

CATEGORY MANAGEMENT | MAKING IT A POWERFUL CONTRIBUTOR TO ORGANIZATIONAL SUCCESS

An Insight Whitepaper

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Category Management

Category Management is a firmly established strategic procurement approach to maximize profit and organizational outcomes through reduced cost and risk, and increased value and innovation from the supply base. Although a key enabler of competitive advantage for many companies worldwide, not all organizations have been able to achieve the same scale and level of breakthrough benefits. In this guide, which features the findings from the Positive 2018 Category Management for Results Survey, leading procurement and negotiation expert Jonathan O'Brien examines what organizations must do to make category management a powerful contributor to business success.

PURSUING DRAMATIC SAVINGS BENEFITS

A category management approach offers significant benefits with more than a third of Chief Procurement Officers (CPOs) reporting double digit reductions in the price and cost of bought-in goods and services (Figure 1). Yet around a quarter realize much less in terms of reduced price, cost or cost avoidance and achieve less than 4%. Whilst some enjoy dramatic benefits, others fall short of achieving this. This can result from numerous factors and the benefits that are possible tend to vary according to industry sector, specifically the degree of price flexibility for bought-in goods and services (the degree to which there is scope to influence price, for example how many added value elements exist), and also the level of category maturity (the degree to which strategic procurement thinking has been applied).

However, these were not typical constraining factors for many of the CPOs who reported lower average savings which suggests that something else is at play here, and potentially indicating a wider range of levels of success in using category management to realize savings. Indeed, the apparent 'double peak' in this graph is significant and begins to suggest some grouping here between those who realize moderate benefits vs those who realize dramatic benefits.

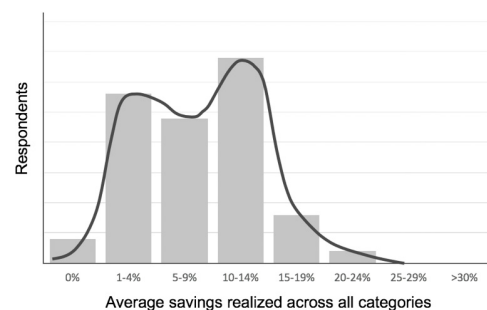


Figure 1 – Distribution of average savings from category management

EARLY DAYS FOR THE NON-FINANCIAL BENEFITS

The benefits possible from category management clearly extend some way past financial returns, and the approach can yield dramatic added value and innovation from the supply base as well as reducing risk. However, organizations seem to be slow to pursue these benefits, with price and cost reductions, and cost avoidance continuing to be the primary benefits pursued by CPOs in companies that practice category management (Figure 2). In fact, only 10% of CPOs suggested that they actively pursue reduced risk, innovation or some form of added value.



Figure 2 – The benefits CPOs pursue using category management

It is easy to suggest that procurement functions are missing the point here and are putting the traditional pursuit of savings above the factors that hold the potential to bring greater competitive or brand advantage in the

longer term. However, this is not necessarily the case, but rather it is systematic of the overall expectations organizations hold. Despite the talk about how the supply base can offer game-changing innovation or new value to organizations, and notwithstanding the exemplar examples of companies who have managed to achieve this, in reality most organizations still demand, and measure procurement based upon, price and cost benefits from procurement above any others. Across those organizations practicing category management, 70-80% continue to measure the contribution of procurement to the organization based upon financial return (Figure 3). This is almost certainly due to the simple fact that, for the majority of organizations, performance is measured in financial terms and the organization is structured around a financial framework.

Around half of the CPOs surveyed cited measures of contribution based around risk, effectiveness, and added value, yet the number of organizations that measure contribution based upon factors such as supply base innovation, bringing brand or competitive advantage, or sustainability is relatively low. The degree to which procurement adds social value is low across all industry sectors but is high, and a key measure, amongst organizations in the public sector. A handful of companies have abandoned financial measures and instead use unique measures such as procurement project success, as judged by the wider organization.

