Defining Customer Boundaries:

The First step in Customer Portfolio Management

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ABSTRACT

In this paper we focus on the relationships between a supplier and its customers through an analysis of customer portfolio methods. Indeed, several methods of customer portfolio management have been proposed in the literature for fifteen years. These methods present some strong similarities, namely the choice of two distinct dimensions, choice of different criteria qualifying those dimensions, and use of a matrix representation. But, one of the problems when using these methods, remains the choice of the relevant customer unit boundary to be taken into account. In the case of industrial groups with complex decision making process, the definition of the relevant unit of analysis is not obvious.

This complexity makes it difficult to undertake a customer portfolio analysis. Indeed, on which entity (or customer level) must the analysis be carried out? For instance, organizational complexity often means a geographical multi-location: in this case which "part" of the customer must we consider to build up the customer portfolio? Is it the central level (e.g. the headquarters)? Is it the whole set of sites? Is it only part of these sites?

Three firm cases are presented. They lead us to highlight that the characteristics of the buying decision process in the customer organization and the characteristics of the supplier organization both influence the delimitation of the customer unit boundary. Finally we make an attempt to include the definition of customer unit boundary within existing customer portfolio methods.
INTRODUCTION

In the last 15 years or so, different methods of customer portfolio management have been developed aiming at managing in a differentiated way supplier-customer relationships. These methods point out the recognition of the relationships heterogeneity a firm has with its customers, and the various contributions these relationships have on the development and creation of a firm's resources (Fiocca 1982; Cunningham and Homse 1982; Campbell and Cunningham 1983; Dubinsky and Ingram 1984; Dubinsky 1986; Turnbull and Valla 1986; Yorke 1986; Yorke and Droussiotis 1993; Salle et Rost 1993). All these approaches are part of a theoretical and managerial trend to focus on the management of customer-supplier relationships this latter being integrated in a wider context of business networks.

One can find many similarities between the different customer portfolio management methods (the same is true for activities portfolio used in strategic management). Usually, these methods are based on the definition of two independent and discriminant dimensions each composed of several criteria. Some of these methods specify measurement modes for different criteria. Lastly, all these methods use a matrix to position customers and then define strategic choices and resource allocation methods.

So, we cope with a set of relatively homogeneous approaches regarding their objectives and the methods used. However, the issue of the unit of analysis (the customer), which should be a crucial point in customer portfolio method, is rarely investigated. Implicitly the customer unit seems to be an obvious reality easy to grasp, self defined, and well delimited. So, is the customer a multinational company composed of many more or less independent subsidiaries? Is it an industrial group at once including production plants and administrative sites spread within a given geographical area? Is the customer a branch or simply a production plant of this group?

The topical development of outsourcing, leads to consider firms at once as incorporated in a complex network of connected organizations and themselves as complex internal networks. As a consequence, this view complicates the definition of the relevant customer unit to choose. This statement may be linked to the debate on firm boundaries. This debate is present in disciplines such as sociology or economics. Due to research developments in business networks, this issue has also appeared frequently in management disciplines. Moreover, one can notice that the concept of firm boundaries doesn't cover the same reality among these different disciplines. In customer portfolio approaches, this issue seems to use to be worth researching and exploring in practice.
In this paper our objective is to tackle the issue of customer unit definition in order to draw some useful managerial implications. In the first part of the paper we briefly summarize the customer portfolio literature, putting special emphasis on how the customer unit boundary is regarded. Then, we present three situations in which firms face difficulties to delimit the relevant customer boundary and as a consequence have to cope with the difficulties of implementing different strategic orientations. Finally, we reinstate the definition of customer boundary as the first step in existing customer portfolio methods.

**LITERATURE REVIEW**

This section has two objectives. On the one hand it summarizes the main characteristics of customer portfolio literature. On the other hand it emphasizes how the customer unit boundary is taken into account.

