiar? Today’s supplier managers are struggling with expanding portfolios that often contain three to five suppliers for every million dollars in purchases and include everything from commodity and niche product life cycle suppliers, to large consulting and IT service management contracts—even advanced robotic process automation software providers.

But while these portfolios have grown in size and complexity, the approach to handling supplier services hasn’t changed much. Cost-minded executives may prioritize the top 10 suppliers in terms of spend, but that approach may be at odds with the true business value of each supplier, or not fully reflect the depth of the relationship. Further, this approach may not align with the aspirations and capabilities of suppliers to achieve business objectives.

Among every company’s cadre of suppliers are those with the potential to deliver greater value if only given the path to become more of a strategic partner and less of a transactional provider. At the same time, the need for organizations to identify and cultivate these strategic supplier relationships cannot be met by conventional methodologies.

For years, traditional supplier management has included segmentation methods, which generate a typical 2x2 model focused on spend. Meanwhile, firms with extensive large services contracts have worked with relationship continuum theory, which describes how to interact with predominately strategic suppliers. These two approaches typically used in isolation tend to focus on select suppliers, with mixed results.

However, combining these methods creates a robust, fact-based supplier strategy that both leverages the most valuable partners while at the same time simplifying interactions with commodity suppliers.

The following strategy uses a refreshed combination of techniques for segmenting the supplier mix and applying logical conclusions in order to effectively managing the entire portfolio, and put an end to those common supplier manager complaints.
Key elements and methods of the combined strategy

Segmentation planning
Supplier scope
When planning a supplier segmentation effort, it is critical to focus on a workable portfolio of suppliers.

For example, your IT department most likely has hundreds of suppliers that provide everything from replacement parts to critical data analytics services. Including them all into the effort will be untenable, so limit the project to a manageable subset of suppliers. Consider including only your large services suppliers or suppliers for your most critical business functions.

The number of suppliers you choose to include will have a direct impact on the time it takes to successfully execute the strategy. Suppliers you don’t include in your segmentation planning are not ignored, but will be managed in a lighter, ad hoc fashion.
Keep in mind that the ultimate objective is to implement a supplier strategy that will be updated on a yearly basis.

Treat the development of the segmentation model as a distinct project with budget, timeline, resources, and deliverables.

Clearly define the objectives of the project to potential stakeholders.

Engage procurement, sourcing, and the VMO early in the project to secure their support and commitment.

Define what types of suppliers should be entered into the matrix—equipment suppliers, service suppliers, etc.

As you collect data about the suppliers, also document the names of the staff who are closest to the supplier—you will need their input and opinions to complete the model.
Data collection
Spend data
Begin your data collection process with a yearly supplier spend analysis. Understanding the range of spend across your chosen mix of suppliers will focus the scope of the effort and provide a basis for comparison. The spend analysis results also will assist in separating out the smallest suppliers while highlighting the largest contracts.

Business value
The best way to understand actual delivered value is to scrutinize the supplier’s impact to your critical business functions.

To assess each supplier, ask the question: “Do the supplier’s products or services directly help our business to be more competitive, to grow faster, or to increase operational effectiveness?” Business value also can be measured by the supplier’s ability to keep pace with your business needs while exceeding performance requirements.

Note that the business value you determine for a supplier may conflict with the value perceived by an internal customer with an intimate relationship with that supplier. Segmentation mistakes are made when practitioners rely solely on business input to determine value; instead, they must weigh the input against the above questions, and make a judgment call as needed. In some cases, escalation or executive consultation may be required to reach an effective business value rating.

Relationship complexity
Relationship complexity can be measured by the amount of time it takes to effectively work with the supplier and at what level the necessary interactions take place.

For instance, if the supplier provides a variety of products or services across multiple business lines, the relationship could be considered complex. Other measurements such as the type of service, contract complexity, and potential exit risk also can reflect relationship complexity.

Data analysis
The segmentation matrix
In order to facilitate the categorization of suppliers, many companies utilize a quadrant-based model that provides a visual reflection of supplier scoring data, measured against a weighted rating scale.

The following is an actual example of one company’s supplier segmentation model that leverages a customizable weighting schema based on data from a significant number of KPMG’s engagements to inform the supplier scoring. The supplier scoring is based on the above criteria for both business value and relationship complexity, and the yearly spend for each supplier is reflected by the size of the “bubble.”
Additionally, this matrix characterizes suppliers that fall into the scoring ranges. The typical supplier characterizations are defined as follows:

**Commodity**
Suppliers that typically provide a high volume of products and services that are only differentiated by cost

**Niche**
Suppliers that provide specialized products or services and may be engaged across the enterprise or by specific business units

**Major**
Suppliers that are engaged across the enterprise, providing critical operational functions

**Strategic**
Suppliers that are aligned to the business strategy. These suppliers share risk and are governed by senior executives on both sides of the relationship.

### Segmentation matrix – takeways & action items

1. **Note** that supplier spend should not be considered a component of relationship complexity as it does not necessarily reflect delivered business value.

2. When plotting the spend metric in the matrix, the total yearly spend on a particular supplier must be compared to that of other suppliers—not against a range that starts at zero. This exercise is about relativity to your other suppliers and not some absolute threshold.

3. The actual business value of a supplier may be perceived differently by key stakeholders so a judgment call may be required. However, you should be as consistent as possible.

