“Far from being a re-run of old information, this third edition of Category Management in Purchasing includes significant new sections that make it relevant for a larger audience, including governance and category management information for small to medium-sized enterprises. The book also includes compelling new looks into the future, one of which – on the trends of greatest concern for procurement – is worth the purchase all on its own.”

Kelly Barner, Editor, Buyers Meeting Point

Category Management in Purchasing is a comprehensive guide to strategic category management which provides a step-by-step guide to its implementation and use, and enables readers to deliver value and cost savings when sourcing and purchasing.

The third edition of Category Management in Purchasing has been rigorously updated to reflect the latest thinking in the field. Jonathan O’Brien shows how a strategic approach needs to work effectively together with other approaches, such as supplier relationship management. The book also examines governance in more detail, and includes pragmatic guidance and detailed advice for smaller businesses.

Through real company case studies including Ikea, The Body Shop, NHS, Heinz and GlaxoSmithKline, Category Management in Purchasing connects theory and practice and provides readers with the tools to analyse complex sourcing situations quickly and clearly, and so develop innovative and creative proposals for sourcing.

JONATHAN O’BRIEN is CEO of the international purchasing consultancy and training provider Positive Purchasing Ltd. With over 25 years’ experience in purchasing, he has worked all over the world to help global organizations increase their purchasing capability through training and education, working directly with practitioners and executive teams to drive the adoption of category management and other strategic purchasing methodologies. He is also author of Supplier Relationship Management and Negotiation for Purchasing Professionals (both also published by Kogan Page).
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Introduction

Using this book

This is a book about ‘category management’ – a strategic approach to maximize value, benefit and profit to the organization through structured procurement intervention and business-wide involvement and participation.

This is a practical book for those who want to get on and make purchasing category management a reality and realize the dramatic value and benefits that are possible when it is well executed. It is a book about value and how to secure the best possible value from the supply chain through planned and structured purchasing intervention. It is also a book about changing the game, about doing something fundamentally different and achieving breakthrough improvements.

This book is not like so many books that simply explore academic or theoretical concepts and leave it to the reader to interpret and apply these in practical terms. This book represents the culmination of years of experience of practising category management for real and delivering real dramatic benefits to global organizations. It represents a current best-practice view of purchasing category management and not only provides the necessary framework and toolkit but explains in a clear sequence how to use them. In this, the third edition of this book, a suite of new templates has been provided to help practitioners make category management a reality.

The book is designed to provide insight and a reference point for executives and stakeholders who want to use or understand the approach within their organizations, as well as for practitioners who want to learn how to use category management on a day-to-day basis.

As we will discover through this book category management is much more than a process; it is a philosophy, and when embraced holds the potential to deliver a dramatic benefits to the organization. It is also a prime enabler to help build stakeholder value and brand equity by creating competitive advantage or differentiation.

I have been practising category management and working with organizations to deploy it for more than 25 years now, and whilst the approach is
‘the way to buy’ in some sectors, for many it feels like it is only just begin-
ning to be embraced, understood or gain traction. Many companies claim to
practise category management, few truly do. If purchasing intervention is
little more than an approach based around tendering and contracting for
repeat requirements ‘by category’ then this is not category management; it is
tendering and contracting under a different name. Here benefits will be limited
to small incremental improvements only. True category management changes
the game, but achieving this demands a quality deployment, and requires the
entire organization to embrace, live and breathe the philosophy.

As we move through this book I will explain what category management
is and we will explore in detail the process behind it, providing deep expla-
nation of each of the core tools. I have also included a range of templates
and support tools to help practitioners. But before we get to that we will
explore the core principles and enablers behind a quality category manage-
ment deployment, and what is needed for an organization to embrace and
embed the philosophy.

A strategic purchasing trilogy

This was originally my first book and is now in its third edition. Since the
original version I have written two further books on key strategic purchas-
ing methodologies. These three books have been written as a collection, each
designed to enhance, complement and integrate with the frameworks and
approaches of category management, Supplier Relationship Management
(SRM) and negotiation planning. Indeed many of the tools you will find in
these pages can also be found applied slightly differently within SRM and
negotiation approaches. These three separate methodologies are in fact
the core strategic approaches necessary for modern, best-practice strategic
procurement and to be effective need to work in concert with each other.
Therefore this book has been written so as to be used together with Supplier
Relationship Management and Negotiation for Purchasing Professionals
(both published by Kogan Page). Where a tool has already been expanded in
one of these other works it is not repeated again in this book but referenced
at a high level. It is recommended all three publications are used together to
provide the complete strategic purchasing approach
Introduction

This book is organized so as to explore all aspects of category management in the most logical way possible. It seeks to provide answers and practical steps for 15 key or ‘pathway’ questions. If you can answer all of these questions with confidence then you’re in great shape. However for many organizations these are difficult questions that represent the gap between aspiration and reality. They also help reveal the pathway to move towards making effective category management a reality. This book will help to not only form answers to these questions but will help to develop real actions that enable the firm to progress and realize great value from a quality category management deployment.

Category management pathway questions

1. How can procurement intervention make a strategic and significant contribution to my business?
2. What is category management and how can it add benefit?
3. What are the right categories to work on?
4. How can I identify and prioritize potential opportunity for each category so I can direct my resources accordingly?
5. What is required in order to successfully adopt and implement category management?
6. How do I engage the wider organization within a category-based approach?
7. For any given category, how do I identify what the organization needs to buy?
8. For each and any category, what is my current position?
9. How can I identify the optimum, and ideally breakthrough, future sourcing strategy for a category?
10. How do I ensure all our future sourcing strategies are based upon a robust understanding of all market and external drivers and factors?
11. How can I effectively implement new sourcing strategies so they become a reality and we realize the benefits?
Once improvements are implemented, how do I continue to drive them?