Cunningham and Homse (1982) do not directly stress the customer unit boundary issue as such. In the customer portfolio approach they detail a symmetrical issue: what is the relevant level of aggregation to consider within the supplier organization. These authors stress that: "One of the difficulties of the customer portfolio concept is to determine the level of product aggregation to which it should be applied. Should there be a balance of customers for individual products or is the unit of analysis the product group or even the company as a whole possibly including several quite different areas? (Cunningham and Homse 1982, p. 332)". It seems to us that this issue is strongly related to the customer unit boundary issue as much as one can condition the other and vice versa. So the questions stated in a customer perspective in the introduction can be applied from a supplier perspective. In a supplier customer relationship, the initial choice of the organizational level within the supplier (e.g.: group level, branch level, subsidiary level, production plant level) can determine the customer unit boundary (e.g.: group level, branch level, subsidiary level, production plant level).

Fiocca (1982) suggests a two step method. The first step consists in the identification of the key customers analysed on a set of criteria, and grouped in a two dimensional matrix: strategic importance of the account and difficulty in managing the account. The second step focuses on each key account which is analyzed on the bases of the unit: supplier product/customer use. The units then are positioned on a two dimensional matrix: customer business attractiveness, relative buyer/seller relationship. According to the specific positions the author suggests a set of orientations. Concerning the customer unit boundary Fiocca states: "Since the customer becomes the core of the analysis in industrial
marketing, it can be convenient for the selling company to divide its business among accounts, rather than among products or product lines. In so doing the selling company should always consider that each account must be a homogeneous entity and must be meaningful from a quantitative point of view. As a rule each account fits in with one company, that is, with a buying company. However, when the buying company is very diversified and centralized purchasing operations are not used it can be more useful for the selling company to deal with the divisions as a single account (Fiocca 1982, p. 54). The author highlights customer organization complexity as the factor conditioning the definition of the relevant customer unit boundary. Fiocca (1982) adds: "Often the selling company sells three different products to the same customer (i.e. to the same account) it is likely that there exist three different relationships, perhaps of different strength, each one based on one product. In these cases the measurement of the strength of the relationships must be arranged separately (Fiocca 1982, p. 58)."

Campbell and Cunningham (1983), propose a three step approach similar to the one suggested by Fiocca. In the first step customers are distributed on a life cycle classification basis. In the second step the authors take into account the competitive dimension to assess customers. The last step, dedicated to the selected key accounts is very similar to Fiocca's approach.

Due to the complexity of key account organizations (several subunits), Campbell and Cunningham (1983) argue: "a more detailed breakdown is needed where the customer is split up into a series of subcustomers". They add: "the most important and largest customers are then subjected to a further analysis of the component parts to ensure that the overall relationship with the customer is being managed satisfactorily (Campbell and Cunningham 1983, p. 135). In the resulting customer portfolio matrix the authors suggest to put subcustomers considered as separate business.

In a research publication on customer portfolio management, Rost (1988) notes that "The basic issue concerns the unit of analysis". She adds "in certain cases, the supplier does not cope with a unique organization, but with several organizations interacting among themselves". She concludes: "in an analytical or resources allocation perspective, what is the relevant unit: the customer or the connected network ? (Rost 1988, p. 44)."

In the work of Dubinsky (1986), specifically dedicated to the use of sale forces, no reference is made to the characteristics of the customer unit. The same comments can be done regarding the articles of Yorke (Yorke 1984, 1986; Yorke and Droussiotis 1993), Turnbull and Valla (1986), Salle and Rost (1993).
To conclude this brief literature review about customer portfolio management, one can say that the issue of delimitation of customer unit boundary has rarely been mentioned. A double perspective seems to condition the choice of customer unit boundary: a supplier and a customer perspective (Fiocca 1982; Campbell and Cunningham 1983). However, the issue of defining the customer unit boundary in the methods of customer portfolio management appears an essential first step. This initial definition actually conditions the following steps within the approaches quoted in the literature review.

In the next part, we present three case studies which aim on the one hand to illustrate the inherent difficulties in defining the relevant customer unit boundary and on the other hand to emphasize the main factors that one has to check initially before dealing with customer portfolio management.

**CASE STUDIES: PRESENTATION**

**Firm A:**

Firm A produces cardboard packaging boxes used by several customers industries and especially by the food industry which represents an important part of C's turnover. A is the subsidiary of a group in the paper industry. A is organized in four regions, each of them dealing with a part of France. Each region is a profit center managed by a Regional Manager who benefits from large autonomy in decision making. The region has its own sales department and its own factory. The region's customers are located 150 km within an area around the factory. Consequently, the customer portfolio analysis is conducted on the basis of this geographical perspective. A's customers are companies or production plants belonging to industrial groups and regionally located, as well as regional firms of different sizes.