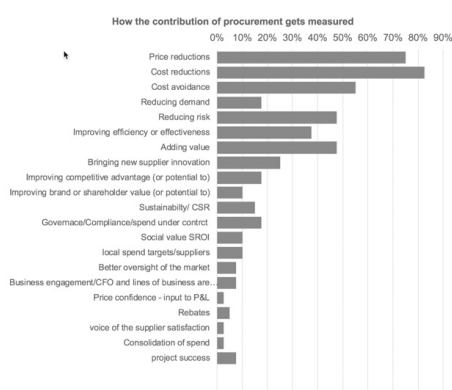


Figure 3 – How organizations practicing category management measure the contribution of procurement

QUALITY OF IMPLEMENTATION

Across those practicing category management, there are different degrees of financial return, and non-financial benefits are beginning to gain relevance. As we have seen, this is due in part to differences by sector, what is being sourced, and levels of procurement maturity. There is, however, another key factor here which is the overall implementation of category management within the organization, and the degree to which it is applied with good, far-reaching rigour to deliver breakthrough results. It seems there is a direct link between the ‘quality’ of category management, including sufficient provision in terms of capability, process, available resources and governance, and the return on investment.

The Hackett Group suggest that the return on investment varies according to how ‘effective and efficient’ the organization is – the factors they define as primary attributes of world-class procurement. This is supported by KPMG who state that there is a direct link between cost savings and maturity in category management, as well as strategic sourcing and SRM. This is something that I have seen first-hand in many of the companies I have worked with who are proud to tell me they have implemented category management; however, when the ‘category management label’ is peeled back, often it is quickly apparent that they are doing little more than tendering and contracting under a category framework. They may already have a good process but are either ticking boxes or skipping over key steps. An approach such as this will only ever yield small, incremental benefits. In such cases, the senior team seem to either be able to fool themselves into believing they are doing category management, or they fail to truly understand how category management needs to be implemented. Generally, and in my experience, if the category teams are not finding and realizing game-changing benefits, it is likely they are not practicing category management effectively. It therefore seems that across those companies that have adopted category management, there is a polarization between those who realize moderate benefits and those who realize dramatic benefits, which could explain the dip in the graph in Figure 1.

Moreover, whilst category management exists in organizations across the globe as one of the core tools to enable strategic procurement, within these organizations there appear to be differences in what is being called ‘category management’. Of the companies who claim to have a strategic procurement function, less than half are able to boast a dedicated category management structure or can say that they have category management positioned as a key business enabler (Figure 4). The remaining companies claim to be doing category management to some degree, where the approach is practiced in part using some of the key tools, but operating outside of a dedicated category management structure. Category management, therefore, does not exist in one universal form, rather it has different degrees of adoption or maturity. This is further supported by considering the degree of spend that is managed using category management, where only 60% of organizations who practice category management can claim to be using the approach for more than 40% or more of the organization’s addressable spend. Only 10% have all addressable spend managed using category management.

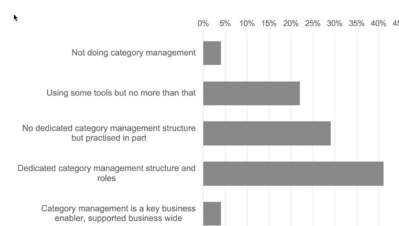


Figure 4 – Nature of category management within strategic procurement environments

Looking further still, this range of approaches is also supported by reviewing how CPOs in organizations who have implemented category management describe what category management means to them (Figure 5). Whilst, as might be expected, nearly 90% state it means engaging with stakeholders to agree needs and wants, or developing category strategies based upon end customer desires, only 60% suggest category management involves the application of strategic tools and thinking or pursuing breakthrough sourcing strategies. In contrast, 63% describe category management in their business as something that is built around the process of contract expiry, competitive exercise and agreeing a new contract. Across all the companies who have adopted category management, there are differing and even conflicting perspectives of what is category management, with varying levels of true strategic intervention and degrees of benefit realization in the organization.