How should I manage those suppliers who are important to my business?

How does the company need to structure and organize itself to deploy category management effectively?

Is category management an approach that will still be relevant in the future?
Introducing category management

This chapter aims to provide an introduction to category management, why it is highly relevant for leading companies all over the world and the significant value it can bring to organizations. It explains how this value can be realized in different economic and market conditions and how the approach can help respond positively to a variety of different business needs and drivers.

Pathway questions addressed in this chapter:

1. How can procurement intervention make a strategic and significant contribution to my business?
2. What is category management and how can it add benefit?

Category management explained

Category management is a strategic approach that focuses on the vast majority of an organization’s spend on goods and services with third-party suppliers. It is a process-based approach and incorporates many familiar aspects of business improvement processes and change management. It is not an approach that is confined to purchasing but typically requires the active participation of and engagement with stakeholders, functions and individuals across the business to make it successful. Organizations therefore have to make an investment in time and commitment in order to deploy category management; however, the return on this investment is potentially very large.
Category management is defined as:

The practice of segmenting the main areas of organizational spend on bought-in goods and services into discrete groups of products and services according to the function of those goods or services and, most importantly, to mirror how individual marketplaces are organized. Using this category segmentation, organizations work cross-functionally on individual categories, examining the entire category spend, how the organization uses the products or services within the category, the marketplace and individual suppliers.

This extensive review process is structured to actively challenge what has gone before, and seek out and implement breakthrough opportunities that will generate significant value for the organization. Value might take the form of leveraging dramatic reductions in purchase price but it could equally be about reducing the whole-life cost or total cost of ownership, mitigating price increases in a rising market, reducing supply chain risk, improving effectiveness and efficiency or securing increased collaboration and innovation from the supply chain to help build our brand equity.

**Category examples**

There are fundamentally two types of category:

- direct categories: raw materials, components or services that are directly incorporated into, or help produce, the final product; and
- indirect categories: products and services that are non-product-related or enable the company to function overall.

Organizations deploying category management will often organize the programme of work and cross-functional teams around direct and indirect categories in order to identify potential linkages and opportunities between categories. For example, an indirect category team working on the indirect category of car fleet would ideally be the same team or close to the team that is working on another indirect category of insurance (the cost of fleet insurance being linked to the selection and specification of vehicles).

A typical but not exhaustive list of direct and indirect categories is shown in Table 1.1.

The precise list and the categorization of direct and indirect will vary from organization to organization, according to what it does. For example, the category ‘print’ is often an indirect category, containing general printed matter used by marketing and not part of producing finished goods. However, in a publishing business print would be a direct category.
# Introducing Category Management

## Table 1.1 Examples of direct and indirect categories

<table>
<thead>
<tr>
<th>Direct categories (typically)</th>
<th>Indirect categories (typically)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Packaging</td>
<td>Utilities</td>
</tr>
<tr>
<td>Castings</td>
<td>Legal services</td>
</tr>
<tr>
<td>Plastic mouldings</td>
<td>HR services</td>
</tr>
<tr>
<td>Bulk chemicals</td>
<td>Fleet</td>
</tr>
<tr>
<td>Fabrics</td>
<td>Facilities management</td>
</tr>
<tr>
<td>Tomatoes</td>
<td>Consultancy</td>
</tr>
<tr>
<td>Polythene bags</td>
<td>Contract labour</td>
</tr>
<tr>
<td>Bottles</td>
<td>Insurance</td>
</tr>
<tr>
<td>Yarns</td>
<td>Marketing, design and agency</td>
</tr>
<tr>
<td>MRO (Maintenance, repair and operations parts)</td>
<td>Logistics</td>
</tr>
<tr>
<td>Fasteners</td>
<td>IT</td>
</tr>
<tr>
<td>Chicken breasts</td>
<td>Telecoms (land, mobile, video, web)</td>
</tr>
<tr>
<td>Machined products</td>
<td>Capital equipment</td>
</tr>
<tr>
<td>Hip and knee joints</td>
<td>Civil engineering</td>
</tr>
<tr>
<td>Steel rope</td>
<td>Reprographics</td>
</tr>
<tr>
<td>Sheet metal</td>
<td>Waste management</td>
</tr>
<tr>
<td>Printed circuit boards</td>
<td>Travel</td>
</tr>
<tr>
<td>Process filters</td>
<td>Buildings and grounds maintenance</td>
</tr>
<tr>
<td>Sub-assemblies</td>
<td>Stationery</td>
</tr>
<tr>
<td>Social care</td>
<td>Print</td>
</tr>
<tr>
<td>Motors</td>
<td>Catering</td>
</tr>
<tr>
<td>Soft drinks</td>
<td>Security and guarding</td>
</tr>
<tr>
<td>Control and automation</td>
<td>Cleaning</td>
</tr>
<tr>
<td>Tyres</td>
<td>Pest control</td>
</tr>
<tr>
<td>Paint cables</td>
<td>Software</td>
</tr>
<tr>
<td>Rubber</td>
<td>Production machinery</td>
</tr>
<tr>
<td>Airport landing slots</td>
<td>Networks</td>
</tr>
<tr>
<td>Wound care</td>
<td>Healthcare</td>
</tr>
<tr>
<td>Electronic components</td>
<td>New building fit-out</td>
</tr>
<tr>
<td>Cans</td>
<td></td>
</tr>
<tr>
<td>Sugar</td>
<td></td>
</tr>
<tr>
<td>Syringes</td>
<td></td>
</tr>
</tbody>
</table>
How it all started

Category management first appeared in purchasing in the late 1980s. There does not appear to be a single pioneer of category management, but rather the approach grew up across a relatively small number of progressive companies working at the forefront of strategic purchasing. It was in response to the need to counter the growing power of suppliers born out of globalization and of suppliers getting smarter and finding new ways to secure and retain their routes to market. It was also in response to a growing realization that organizations could gain advantage if purchasing could play a more strategic role. These early pioneers began to develop similar strategic approaches that combined tools and techniques from purchasing, economics, quality management and organizational change theory. Over the years different practitioners and consultants have refined the approach based upon what has been proven to work. Today you will find category management presented in various forms, each having subtle variations in structure and content, but the underlying principles remain the same.

