

Category Management

Intelligent use of good management information is a key driver of business success. Category management is seen as a methodology and process for systematically managing the goods and services procured by an organisation

CIPS have developed a practice guide recognising the importance of category management within business. The paper considers the various methods of segregating goods and services, making use of case studies. Factors to consider when implementing category management are also suggested. The following highlights some of the aspects of the practice guide.

Background to Category Management

The first five years of this decade have confirmed what many have thought; that in the modern global business environment, technology is being used as an enabler to deliver increasingly sophisticated products to customers.

Due to changing business dynamics, there has been an increasing use of allocating goods and services to buyers. Global research organisations, such as the Aberdeen Group¹ apply their Total Cost Management (TCM) frameworks to all categories of spend. Their research shows that “companies are turning to category management strategies, combining standard sourcing and compliance procedures with process automation and improved data management and spend analytics to holistically manage the total costs of a good or service and its associated supplier relationships”². Important benefits generated include the standardisation of specifications and processes and the aggregation of demand (which is discussed in greater detail).

Category management often refers to the methodology by which this ‘portfolio buying’ approach is put into practice. It is usually defined by a number of clearly defined stages or sequences of activities. Within a strategic procurement framework, for maximum effectiveness, category management should be a continuous and embedded process, and yet demonstrate the agility to meet the demands of a dynamic supply market and business.

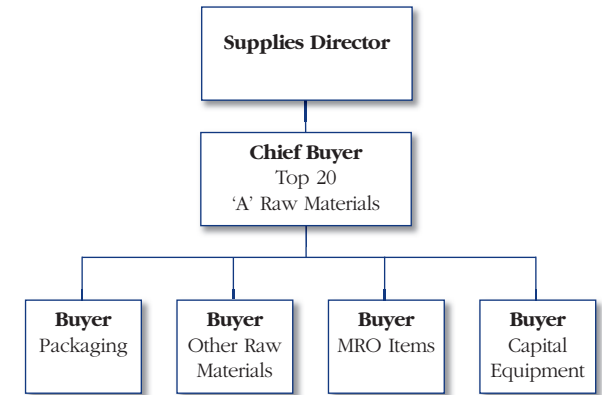
The process flow would include the following stages:

- Stage 1:** Developing a thorough understanding of third party spend and future demand
- Stage 2:** Segmenting spend into market sectors
- Stage 3:** Developing market sector strategies
- Stage 4:** Supplier selection
- Stage 5:** Supplier performance management, including strategic supplier partnering.

Effective strategic category management will be embedded within the complete procurement/supply chain management process chain, with the involvement of the category management team right through to an evaluation of supplier performance. To maintain the effectiveness of the process, feedback would be generated and fed back into the earlier stages of the supply chain.

The strategic activities that have been described are applicable to both the supply of goods and services. They will vary by business sector and the markets they serve. In the public sector within the United Kingdom, the methodology forms part of the OGC Gateway™ Process³. Figure 1 applies the supply chain methodology framework in a manufacturing context, which is then drilled-down to the micro-level to provide the basis of the first case study (procurement at Rolls-Royce Aerospace in Derby, UK).

Figure 1: Typical commodity based organisational structure (drawn from the manufacturing sector).



Case Study 1: Category Management and Rolls-Royce Aerospace

Rolls-Royce Aerospace is a global provider of power systems solutions. This table has been adapted from the original document, and is illustrative of the categorisation of machined forged material procured by the Machining and Components division in the Procurement Department. Each category of material has a unique material code and ‘Concept Code’ allocated to it.

| Material code | Concept Code | Description |
|---------------|--------------|---|
| 191339101 | M1L | Machined Forging Other Met Irregular shape 0-75mm cube |
| 191339202 | M1M | Machined Forging Other Met Irregular shape >75 - 250 mm cube. |
| 191339303 | M1N | Machined Forging Other Met Irregular shape >250 - 550mm cube |
| 191339414 | M6O | Machined Forging Other Met Irregular shape >550 - 750mm cube |
| 191339435 | M6P | Machined Forging Other Met Irregular shape > 750 - 1500 mm cube |
| 191339436 | M6Q | Machined Forging Other Met Irregular shape > 1500 mm cube |

In this example, category management has enabled the following:

1. The product commodity/category

As part of the order fulfilment process, generation of the customer order sets in motion a series of processes including generation of a 'bill of materials'. This is a list of all the assemblies and sub-assemblies required to make the product for the customer.