4. Document the definitions of each measurement criteria in order to make them as fact-based and impartial as possible.

5. Be sure to get input from operational staff on the placement of the suppliers in the matrix; confer with the people who are most familiar with the supplier’s products or services.

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Supplier strategy development

The Relationship Continuum
At many clients, the traditional approach to managing suppliers stops at the segmentation model. In fact, it’s more nuanced than what the 2x2 shows.

Each type of supplier requires a different management approach depending on their placement in the matrix and, more importantly, in your company’s value chain. Accordingly, strategic suppliers will deliver more tangible business value if your management team works closely with the supplier’s account team and operations staff, developing a relationship.

On the other end of the spectrum, the commodity suppliers should not consume inordinate amounts of time to manage, thereby requiring a structured approach.

In order to provide context to this concept, the following framework can be applied. It’s called the relationship continuum and it breaks supplier management activities into three basic approaches: Transactional, Collaborative, and Partnership.
Suppliers that provide products or nonvariable services with static monthly service fees are usually considered transactional as they require limited oversight, have basic or no service levels, and thereby pose minimal risk to the client organization. These suppliers are usually managed by purchasing or a line manager.

Collaborative relationships
Suppliers that provide more critical products and services most often have more complex contract structures that feature variable fees based on utilization of services, and performance management mechanisms that may contain penalties for poor service. These relationships require additional effort to oversee monthly activities and changes; however, they also tend to produce more value due to the services they provide. Therefore, a more collaborative approach is recommended to drive value for both the supplier and the client business.

Partnership relationships
Partnership suppliers are those that maintain a critical role with the client through tight alignment with business functions, such that they really cease to be suppliers in the traditional sense. These relationships tend to be based on shared risk and reward between both parties and usually result from proven, long-term delivery of shared business value. It is safe to say that most organizations have relatively few true partnerships with their suppliers.
Combining segmentation and relationship approaches

A combined segmentation model and relationship continuum has been successfully implemented by multiple companies in a mix of industries when rationalizing their suppliers, either as part of a corporate action or just as good business practice.

Use of the combined approach in support of a comprehensive supplier strategy can help to:

- Enable consensus that supports the strategy
- Eliminate undeserved executive or departmental favoritism
- Reduce nonstrategic supplier management overhead
- Quickly identify areas for supplier performance improvement, and recognize success
- Understand tangible supplier business value
- Build stronger relationship with your key supplier partners.

The following shows how to develop a matrix that incorporates both segmentation and relationships.

**A new methodology**

From a supplier strategy perspective, the segmentation matrix can illustrate a supplier’s importance to your company, while the relationship continuum can be instructive as to how to work with those suppliers. When the segmentation matrix and the relationship continuum are combined, the matrix looks like this:
In building your strategy for each type of supplier and relationship, it helps to consider the people, processes and technology that are required.

**People**

Suppliers that typically provide a high volume of products and services that are only differentiated by cost.

**Processes**

Management processes vary widely as transactional suppliers may only require a yearly procurement review while partnership suppliers require almost daily activities at all levels of your organization. Shared methods of resolving issues and sharing innovative initiatives will support the delivery of value from critical suppliers.

**Technology**

From a technology standpoint, a partnership supplier may offer their own proprietary solutions, which may prove attractive but will increase the potential for supplier lock-in. Where there are multiple critical suppliers, the technology that supports critical relationships should be run and controlled by the client company.

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**Supplier strategy development - takeaways & action items**

1. **Plan to revisit the model at least every year**—updating your supplier portfolio and strategy to align to changing business needs and market conditions.

2. **Share the segmentation measurement criteria and the relationship continuum with your key suppliers** in order to provide them with guidance for collaboration and continuous improvement.

3. **Large suppliers often provide a broad spectrum of products and services**; for example, some could be rated as commodity and others as more strategic. In that case, simply split the supplier by category and rate each separately.

4. **Recognize that suppliers that fall between the transactional and collaborative bands in the relationship continuum may require increased planning time**, as managing them may fall between different parts of your organization (i.e., Procurement, Supplier Management, Operations, etc.).

5. **The model you build will most likely need to be adjusted to accommodate different types of suppliers or different measurement criteria**. Be prepared to update or improve the model as things change.

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Stop wasting valuable time and energy on the wrong suppliers.
Conclusion

Given changing demands on supplier managers and their increasing desire to extract greater value from their providers, the existing 2x2 and relationship continuum segmentation approaches are no longer as effective as they once were. Defining top suppliers by dollars spent doesn’t reflect the full value of the relationship, while time and resources are wasted on more commodity suppliers.

A data-driven strategy that combines the two segmentation methods is a solution for organizations with suppliers that run the gamut from transactional to collaborative and partners. By managing each type differently, supplier managers can not only draw exactly what they need out of them with maximum efficiency, but also build relationships with suppliers that can make a positive, long-term impact on the business.
KPMG has worked with companies across a wide range of industries to improve their supplier management processes through combining segmentation and relationship continuum approaches, as well as by implementing other models and strategies. Because of our extensive work with vendor management and other organizations, we can provide a customizable weighting schema based on our proprietary data for an even more accurate analysis.

In tandem with our hands-on service, we offer Spectrum Contract Performance Manager, a cloud-based intelligence engine that helps organizations more efficiently oversee vendor relationships, with data-driven insights into supplier performance against expectations.

We look forward to working with you to create an exceptional supplier management strategy. For more information, please contact Duie Block at 314-504-5445, or wbblock@kpmg.com.