If you run an internet search for ‘category management’, you could be forgiven for being confused by what you see. Search results are most likely to have a marketing or retail theme. If you talk to marketing professionals or retailers, they will most probably understand the term ‘category management’ but they will be thinking of an approach very different from the one outlined in this book (although we will touch on it in the next chapter).

The term ‘category management’ originated in the world of sales and marketing in the early 1980s. The definition a marketer would recognize is ‘a brand management approach to manage groups of products according to how the consumer uses the products’. This is different from the purchasing version of category management, and clearly the role of brand management in a business is not usually something undertaken by purchasing. Whilst the two approaches are quite separate for most, there is a clear similarity between this and category management in purchasing. In retail however they are less separate.

Marketing category management

Big retailers learned that they could improve sales and profit if they could more efficiently administer all their different products and product classifications. The idea was to see a retail outlet not as an aggregation of products but as an amalgam of categories, with each one unique and based on what the consumer does with the product and how this is predicted to change
over time. For example, instead of managing products at the level of Kellogg’s Corn Flakes or Quaker Porridge Oats, marketing category management seeks to focus on the category of ‘breakfast cereal’, its various target customers, its place in the store and how best to merchandise, present and promote the category in order to maximize profit. Whilst consumers will enjoy apparent brand choice, often a single manufacturer will be given a certain ‘primacy of presence’ across the category with the least possible unproductive competition between their individual brands. This of course comes at a price, with that manufacturer discounting heavily, running promotional offers and perhaps even supporting the retailer by helping to manage the category on behalf of the retailer. The net result is increased profit for the retailer.

Purchasing category management

Throughout this book, this core principle of ‘categories of products’ remains the same – except here we are segmenting third-party spend, not finished goods, and it is not ‘how the consumer uses the product’ that drives the segmentation but the function of the products or services and the discrete marketplaces they originate from. As with much of purchasing best practice, many elements are the reverse of the marketing approach. Indeed, many of the strategic analysis tools contained within this book originate from marketing tools but have been adapted to work ‘in reverse’ to benefit the buyer.

THE RELEVANCE OF CATEGORY MANAGEMENT TODAY

Kraljic (1983) stated that ‘no company can allow purchasing to lag behind other departments in acknowledging and adjusting to worldwide environmental and economic changes’. He was saying that purchasing skills had been developed and established in an era of relative stability, but that as the pace of economic change was about to accelerate at global level, purchasing had to change too. That was more than 30 years ago and since then we have seen profound changes within our world, organizations, international business and how we live our lives. We have also experienced one of the greatest economic downturns since the Great Depression of the late 1930s. The role and expectations of the purchasing function have also changed considerably in this time and continue to change.
Category Management in Purchasing

When I began my career in purchasing the role of the function as seen by the wider organization was to ‘buy things’. Decisions regarding what to purchase and which supplier to use had usually already been taken by marketing, production or R&D, of course in consultation with the supplier. Purchasing would be called in toward the end to ‘do the deal’ and negotiate things like delivery charges and returns policies. If we could also get a bit more off the price, this was considered an excellent result. In contrast today’s leading-edge businesses will position purchasing as a strategic function, often with board-level representation, and the function will have a clear remit to own and manage the commercial relationship with the supply base. Smart organizations do not allow technical functions to make purchasing or buying decisions alone, but rather encourage a culture of collaborative working to identify and implement the most effective sourcing approach.

Today purchasing functions are presented with opportunities to add significant value to the organization and its stakeholders like never before with category management being one of the important enablers needed in order to realize these opportunities. To understand what these opportunities are, and how they have come about, it is necessary to look at how technology, markets and our lives have evolved over the past 30 years or so and how these changes now point to the need for a new modern and more strategic approach to purchasing within organizations.

Technology as an enabler

The internet, e-mail and e-commerce have revolutionized business on a global scale. This is old news and now the generation of social, mobile, analytics and cloud (SMAC) are continuing that journey. Purchasing transactions in large companies are almost entirely electronic, often with little or no intervention for regular or routine purchases. Using the same principles as eBay, but in reverse, purchasing teams can now run reverse auctions with suppliers bidding against each other in real time to win a specific piece of business, all conducted over the internet in quick time without either party ever meeting the other. Reverse auctions (or e-auctions) have made the process of running a tender much simpler and quicker and have created the ability to leverage price to the best point in the market.

Advances in technology have made the process of buying much more effective, but that’s not all. Technology now allows teams around the world to work together and collaborate in a way that was thought impossible
20 years ago. Today we have mobile and desktop applications that allow us to network, message, get answers, connect, see and share with anyone, anywhere, whenever we choose. ‘Virtual meetings’ are commonplace, with most desktops equipped with some sort of meeting and messaging app and most global organizations using virtual conferencing suites as routine. Some of these are so sophisticated the meeting experience is almost as if the life-size people talking to you from the other half of the table are really in the same room as you and not halfway around the world. Crucially, though, workplace skills and culture have developed to embrace and use these tools. Running an effective telephone, video or web conference is now as much a part of a professional person’s toolkit as hosting a face-to-face meeting.