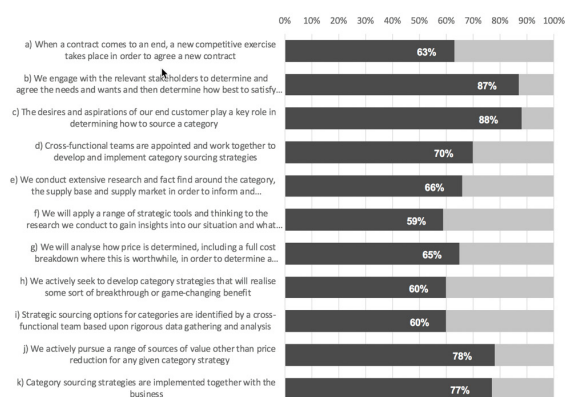


Figure 5 – How CPOs describe the nature of category management in their business

MAKING CATEGORY MANAGEMENT A SUCCESS

Whilst potentially dramatic and game-changing, the benefits of category management will only be realized with the right organizational approach and deployment. Category management is both a process and a philosophy. The process drives what happens, but the philosophy is the way the organization embraces the approach and organizes and aligns itself for strategic procurement intervention using a category management framework, perhaps coupled with other strategic procurement initiatives. The philosophy cannot reside in the purchasing function alone - it must become organization-wide and win the hearts and minds of everyone across the business who has any involvement or interest in what, where, from whom and how the organization buys.

Making category management a success requires a number of key ingredients to be in place or provided for. CPOs across leading organizations practicing category management effectively cite good facts and data, stakeholder engagement and competency of category management as the three most important success factors (Figure 6).

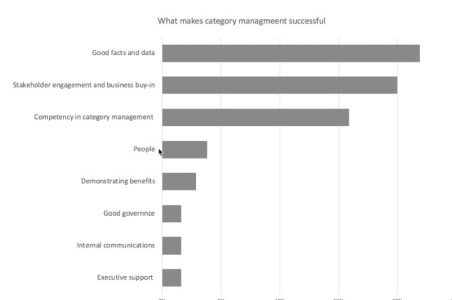


Figure 6 – What CPOs believe makes category management successful

THE POWER OF FACTS AND DATA

Good facts and data drive everything. It is almost impossible to drive any sort of strategic procurement intervention without them, although access to good facts and data is still lacking for many organizations. We are fast transitioning into a new digital world that promises access to big data, new insights and automated procurement decisions, yet for most of us we are some way away from this being the reality. Increasingly, we have access to greater information and new data rich systems are becoming a part of the suite of tools procurement practitioners have available. Effective category management requires successfully obtaining facts and data for the category, how the organization and our end customers use the products and services in the category, our existing and potential suppliers, and the market. Next generation digital platforms can help here, but they are not a pre-requisite.

In fact, success is about the right facts and data mindset and ensuring the right rigour. An experienced category management practitioner can still secure valuable insights by using creative ways to conduct research and through good old-fashioned hard work. The reality of why organizations fail to use good facts and data to support developing breakthrough category strategy is not typically because the firm lacks the right system, but more so because it is easier to cut corners or assume that we already know everything we need to know. Therefore, success in category management requires us to establish and drive in a culture of rigorous research and analysis to support the development of great sourcing strategies, which may also help us to discover breakthroughs.

STAKEHOLDER ENGAGEMENT

Stakeholder engagement and securing business buy-in is critical for the successful determination and implementation of any category strategy. Category management is an organization-wide philosophy, not a process confined to procurement. The suppliers are the organization's suppliers, what we buy is determined by the business and so on. Therefore, we cannot avoid or ignore the need to be effective at engaging with the business and working to secure their full support. This is, in fact, one of the hardest things to achieve, and possibly the thing at which procurement functions have been the least successful historically.

Good engagement means we need to truly understand, and possibly challenge, the needs and wants of our internal customers. We must also understand what our end customers need. Category management is more about change management and business improvement than it is about procurement. Agreeing and implementing new sourcing strategies, perhaps that necessitate change in our business, require us to win hearts and minds and galvanize support to our cause. This is a key component within stakeholder engagement.

