

## Importance of Tier 1 And Tier 2 Programs

By Richard J. Hernández, CPCM

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**INTRODUCTION.** Supply chain management can involve several layers of suppliers. For example, a major corporation may have several thousands of suppliers in hundreds of product & service areas, not to forget multiple geographic regions. This means supplier diversity programs must also operate at several levels. Technology and the gradual movement toward a global economy are changing the shape and nature of the supply chain to a more streamlined and less-layered form. The change is impacting minority- and women-owned businesses (M/WBEs). To remain effective, supplier diversity must adapt to these changes.

**DEFINITIONS.** Corporate and government supplier diversity program typically define the terms as indicated below:

- Tier 1 (Prime Supplier) Submits invoices to the final customer, e.g., major corporation or government agency.
- Tier 2 (Subcontractor) Submits invoices to the prime supplier.
- Minority Business Enterprise (MBE). At least 51 percent unconditionally owned by one or more socially and economically disadvantaged individuals.
- Woman Business Enterprise (WBE). At least 51% owned by one or more women; or, in the case of any publicly owned business, at least 51% of the stock of which is owned by one or more women; and whose management and daily business operations are controlled by one or more women.

A footnote to the tier 2 definition involves the terms “direct” and “indirect”. Direct refers to those dollars that can be linked directly to a task or deliverable for the tier 1 supplier. For example, a tier 2 MBE firm performs a research study to provide to the tier 1 suppliers. Indirect refers to those dollars that cannot be linked to a specific task or deliverable. For example, a tier 2 WBE firm performs custodial services for at a tier 1 supplier’s facility that supports several clients. Some buying organizations only count M/WBE “direct” tier 2 dollars. Others use a formula to take credit for indirect dollars. Indirect allocations are commonly used. However, care must be taken to ensure no “double counting” occurs, i.e., where two buying organizations count the same M/WBE tier 2 spend.

Subcontracting plans can also apply to other groups such as Historically Underutilized Business (HUB) zones (i.e., a small business concern that appears on the List of Qualified HUBZone Small Business Enterprises maintained by the SBA) and disabled veteran business enterprises.

**GROWING ROLE OF TIER 2 PROGRAMS.** M/WBE traditionally could perform as a tier 1 supplier for low-level contracts. However, the increased trend toward contract “bundling” or combining of purchasing requirements has raised the barriers to entry. Bundling has been pursued

**CUSTOMER REQUIREMENTS.** For government contracts, Part 19 of the Federal Acquisition Regulation (FAR) provides a comprehensive set of requirements for M/WBE subcontracting for contracts valued at \$500,000 and up. The FAR requires tier 1 suppliers provide a subcontracting which provides a breakout of

- which proposed subcontractors are MBE and WBE
- anticipated dollar spend for each M/WBE subcontractor
- the type of work each M/WBE subcontractor will perform

If not addressed in bid or proposal then a tier 1 supplier's offer could be deemed non-responsive. This eliminates them from any further consideration.

In selected instances, the FAR allows large business tier 1 suppliers to submit a "blanket" subcontracting plan. This helps where large number of similar subcontracts are involved.

**BEST PRACTICES.** There are several best practices associated with tier 1 and 2 programs. They are:

- Benchmarking. Reviewing historical use of M/WBE suppliers to determine what types and level of goals should be used.
- Pre-Sourcing. Determining potential areas for M/WBE participation and locating potential suppliers to meet them.
- Multi-Year. Using multi-year contracts allows M/WBE firms to make the necessary investments in staff, technology and infrastructure. This helps them move from tier 2 to tier 1.
- Award Fee. The FAR allows the use of award fee contracts to provide flexible and targeted incentives to tier 1 suppliers. Increased and non-traditional use of M/WBE subcontractors could be an award fee factor.
- Mentor-Protégé. Some government agencies have programs where their tier 1 suppliers can provide targeted assistance to their tier 2 suppliers. In the corporate world, this is referred to as supplier development or mentoring.
- Administration. Assigning someone to be review tier 1 subcontracting plans and their performance during the term of the contract helps ensure actual results are achieved.

Tier 1 suppliers who cannot meet all buying agency tier 2 goals, may seek to phased subcontracting plan. This allows them to mobilize a tier 2 program and gradually improve their performance.

**SUMMARY.** Subcontracting programs are becoming more important since fewer tier 1 opportunities exist due to contract bundling. Having an effective tier 2 program can help improve a prime supplier's competitive position since it can be a tie-breaking factor. Success in supplier diversity is no accident. It requires planning and creativity to ensure success.

**FOR ADDITIONAL INFORMATION.** Please contact the author at:

Richard J. Hernández, CPCM  
E-MBE.net  
P.O. Box 617995  
Chicago, IL 60661  
312-404-2224  
[rhernandez@e-mbe.net](mailto:rhernandez@e-mbe.net)  
[www.e-mbe.net](http://www.e-mbe.net)

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