For non-differentiated products the lowest price is now just a few clicks away and gaining insights into a marketplace or a supplier can be achieved almost entirely online with good research skills where once the business of providing specialist market knowledge was an industry all of its own. The global buying community now shares information and knowledge and in turn propagates best practice.

It is easy to forget how far we have come, but these advances in technology are important because they have enabled purchasing functions to become more effective, consume fewer resources for the day-to-day business of purchasing and instead direct our energy into working across geographical boundaries in those areas that will add the greatest value.

The world is a smaller place

Purchasing functions now have greater access to larger marketplaces. The world has opened up and the global marketplace has long since been open for business. What previously were either holiday destinations or underdeveloped countries are now ‘emerging markets’ or credible players, capable of producing repeatable good-quality output and with a hunger for Western currency that means the producers will do whatever it takes. However the nations that supply the world are changing.

Countries like China and India offer the latest state-of-the-art, well-equipped factories with low-cost, motivated workforces, an absence of trade barriers and early stages of enforced regulation for safety and HR, so it is no surprise that many of the goods originate from these regions.

China now equals the United States in terms of manufacturing output (Markillie, 2103), but as China’s workforce expect their pay to rise, and the
economy begins to slow down some, other developing countries are waiting in the wings to take on the world’s manufacturing at lower cost. India is pushing Japan aside to become one of the biggest purchasing nations on the planet. Other economies are on the global stage or at least about to enter it; Brazil and Russia were well talked about but don’t lose sight of countries such as Sri Lanka, Indonesia, Nigeria and Iraq. Libya’s economy shows great promise, so too does Mongolia’s, with its mining boom from the advent of copper production in the Gobi desert fuelling an 18 per cent growth in GDP in 2013, and economies such as Macau may take us by surprise.

You might think that the cost associated with moving goods and raw materials around the world would counteract the competitive advantage these countries can offer, but it doesn’t. For example, it costs just £6 to ship a washing machine from China to Europe. Smaller items are proportionally cheaper according to size.

Our planet is now one with more people on it and many more on the way, living in more densely populated regions, who move around more and interact more. Global communication is just a tweet away and global commerce requires just a click or two. Suppliers, or at least some of their operations, can now operate from anywhere on the planet, wherever there is a willing, capable and organized workforce with sufficient infrastructure to make it viable. The suppliers of tomorrow may not reside in the countries they are in today and may not even exist in any single building or location but rather could be sprawled across the globe, connecting and interacting through technology. The world is no longer a collection of different groups of people isolated by geography and culture, but a giant network, connected in real time.

The development of these new economies presents purchasing functions with an incredible opportunity to secure great value at low price points providing they can work out how to source reliably from these regions. As new economies respond to the challenge of every changing customer preference, smart purchasing functions are beginning to take advantage of the increased leverage that results from new competitors entering the marketplace. However, this opportunity comes with responsibility and there is a note of caution here.

You don’t have to wear sandals to talk about ‘sustainability’

‘Sustainability’ is a relatively new word in the business community. It now appears in all sorts of business discussions and at all levels and is a growing
factor within decision making. We could also talk of Corporate Social Responsibility (CSR) or Corporate Responsibility (CR) and mean the same thing. Anyone talking about the need for ‘sustainability’ 20 or 30 years ago would stimulate little interest at executive level of most businesses. But things have changed and ensuring the actions of business are sustainable is no longer just the concern of a small group of sandal-wearing activists.

As purchasing functions source more globally, achieving sustainability within the supply chain becomes increasingly difficult. The rate of change of some global economies is so fast that textbooks may soon need to be rewritten as new, previously unseen, economic dynamics also emerge. Huge global organizations have begun to amass unprecedented levels of power over supply chains and whilst this creates leverage it also increases the likelihood of purchasing in a way that is unsustainable. Not only that, it is also exceptionally difficult to control what really happens at the plantation or garment factory many contractual steps up the supply chain.

Whether or not ‘sustainability’ matters to an organization today is determined by factors such as the overriding brand principles and values of the organization, the company’s internal policy, customer and stakeholder expectations and need for brand protection. In the future the driving force here is likely to be legislation, with companies becoming obliged to be responsible beyond their immediate contractual relationship with suppliers.

What happens many contractual steps removed up a supply chain can no longer be ignored when engaging the immediate supplier. Today most consumers now expect companies to be socially responsible (Penn Schoen Berland, 2010) and some even manage to factor this into their buying decisions, although there remains a significant gap between good intention and action (Pelsmacker et al., 2005). While this gap will most likely close, there seems to be a growing expectation on the companies we buy from, that they have their entire house in order. Perhaps sustainable, fair trade, responsible, ethical can no longer be a unique differentiator that attracts premium pricing, but a basic feature for everything a company does. Perhaps the person who picks the coffee beans is as much part of the product as the experience of the outlet itself. If our societies didn’t hold this expectation then there wouldn’t be so many investigative journalists trying to find cracks in the reputation of big corporates for what lies in their supply chains and organizations wouldn’t be so worried in case something unexpected gets uncovered. It seems customers and consumers are also now paying more attention to stories of how household names operate and are ready to question any suggestion that things are not in good shape.
Here the opportunity for purchasing is first to understand what happens within the supply chain and to drive the right interventions so as to align what happens upstream with organizational objectives. This in turn can help claim competitive advantage, protect and even enhance a brand with the right approaches. Achieving this can in fact be incredibly difficult, and sustainability initiatives rarely succeed as stand-alone projects, but if they become an integral part of how the purchasing function is operating and moving forward, then sustainability can become a reality. The primary opportunity for purchasing here is therefore to respond to the organization’s sustainability aspirations and make them part of how the organization buys.