In order to manage relationships with these customers, the sale force is allocated according to the importance of each account. Senior salesmen deal with high potential customers; younger and less qualified salesmen cope with the numerous customers with lower potentials. In each region, strategy results from the nature of the regional market structure, the type of competition and the characteristics and the choices of the regional management.

For these reasons, the four regions have different approaches to their geographical zones and the role of the Head Office is relatively limited, due to the nature of production
processes, or the Regional Manager's behavior aiming at protecting his autonomy. Exchanges between regions and specifically productions between two or several regions (an order taken in a region then produced in the production plant of another region) are very limited. Until recently all attempts to coordinate actions between regions which come from the Head Office, were perceived as interference. Recently (no more than two years) several industrial groups in the food industry concentrated on merging firms, and centralized their purchases at a national or European level. They aimed at rationalizing packaging purchasing, reducing the number of suppliers used, and negotiating in a better position. In doing so, they aimed to reduce costs and increase profitability. In fact A's customers face hard negotiations with their own customers. To cope with the new purchasing strategy of food industry firms some suppliers in the paper industry, proposed to set up plants dedicated to one particular customer such as Nestlé or Danone.

These evolutions in customer purchasing strategy caused a loss of customers in each of firm's A regions. Indeed, in spite of having a high customer share in a regional company belonging to a group, A was not always selected, because of its relatively weak position at a group global level. These evolutions which changed the customer portfolio structure at both a regional and global levels lead firm A to implement different actions.

First of all, a key account function was created. It is located at A's Head Office. It dealt with industrial groups which centralize their purchases at a French or European level, and with these which could centralize later on. In this case the key account management function monitors the evolution of customer decision processes and purchasing strategies.

In each region salesmen directly manage relationships with companies and plants belonging to different groups. They also are involved in global coordination with the key account management function which acts as a support function. The evolution to a central coordination highlights the new customer boundaries firm A takes into account. This new approach takes time to be effectively implemented. Indeed, in some regions the profit centre perspective and power game between the Regional Manager and the Head Office, lead sometime to invest more within relationships with regional customers having high profitability, than within relationships with regional company belonging to group with which firm A negotiated a global agreement. In fact taking the region's point of view global agreements appear much more interesting at firm A level than at regional level.
Firm B:

This firm produces and distributes energy on the national territory to a very wide range of consumers from private individuals to firms. B has the monopoly for the distribution of electricity, it has always had very close links with the French State and acts both as a private actor (because of its production means) and as a public agency (as it must provide energy wherever it is asked to).

Firm B is composed of four divisions: Research and Development Division; Engineering Division (which designs electrical plants); Production and Transportation Division and Distribution Division.

The Production and Transportation Division is organized among fourteen Energy Units spread over the national territory. The Energy Units gather all the means necessary for electricity production and transportation as well as a small sales and quality department. They deal with every plant consuming high voltage current and high quantities. Most often, they belong to industrial groups. Distribution Division deals with medium and low voltage current used by some medium and small size companies and with individual customers.

Within the B's customers portfolio there are about 100 very large groups representing more than 500 industrial or administrative sites which are directly managed by Production and Transportation Division. This 100 large firms represent approximately 30% of the B's total turnover. These very large customers are more or less the biggest firms in France. They are both important because of the volume they buy, but also because the image they have: they are prestigious firms and they have a strong weight in the French economic life. But above all they are complex organizations. Most of them are geographically scattered across the whole French territory, or even internationally.

These 100 customers, known to be B's major accounts, because of their special importance, are managed in a very specific way by B. Thus, a department of 20 persons has been dedicated to the management of the relations of these customers: the Major Accounts Department (M.A.D.). This department depends on B's central staff. They are especially in charge of the promotion of new processes using electricity. They also have a good knowledge of what's happening in the industries the major accounts belong to. Nevertheless, the agreement concerning electricity delivery is set up directly between the Energy Units and the customer plant or local site (with a more or less centralisation from the customers' headquarters).
Within B, the rule is that one energy supplying contract must be directly established with each plant or each consuming site by the nearest Energy Unit. The Production and Transportation conditions are not similar from one Energy Unit to another, for instance it depends on the territorial setting up of production means such as nuclear, thermal or hydroelectric plants which condition the ability to easy deliver or not. As a consequence, electricity rates are not the same for all the sites even belonging to a same group.