Success in category management therefore requires a systematic way for procurement teams to initiate and facilitate this, with a planned approach to stakeholder engagement and internal communications. Practitioners must do this, as well as have the capability and ability to manage organizational change. Crucially, stakeholders need to actively participate in the process of category management. This is accomplished by cross-functional teams, agreed by the wider business, who will work together on new sourcing strategies.

COMPETENCY

Effective category management demands good understanding and capability within the organization. Clearly this means capable practitioners who are equipped with a deep understanding of the approach, the process, tools and how to use them as well as the soft skills, facilitation skills and leadership skills required to engage with and lead cross-functional teams. It also means they must be equipped with common process, language and ways of working to ensure a consistent approach throughout. Yet, as we have seen, successful category management has to be an organization-wide concern. Therefore, this means that key stakeholders across the organization also need a degree of category management capability and knowhow. Whilst it is the core practitioners who will need to be across the detail and complexities of developing new sourcing strategies, category management will not succeed unless the executive team understand the approach. In particular, they will need to comprehend the power and necessity of it, how it works in practice and, crucially, their role to support and enable it. Other members of the procurement team (ie the non-category management staff) also need to understand the approach and be equipped to support it.

However, the most important capability required here is that of the wider organization. Outside of procurement, few ever receive any training in what procurement is about or how it can add value. It is perhaps no surprise that misconceptions abound and non-procurement functions don't naturally fall in line to align with and support the overall procurement approach. The wider organization must hold a basic understanding of what procurement is about, its role and key goals and that the process of category management is how the organization is seeking to achieve key benefits.

In essence, we have to create a 'felt need' for the program. This can only happen if anyone who has any involvement in what and how the organization buys, or has any contact with suppliers, has had some training in the fundamentals of what procurement is about and what is expected of them. Leading organizations do this with simple elearning programs or video modules that are mandatory for the entire organization. Figure 7 gives the distribution of competency levels by role in the organization for organizations who are successful at category management.



Figure 7 – Distribution of category management competencies by role in the organization

MAKING IT HAPPEN IN PRACTICE

Successful category management as an organization-wide philosophy means that growing category management organically from the ground up is unlikely to gain traction. Therefore, success requires a more systematic approach to create the right conditions to enable it. Across the companies who have implemented category management, the degree to which governance approaches are fully set up and part of how the organization works is, in fact, quite low at around 30%.

There is a correlation between companies who have put governance in place and the overall return on investment. Those with good governance tend to realize greater financial returns. The degree of governance varies, yet for the 30% of CPOs who assert good governance is in place almost all state they have a senior steering group responsible for the program and the organization reports, and can demonstrate, the benefits the program is achieving for the business. Most cite having a dedicated category management structure and three quarters have progress reporting, stage gate reviews of progress, dedicated project management and full executive support (Figure 8 gives the full range of governance attributes CPOs claim to have adopted).



Figure 8 – Governance arrangements and how category management is structured

It is clear that category management is a key enabler not only of procurement, but also business, success. It has the potential to contribute dramatic value to the organization in terms of financial benefits in the range of 10-15% typically, as well as non-financial benefits. However,

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across the companies practicing category management, not all realize its full potential. In fact, there appears to be two distinct types of company, namely (i) those who realize only incremental benefits where the nature of category management is not that different to previous procurement practice, and (ii) those who realize dramatic benefits where the organization has implemented it as an organization-wide philosophy and embraced the supporting enablers and systems to make it happen.

Jonathan O'Brien, CEO of Positive Purchasing Ltd, is a leading expert on category management and procurement and works with global blue-chip organizations to help transform their capability.

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WE'RE POSITIVE - WE HELP ORGANIZATIONS WORLDWIDE MAKE PROCUREMENT A STRATEGIC CONTRIBUTOR TO BUSINESS SUCCESS

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