Our love affair with brands, bargains and something just for me!

Our lives have changed considerably over the past 30 years. Today in many First World countries our everyday lives are now built around products and services from the global marketplace, with our buying choices driven by our love of brands and the simple fact that as consumers we love a bargain. Today we are more aware of the brand or specification we want and the best place to get it at the best price. Walmart has built its entire business empire on this phenomenon and has managed to lower prices constantly through economies of scale and by finding new efficiencies in the supply chain. In fact, Walmart was credited with changing the global economic weather and keeping the US inflation rate down through repeatedly enticing consumers back for ‘just one more bargain’. When the US economy started to take a downturn in 2008, Walmart’s profits increased even further as cash-strapped customers who had previously shopped elsewhere switched to Walmart to keep their shopping bills down.

Shopping online is now mainstream, allowing new, low-overhead sellers to outperform big established names and offer the same product for less; that is unless the manufacturer is restricting routes to market in order to reduce competition and preserve price points. Try comparing prices for genuine brand-name perfumes from different retailers around the world and you’ll find there’s not a lot of difference. This has little to do with market dynamics or the cost of making a bottle of perfume (which is a relatively small percentage of the selling price) but is part of a well-executed pricing strategy for a unique product people want to buy; and that brings me to the value of brands.
Despite our love of cheap, we will still pay more for a product we believe is exceptional, that is unique and differentiated or shows we can afford a premium brand. The intangible benefits we get from wearing the right trainers or driving a certain car makes us part of the right group of people or projects the outward signs of success that make us feel good. But that is not the end of the story. What we want as consumers is changing and there is a new kid on the block that could prove even more desirable than a brand. Now the ability to create something personalized and unique for every customer is opening up a new differentiation opportunity enabled through module production and using new technologies such as 3D printing.

Where there is no differentiation, ‘Better, faster, cheaper’ still stands and although we expect ‘cheap’ we don’t need it. As consumers become more affluent with more choice than ever before we seem to know where to find the best price but yet consumers are prepared to pay for something branded and something unique. Perhaps ‘better, faster and just for you right now’ seems to better describe the consumer appetite. The implications of this are enormous, and they now shape the world of global business; the challenge for companies to compete and succeed becomes ever more difficult but crucial in order to survive.

It is here that purchasing perhaps has the greatest opportunity of all, and one that if realized can bring huge value to the organization. The first opportunity for purchasing here is to help the organization compete effectively in his ever more competitive landscape. If ‘cheaper’ is part of what is needed to do this, then purchasing must find ways of reducing the cost of producing the goods or providing the service, including driving down the cost of raw materials, production (or service provision) and the route to market.

However if the organization needs to compete through differentiation, either through brand or uniqueness then the second opportunity is for purchasing to help create the differentiators that bring competitive advantage and enhance brand value by connecting supply chain possibilities with consumer needs and desires, including those the consumer doesn’t realize yet.

Supply chains represent potential ‘goldmines of innovation’ – specialist companies who understand their respective marketplaces and are working on the ‘next great idea’. If you can connect what your suppliers are working on with what you believe your customers need and could want, then you have unlocked the potential to greatly enhance your brand. The secret to unlocking this is first in knowing what your suppliers are working on (and not just the obvious ones) and second in having the right relationship with these suppliers so they bring innovation to you first and not to your competitors or where it is possible to work together to create something
significant. It is here where the opportunity for purchasing is so great. Keep your purchasing function supplier-facing and you’ll have a function that buys things. Have purchasing work across the entire ‘end-to-end’ value chain, collaborating with customer-facing functions and you begin to connect supply chain possibilities with end-customer needs and desires.

CASE STUDY  How the supply chain put honeycomb in IKEA’s table

IKEA’s ‘Lack’ coffee table has been one of its most successful products ever with more than 10 million sold worldwide each year. Its thick square legs and the 50 millimetre-thick veneered tabletop design were an instant success but the winning factor here was its affordability. IKEA offered the table at a price point to suit any budget, yet its appearance was so solid it was perceived as great value for money. The secret behind this is simply due to IKEA connecting customer needs, desires and preferences with supply chain possibilities. These possibilities, however, didn’t come from any of IKEA’s table manufacturers. In fact, the production and shipping costs associated with manufacturing a 50 millimetre-thick tabletop using traditional veneered fibreboard or chipboard techniques would prevent IKEA achieving their desired price point. Instead the innovation came from a door supplier by using the same technology of creating a thick substrate by laminating a thin paper honeycombed inner between two thin laminated sheets. The result is an incredibly strong and thick but lightweight tabletop that could be manufactured and shipped in high volumes cost effectively, and one that IKEA’s customer base loved.

IT’S ALL ABOUT VALUE

All of the opportunities described above mean purchasing functions have the potential to be a primary value generator for any organization. Category management is a key enabler here and if well executed with a visible and effective level of purchasing intervention across a business, category management has the potential to deliver dramatic results. Furthermore, it is possible to respond directly to the drivers of the organization and the sector
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it operates within as well as the prevailing macro-economic or any specific market conditions. In some organizations achieving lower prices for bought-in goods and services may be all that is required. If the goal is ‘better, faster, cheaper and just for you’, category management has a proven track record here. There remains a mindset in some organizations and amongst some purchasing professionals that the sole focus of efforts with suppliers should be to reduce price. This is an admirable pursuit, but much more is possible through a good level of purchasing intervention. The reality, however, is that in many businesses there is a disconnect between what the organization is trying to achieve and the day-to-day activities of purchasing teams, further exacerbated by an ignorance of the huge potential that can be realized.