These organizational specificities are directly linked with the representation each of the partners (energy supplier on the one hand and the group consumer on the other hand) has of its counterpart.

First of all, especially when energy purchases are centralised, customer groups are willing to ask to be treated as a global and unique unit. Same rates applied to all sites allow, for instance, financial comparisons; and an homogeneous treatment of all sites is one way to avoid worthless internal competition. But these customers' demand cannot be met by B. The problem is all the more important when M.A.D.'s sales Engineers are working on a customer group global view, and are not allowed to provide an homogeneous treatment.

Secondly, some sites belonging to customer groups consume low quantity of electricity of medium and low voltage current and consequently they are managed neither by the Energy Unit nor by the M.A.D. They are directly managed by the Distribution Division. Available resources in the Distribution Division (specifically technical and financial supports) are not at all the same compared to the ones of Production and Transportation Division. Some groups do not accept to have part of their plants treated in a way and another part treated in an other way.

Firm C

Firm C is the subsidiary of an international French group in the telecommunication industry. C's activities are centered on computer support services to industrial groups. C's offering is large and requires different level of knowhow. To summarize one can say that C's offering includes four types of services:

Consultancy in the organization and architecture of information system and private telecommunication networks. These services are delivered by high qualified specialists attached to the Consultancy Division in C. This kind of consultancy often implies high level contacts within the customer organization at the Head Office and
centralized department as well as companies sites belonging to industrial groups. Most often, contacts are personalised.

- Engineering of data processing projects for a customer. The customer outsources the whole project implementation to a service company (turn key project). The project are different in size, in complexity and in cost. Consequently, the customer decision process changes according to these characteristics.

- IT manpower contracting. The customer includes these people within their own team dedicated to a particular project. In this case, the customer himself manages the project. It uses the service company to gain access to specialists which are not available within its organization. In industrial customer groups, the buying decision is located within companies or sites. Central departments are rarely involved in these decisions.

- Off the shelf products. It consists in prepackaged solutions dedicated to given applications. Generally these solutions include standard software and hardware, installation by the service company and maintenance contract.

C's organization is composed of several agencies over France. Each agency is a profit centre which is relatively autonomous. Each agency has to achieve objectives within a defined strategic framework defined by the Head Office in Paris. This strategic framework consists of technological and individual sector orientations. An agency generally includes 30 to 100 people, most of them being involved in service delivery in customer computer departments.

Specialized Divisions have been created for two years: Consultancy Division, System Integration Division, Products Division. They are located at the Head Office. They mainly act as support Divisions to agencies, specifically dedicated to complex and high price customer projects. In fact these divisions are internal resources at the agency's disposal. The creation of these divisions aims at clarifying and organizing C's offering. In fact the agencies have developed relationships at a regional level with the companies on sites belonging to industrial groups. To do that, they have used their own resources, that is to say offering mainly bases on IT manpower contracting and engineering of data processing for small projects. This behaviour results from the C's history, formed by the merge of numerous small services companies regionally located, in order to quickly reach a critical size. In this case, the customer unit boundary is defined according to the limitation the agencies choose to have, both taking into account the nature of the customer decision process and the characteristic of the agency's know-how.
C's customer portfolio analysis highlighted that the majority of C's turnover resulted from about 20 industrial groups. However most of the companies and sites were treated independently by each of C's agencies. So the decision was taken to consider each industrial group as a whole, in order to improve efficiency. This approach could allow C to better use previous relationship investments and to better manage the development within customer groups. The widening of C's offering aimed on the one hand at gaining access to higher levels in customer organization (specifically centralized departments which are involved in important decisions) and on the other hand, at proposing new developments to the customer. In particular, the creation of Consultancy Division aimed at earlier providing informations on forthcoming customer projects and then involving agencies and other divisions.

In this new organization, the customer unit is regarded at a global level within C. Implementation of this new approach is not easy. Actually, when transactions are of limited size, the agencies are able to do it on their own. Sometimes, competition between the agencies level and division level takes place. The agencies try to use their own resources (mainly people) to avoid resorting to the resources divisions for help. Faced with this behaviour, divisions try to develop their own customer portfolio as a profit centre. Sometimes, customers are the same which leads to unavoidable conflicts between agencies and divisions.