As each commodity has been allocated a 'Concept Code', management information is generated detailing:

- The quantity of the material required for production
- The type of material required.

2. Assessing the supply situation

Information from all the material codes will help in the assessment of the supply situation. Potential issues affecting delivery of the product can be identified at an early stage and resolved.

Rolls-Royce plc is typical of companies who source globally. Commodities may be managed by an international sourcing team, with the lead buyer being based in the United Kingdom, and the support buyer located in the USA.

3. Determining the Spend/Value of the Commodity

Spend analysis will generate business critical information enabling the organisation to compete more effectively in the marketplace. Typical information of value that is collected will give visibility to:

- The type of commodity being bought
- From which suppliers, under what contract terms
- For what duration and over what frequency.

Knowing and understanding the cost drivers enables resources to be allocated against activities, and supply chain process improvements to be developed, implemented and monitored.

The company has been able to take advantage of the benefits of scale generated by using category management. The aim is to sustain and enhance customer service level agreements, thereby generating greater value for the customer. This is particularly important in a retailing environment, which forms the basis of the second case study.

4. Aiding the business process

Category management may also lead to simplification of the management process. Management information generated on operational efficiency is used to assess the effectiveness of departmental and organisational strategy. Category management may enable some or all of the following:

- Pareto/ABC analysis
- Supply positioning/portfolio analysis
- Evaluation of suppliers' performance, as part of a way of managing the market.
- The general identification of future product development (based on real time information of what is selling and what is not).

5. Category Management as a means of generating specialist skills amongst the procurement workforce.

The increasing sophistication of the procurement business discipline has led to the requirement for specialised competencies. The use of category management in the retail environment is a good example of this.

6. Category Management to aggregate knowledge within the category

There is also a benefit in terms of aggregating knowledge within the category to applying consistency and focus to the category. For example 'consultancy services' would be a part of 'professional services', but could be further sub-divided into 'legal services'.

The Benefits of Category Management

The CIPS Supply Chain Group identified several benefits gained by aggregating the procurement of similar goods and services. The most obvious of these are using category management according to the different modes of segregation.

In the context of this dynamic economic environment, category management is increasingly used within the procurement environment. Aggregating the procurement of similar goods and services creates a number of benefits. These include:

- demand or supply side scale benefits,
 - simplification of the management process,
 - benefits of taking advantage of synergies within categories.
- For example, a category covering 'containers' instead of 'glass' would focus the attention of the person managing the commodity to the various substitution benefits of moving from 'glass', and maybe leverage information in terms of filling technology. Further downstream in the supply chain, the possibility may exist of shared distribution and logistics.

Implementing Category Management

The CIPS Supply Chain Group has identified a number of factors that should be taken into consideration prior to and during the implementation phase. These include, but are not limited to:

- Conducting a pareto analysis to ensure the correct commodities are targeted first.
- Ensuring that a managed internal and external communication process is in place
- Linking category management to strategic sourcing and the wider corporate strategy.
- Involving the use of cross-functional teams
- Using appropriate information technology to manage the categories
- Bearing in mind that a change in business direction will impact on the sourcing strategy.

Conclusion

CIPS believe that the effective Category Management can enable organisations across business sectors to gain competitive advantage in the global marketplace. It should be cautioned however that to the unaware, this approach has been seen to detract from vital post contract supplier development by encouraging procurement professionals to have a narrow, commodity focused approach. There should be particular focus therefore by the category management team for responsibility and accountability for supplier performance management, which is communicated effectively within the organisation. Realising the limitations should enable the buyer to work at maintaining support both internally and within the supplier base for category management.

The full article on Category Management will be available shortly to CIPS Members on the CIPS website. For details of other benefits to becoming a CIPS Member, additional

professional practice resources or information on how to join please go to www.cips.org

¹ Website address: www.aberdeen.com

² Aberdeen Group (August 2005), *Best Practices in Category Spend Management: Travel*, page 7.

³ The (Office of Government Commerce) OGC Gateway™ Process is described at <http://www.ogc.gov.uk/index.asp?id=377>