Good modern strategic purchasing supported by category management requires a shift in our focus and one that allows us to pursue multiple sources of value that will benefit our organization and our end customers in line with wider organizational goals. For some organizations the best possible value improvement may not be a price reduction but could be to secure innovation from the supply chain that will enhance the value proposition to the end customer and improve the brand. Value is also linked to the sector we are in, with different industries typically having differing priorities. For example, historically in the oil and gas industry, reducing the cost of third-party spend was important, but bringing a new pipeline on line faster or ensuring security of supply was even more important, as when the oil flows so too do the dollars at levels beyond our imagination. Yet as oil prices began to fall the priorities shifted to cost reduction.

Securing the value the organization needs

The value an organization most needs at any one time will change according to what is happening around us. At the turn of the century as developed economies were growing fast, the primary outcome sought by companies in many sectors using category management was to reduce the cost of bought-in goods and services. By 2008, as world economies started to take a downturn fuelled by inflation and rising oil and food costs, this had shifted to mitigating price increases and maintaining assurance of supply as the survival of many companies was threatened. By 2012 as the world was trying to pull out of the slump, category management was also being used to ensure the relationship with key suppliers was sustainable, using pricing structures that could protect against volatility in raw material costs. In 2015 organizations
were recognizing the potential of category management as an enabler to new business growth through a range of different types of value from the supply base. It seems also that suddenly the importance of supply chain innovation was being realized and firms were re-galvanizing cross-functional teams to help achieve this. By then category management was also now being firmly embraced in the public sector.

Category management can therefore deliver dramatic value improvement in terms of reduced price but can also deliver reduced cost and risk, increased innovation, brand value, greater effectiveness and a stronger competitive position. It can make a clear contribution to the bottom line or EBITDA (earnings before interest, taxation, depreciation and amortization) and can also make a solid contribution to shareholder equity. Informed shareholders increasingly want to understand the approach to purchasing within the companies in which they invest, and for companies with stock exchange listing, purchasing is increasingly seen as possessing the capability to uplift, protect or recover the share price. Category management is not limited to the commercial sector. In the not-for-profit and public sectors category management can deliver dramatic improvements in performance and yield greater returns against allocated budget; it can help secure better patient outcomes in healthcare, secure more and better social care and public services, provide taxpayers with more for what they pay and can deal with years of poor purchasing where suppliers have gained advantage.

Despite the huge potential the supply base can offer here there are many organizations, including some who claim to be deploying category management, that still fail to realize the full value possible. To understand why we need to look at how organizations operate.

**Value and the virtual brick wall**

Category management requires a ‘value-based’ approach. If we have this then it can help achieve key goals and objectives. However, unlocking value isn’t just a case of the purchasing function pressing a magic button. In fact, if the initiative is confined to the purchasing function it will be unsuccessful. Instead category management must have the support and involvement of the entire organization with active collaboration across functions. The reason for this is simply because if you want to increase overall value to the organization you need to look at all the places where value is added. Porter (1985) describes the concept of the ‘value chain’ with products passing through an organizational business unit and each business function either
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directly or indirectly adding value in some way to create the final product (or service). This internal value chain is bounded by the inputs and outputs of the organization. However, expanding our perspective reveals a chain that extends all the way back to the start of the supply chain and also forward to the ultimate end customer. Growers, raw material suppliers, service providers who provide products or services to other suppliers, each adding some sort of value by processing, building, mixing, packaging, coordinating, shipping etc to create the products or services an organization buys. Then within the organization all the different functions add further value in some way to create a final product (or service) that then in turn provides some sort of value to the end customer, and perhaps even an end customer beyond that. Porter (1985) calls this end-to-end view the ‘value system’ and it is a concept that is well founded in economic theory.

The end-to-end value concept may seem obvious; the problem is that in many organizations we’ve lost sight of this value flow and we fail to recognize its importance. It is as if there were a barrier – a virtual brick wall – between suppliers and end customers (Figure 1.1). Marketing looks after the end customer and purchasing looks after the suppliers. Somewhere in the middle is a production or service process and an organizational hierarchy keeping the two firmly apart with any potential for new supply chain possibilities to enhance the customer experience being missed. By its nature, category

**Figure 1.1** Value flow and the virtual brick wall
management overcomes this and encourages cross-functional working and collaboration throughout the business, getting people working together to achieve significant results. The potential available by connecting what customers want or might want with what your supply base is capable of should not be underestimated, but realizing this potential requires internal collaboration. If the only forum for a key supplier to share what they’re working on is a review meeting with the buyer and the details go no further than the meeting minutes, the opportunity will be lost – or, worse, taken to your competitors.

**CASE STUDY**  How end-to-end value helped build Body Shop

Body Shop opened for business in the UK in 1976 and over the next 29 years Anita Roddick would devote her passion and energy to creating a brand that would support nearly 2,000 stores worldwide serving 77 million customers. Roddick’s mission was to build a business based around the pursuit of social and environmental change and to offer products that complied with a strict ethical, environmental and social framework. Over the years this was further shaped by the growing needs and desires of its customers, creating a huge global business.

One of the key success factors for Body Shop was the way end-customer desires and market opportunities were connected with supply chain possibilities. The value to the end customer in buying a product that is guaranteed to be ‘responsible’ could only be achieved through careful alignment of sourcing strategies with stated brand values. Strategic suppliers to Body Shop dedicated themselves to helping build the brand and enjoyed long-term relationships but only after a rigorous selection process to ensure that they were organized around certain ethical, fair trade and green principles. In addition, suppliers had to demonstrate compliance with these principles through their supply chains and participate actively in a series of initiatives to develop communities in need.