Recently, a central commercial department has been created at the Head Office. It includes the marketing function and key account managers. The latter are in charge of information coordination between agencies and they mainly develop contacts with centralized departments in customers Head Offices. Relationships they have with agencies are sometimes strained. Due to their profit centre perspective, agencies manage thier customers using a local approach, while the key account managers try to widen their view to the global customer group in order to increase C's business. Taking the agency's point of view it is obvious to invest in relationship with a company or a site belonging to a customer group if the return of investment is not directly tied to the agency's results.

CASE STUDIES: CONCLUSIONS

The 3 cases A, B, C stress the fact that the definition of the relevant customer unit boundary does not emerge as a result of an obvious, simple and mechanistic approach. Taking a supplier perspective, this definition constitutes an important step because it determines the
whole management of the relationships with the customer, implemented by the supplier. In these cases, this definition results from a customer perspective and a supplier perspective, both being interdependent. The characteristics of the customer's decision process together with what the supplier sells, allows us to define the customer unit boundary. So, in the case of firm A some industrial group customers centralize their purchasing decisions at a national or European level, others groups do not centralize at all. Having products, that are not easily differentiable (cardboard packaging boxes), that is to say having few possibilities to be fundamentally and quickly altered (by opposition to what firm C can do) leads A to conform to the characteristics of the customer decision process. Consequently, dealing with its customer portfolio, firm A copes at once with industrial groups as unique customer units (in this case the customer decision process is centralized) and with several independent customer units. The fact that customers which do not centralize their purchases but, could in all likelihood do it, leads firm A to put an emphasis on scanning customer buying units to detect signs of impending changes. Firm A and firm C cases shows that factors related to the supplier itself also influence the definition of the customer unit boundary. The way the supplier organization works is an important factor to take into account. Because firm A and C are organized as profit centres (Regional profit centre in firm A and agencies as profit centres in the case of firm C) managers define their strategy in this limited framework in order to achieve their objectives defined by top management. The consequence is that they rather define the relevant customer unit according to these constraints, most often in a limited sense. Faced with industrial groups which centralize their purchases, firm A may choose among two alternative solutions:

- Either to consider each industrial group as the relevant customer unit composed of an internal network of connected actors. In this case the supplier has to coordinate its actions through key account managers for instance. It is what firm A attempts to do.

- Or to refuse to adapt to this customer decision process, accepting a likely decrease of business with these industrial groups. In this case the supplier targets customers whose purchasing decisions are located at a regional level. This leads firm A to mainly focus on industrial groups with decentralized purchasing decisions and regional customers. To firm A, this alternative is a risky one because on the one hand some industrial groups could coordinate and centralize their purchases and on the other hand industry concentration could work against this strategy. Indeed, some regional, middle size, independent customers might be merging with larger industrial groups.

Firm B case illustrates the supplier refusal to adapt to the characteristics of customer decision process. B faces industrial groups which would live to coordinate and centralize electricity purchases. B avoids unique and centralized negotiation using both global
agreement dealing with new developments and specific local agreement according to the characteristics and the location of electricity plants. In this case, the supplier imposes its own definition of customer unit boundary on its customers. The monopolistic position of B allows it to have such a practice.

In the case of firm C, we pointed out the consequences of the behaviour of the profit centre managers (in the agencies) on the strategic orientations of the firm. At their level, agencies try to control the interaction with customers restricting the exchanges process to the skills they directly control. This behaviour aims to avoid the possibility of being faced with customer purchasing decisions which exceed the customer boundaries as defined by the agencies. The development of a key account management function allows firm C to coordinate its actions and to interact with industrial groups considered as a set of interdependent connected actors. This function can be viewed as a means used by top management to control its internal network. In the case of firm C, the characteristics of its offering facilitates an integrated approach in as much as its allows C to develop exchanges at different levels its customer industrial groups.