**The value of maximizing profit**

Category management can generate many forms of value for an organization but it is still its ability to maximize business profitability that gets attention in the boardroom so we will explore this some more.
In many organizations, external purchases or third-party spend account for the single biggest cost. Figure 1.2 shows a typical breakdown of where the money generated from sales goes, with third-party spend comprising just under half of it. Whilst this chart is typical for many manufacturing companies the breakdown would vary from business to business and industry to industry. For example, in the automotive sector, spend with suppliers accounts for a high proportion of turnover whilst professional services that are people-centric, such as consultancies, will typically have a much lower relative spend.

Taking a simplistic view, an organization seeking to maximize its profit can do this in two ways: it can increase the ‘size of the pie’ by increasing sales (Figure 1.3) or it can reduce the size of other segments, ie reduce costs.

Each of the segments in Figure 1.2 has typically received some sort of attention from organizations over recent years. Profit has received direct attention from sales and marketing functions tasked with finding ways to increase sales and therefore profit by growing market share, finding new markets or finding new products.

Organizations have also focused on improving profit by reducing costs and the cost of people has probably received the most attention in recent

**FIGURE 1.2** Where money from sales goes
decades. Many of us will be familiar with restructuring and headcount reductions or where wholesale outsourcing of large areas of the business to ‘low-cost labour’ geographies has taken place. Overheads too have been tackled by a vast range of efficiency-improvement initiatives in all areas of business, including business process re-engineering, lean manufacturing or Six Sigma, increased use of IT, increased automation, relocation, downsizing and home working. However, with third-party spend typically being the largest expenditure area it is therefore the area that can present the biggest opportunity for organizations, yet in some sectors and some organizations it remains the area that receives the least attention.

Nevertheless, strategic initiatives that focus on reducing this cost can dramatically improve profit and this profit potential doesn’t just come from price reduction but from the combined effect of all interventions that add value and help reduce the overall cost of third-party spend. It also requires a new strategic perspective to identify the opportunities that are ‘game changing’ and will deliver significant profit improvements. Furthermore, it is often much easier to increase an organization’s profit by reducing costs than by increasing sales. For example, consider a manufacturing business making plumbing fittings. The company has a sales revenue of €1 million, of which €450,000 is spent on raw materials and bought-in goods and services. The company makes a profit of 10 per cent of turnover (€100,000). If it could achieve a 3 per cent reduction in the cost of bought-in goods and services (€13,500), the profit of the organization would increase to €113,500. This has the same effect as increasing overall sales by 13.5 per cent (turnover increased to €1.135 million, profit at 10 per cent is €113,500). For most organizations the sales effort and investment required to secure a 13.5 per
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A cent increase in profit would be significant. Therefore if an organization can save just £1, €1 or $1 in the cost of bought-in goods and services, this can go straight to the bottom line as increased profit. This is a simplistic view and a variety of accounting and taxation factors could change this for some situations. However, the principle of third-party spend savings making a bottom-line contribution is robust.

Category management can therefore help organizations secure significant additional value from the supply chain by increasing profit by reducing the spend and cost of bought-in goods and services and also through increased sales resulting from securing supply chain innovation.

DETERMINING CATEGORIES

Category management requires a segmentation of third-party spend into categories that can be worked on individually by a cross-functional team with the aim of identifying and implementing the optimum sourcing strategy for that category (see Figure 1.4). In order to determine categories, third-party spend needs to be segmented into discrete market-facing areas. This is not as straightforward as it might seem. Even when equipped with good spend analysis information, there are a number of factors that must be considered – in fact there are five vital considerations here, each of which will be explored in turn:

1. Identifying spend;
2. Directing resources only on addressable spend;
3. Directing resources on the categories where there is a worthwhile opportunity;
4. Identifying market boundaries so categories become market facing;
5. The most appropriate level to work at.

1 Identifying spend

A good analysis and breakdown of third-party spend are required to begin to identify categories. However, businesses often have little detailed understanding of what they spend. The company will have developed and grown over time. Mergers, acquisitions, multiple geographical locations and different
decision-making processes mean big companies can end up with multiple legacy IT systems, often differing from country to country, with no or little communication or integration between them. Few large corporates have managed to reach the point where they have a single fully integrated information system that can provide the ideal information at a push of a button. Furthermore, even if spend analysis data is available, the breakdown may not be suitable; for example, a breakdown by supplier instead of by what the supplier is providing will make it difficult to identify categories, as will analysis derived from missing, incomplete or miscoded data at the original point of entry.

If good data is not available, then an alternative approach is required, and the marketplace is full of providers offering spend analysis services. Some have sophisticated systems that can be installed alongside company IT systems. These have clever software that can interface with multiple internal systems and will periodically extract, manipulate and analyse company finance and purchasing transactional data to provide good data when required. Other providers are adept at bringing in teams of people to analyse transaction history. Some combine both. Most can usually sort, cleanse and optimize the data to a high degree of accuracy to provide good insightful spend analysis data.

An alternative ‘do-it-yourself’ approach to spend analysis can often work too, and with time, effort and energy it is usually possible to gain something meaningful. Approaches that can work include some or all of the following:

- data extraction: using an IT systems/data expert to extract, manipulate and combine data from multiple systems to provide a view regarding spend and segmentation of spend;
- interrogation of purchase orders: reviewing historical purchase orders over a period of time, one by one, and recording and categorizing the spend for each to arrive at a final spend analysis snapshot;
- asking the suppliers: requesting a breakdown by category of spend from key suppliers for the past 12 or 18 months;
- liaising with stakeholders or budget holders to understand what they spend in key areas;
- analysing finished goods and volumes shipped, to derive raw materials and input volumes and thus calculate spend data;
- taking a view based on experience.
2 Directing resources to addressable spend

Not all the spend will be addressable. That is to say, there will be a percentage of spend where it is either impossible or very difficult to influence or change what is spent, short of not making the expenditure in the first place – and even this may not be possible. Examples of non-addressable spend might include:

- tax;
- rates or charges by governmental bodies;
- rent (although it may sometimes be addressable);
- regulatory or government-set licence fees.