As a consequence, it appears that the customer unit boundary as well as the supplier unit emerges from the interaction between the two organizations considered as two networks. This emergence confirms the recognition by each organization of its counterpart's identity. As stated by Hakansson and Snehota (1995): "(Companies) must be perceived by others as a distinct, intelligible entity; a company has to acquire the identity (the meaning) of an actor in the eyes of others without being attributed an identity it will not attract the interest and resources it needs, nor will it elicit action from others. It will then fall apart and cease to exist. Companies are actors because they are attributed the identity of an actor by those who interact with the company. In this perspective, bonds between actors become important as they are critical in shaping the identities of the actors. The identity is not simply a product of features or characteristics of the actors but of interpretation by other (Hakansson and Snehota 1995, p. 195)."

**MANAGEMENT IMPLICATIONS:**

**CONSEQUENCES ON CUSTOMER PORTFOLIO MANAGEMENT APPROACHES**

The definition of the relevant customer unit boundary seems to us to be the compulsory first step before using methods we presented in the literature review section. Indeed this step then determines further steps: choice of criteria, definition of measurement scales, definition of relevant actions related to a given customer account. We suggest a global
approach including this first step of defining the customer unit, which takes into account conclusions we derived from the 3 firm cases.

The approach includes six steps that we detail. Steps 3, 4, 5, 6 are identical to those proposed to different authors quoted in the literature review. Step 0 and 2 complement these approaches adding on the definition of the relevant customer unit to take into account in the customer portfolio.

**Step 0**: Definition of the relevant decision unit within the supplier organization which conduct the analysis. Here the objective is to first define a decision unit within the supplier organization as a starting point in the analysis. Doing that, we both condition the definition of the customer unit (box 0, table 1) and conversely these definition influence the choice of the relevant decision unit within the supplier. These definition has to take into account the supplier's strategic choices (box 0, table 1). The C case illustrates this trade off:

\[ 4 \rightarrow 1 \rightarrow 2 \]

The development of C's offering (corresponding to C' strategic choices) allows C to interact with industrial groups as an integrated supplier and not through independent subunits (the agencies).

**Step 2**: Analysis of the purchasing decision process within the customer organization taking into account the characteristics of the supplier offering. This step aims at defining the relevant customer unit. As indicated previously this definition results from several iterations and does not emerge as such. In certain cases this definition is simple (as in the case of firm A) but it is not always the same, particularly when customers are public agencies or multinational firms.

**Step 3**: Analysis of the dynamics of the supplier customer relationship. This step is similar to those used in almost all approaches presented in the literature review section. All the authors named this dimension in different way e.g. relative buyer-seller relationship in Flocca (1992), life cycle classification in Campbell and Cunningham (1993), relationship vulnerability in Salle and Rost (1993). In step 3 one has to define on the one hand, the criteria constituting the dynamics of the supplier customer relationship dimension and on the other hand the measurement scales.
Step 9: The nature of supplier strategic choices conditions both the definition of attractiveness criteria and the measurement scales. All the approaches quoted in the literature review section take into account this dimension including similar criteria. Then, step 5 and 8 are similar to those included in approaches quoted in the bibliography part.

CONCLUSION

In this paper we focused on the relationships between a supplier and its customers. We have stressed the difficulties inherent in customer portfolio approach which does not only come from the determination of relevant dimensions of analysis including choice of criteria and definition of measurement scales. In our opinion the main difficulty in this approach relates to the issue of defining what a customer is. The numerous developments in business network approaches taking into account interdependencies between actors outside as well as within the organization lead to questions about firm boundaries. If a firm is conceived as a network embedded in a larger network, the relevant issue is how to determine these boundaries.

So, in the different customer portfolio approaches quoted in the literature review section, the main problem comes from the lack of definition of the customer unit boundary, particularly when the customer is a complex organization. The analysis of 3 firm case studies highlighted the issue of the definition of the relevant customer unit and allowed us to reincorporate this step in the customer portfolio approaches quoted in the literature review section.
TABLE 1: CUSTOMER PORTFOLIO METHOD

1. Definition of the relevant decision unit within the supplier organization which conducts the analysis

Choice of the decision unit from a supplier point of view

2. Analysis of the purchasing decision process in the customer organization taking into account the characteristics of the supplier offering

Definition of the relevant customer unit

3. Analysis of the dynamics of the supplier customer relationships

Choice of the relevant dimensions of supplier customer relationship criteria. measurement scales

4. Supplier strategic choices

Definition of attractiveness criteria. measurement scales

5. Customer portfolio matrix and definition of actions according to the position of each account in the matrix

6. Implementation for each account