In identifying non-addressable spend it is important to be clear about why an area of spend might be considered non-addressable, as an opportunity could easily be missed. With the right approach and incentives, governments can make tax concessions, rent can be lowered and so on. There will, however, always remain some areas that are truly non-addressable. These should be identified and ruled out early on – but only after the reasoning behind categorizing an area of spend as ‘non-addressable’ has been considered and challenged.

3 Directing resources where there is opportunity

When segmenting categories, the Pareto principle typically applies: 80 per cent of spend is usually with 20 per cent of suppliers, and 20 per cent of spend with 80 per cent of suppliers. It is the 80 per cent of spend that should form the primary focus for segmentation of third-party spend into categories. This requires the acceptance that it is impossible to address the entirety of third-party spend and there will always be a portion where it is uneconomic to expend effort working on small spend areas (termed ‘rest of spend’ in Figure 1.4). An approach to help here is given in Chapter 3.
4 Identifying market boundaries so categories become market facing

In order to maximize the potential from category management, the segmentation of spend into categories that will be worked on must reflect their market-facing nature, ie they must mirror how the individual marketplaces are organized where the market boundaries lie. We are therefore seeking to develop a definition of each category based not only on spend or how we are organized, but also according to the boundaries of the market from which we are sourcing. Our thinking here, and how we view the market boundaries for each category, is crucial if category management is to open up dramatic opportunities. It is here where we are presented with our first significant game-changing opportunity with category management; narrow-minded thinking at this stage will dilute potential benefits later – the wider the market boundaries the more choice we have and the greater the opportunity.

Market boundaries take many forms and all markets are bound in one or more ways. Boundaries can be natural or artificial. For example, taxi firms exist the world over, but it is not a global market; it is a natural collection of small markets, each bound by practicality, licences to operate and ultimately the limited demand for long-haul taxi services. Factors that determine market boundaries are:

- **Form** – the type and nature of the market, eg a physical space, online etc.
- **Size** – how big the market is, usually measured in total volumes sold, people employed or how much is spent in the market. For example,
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the size of the US fast food market is estimated at $120 billion per annum.

- **Scale** – the geographical reach of the market.
- **Location** – where the market is based and what its boundaries are.
- **Types of participants** – for example, are they individuals or companies?
- **Types of goods or services** – what they are, the function they perform or the need they fulfil.
- **Generic choice** – the generic or proprietary nature of what is being sourced.
- **Restrictions** – any factors that limit a market or the freedom of trade such as government sanctions or regulations reducing the quality or quantity available.

In each case these factors introduce boundaries. If we set out to buy glass bottles we will only look for glass bottle suppliers, but what about plastic, or a completely different packaging solution? (We will return to this later.) A physical market is limited by the space available and where it is; for example, a traditional village square market could only ever be as big as the number of stalls that the space could accommodate. If we buy from a government-subsidized market then these subsidies will naturally prevent competition. Geographical reach depends upon economic practicalities and differences in regional need. For example, in the category ‘fleet’ (company cars and vans) the marketplaces appear global, and companies such as Toyota and Ford are global brands; so a ‘single badge’ sourcing strategy would seem possible. But regional differences in models, regulations and infrastructures introduce barriers. The big car brands may have a global presence but they are not typically organized in a way that can service global accounts, which are still very much regional with different products and support networks in each territory. Here, an apparent global market is, in fact, a collection of smaller natural markets and so categories would need to be qualified by including the boundaries within the name, eg ‘US fleet category’, ‘European fleet category’, etc.

In identifying the marketplace our category faces off against, it is crucial to challenge thinking, open boundaries and identify the widest potential market, and that may involve looking at alternatives to how we have sourced traditionally. Modern freight means emerging countries might also be able to offer what we need. Modern IT means the physicality of a marketplace is less relevant, as a specialist in India can work alongside us as if in the office
next door. Determining the right marketplace is part of category management later in the process once equipped with good market data, but is also something that must happen now in order to define the category we will work on. We are therefore making an initial identification of category segmentation based upon the information available but recognizing that the scope and definition of a category might need to shift later.

It is not only the nature of markets that introduces boundaries but also our choices and how suppliers attempt to maximize their position. Clearly it is in the supplier’s interest to seek to reduce our options so that we have, or are made to believe we have, little choice, thus increasing their power by reducing the apparent size of the market they occupy. Offerings that are branded or differentiated have some form of unique added value or are uniquely bundled do just this. If this drives our choices, then we are limiting the potential market we can source from. For example if we set out to buy ‘an Apple iPad’ rather than ‘a tablet computer’ then we have limited our potential marketplace by selecting a proprietary product. Figure 1.5 shows the effect of market boundaries on opportunity.

FIGURE 1.5 Effect of market boundaries on market opportunity
There is one final dimension to category segmentation and that is the fact that in order to be successful the categories we work on must be large enough to find opportunities and small enough to work on. It is worth dwelling on this part, as getting it right can dramatically influence the potential benefits possible, yet there may be a conflict here between what we might naturally choose to work on and the way the market is organized. For example, consider a global business with a significant spend on travel (Table 1.3 shows what the spend breakdown might be). The category of ‘travel’ frequently appears in lists of segmented categories that companies identify.

At a high level this is appropriate, but there is no marketplace for travel as such. Corporate travel agencies would be quick to suggest that they constitute a marketplace for travel in all its forms; however, the reality is that such agencies are not the market itself but are a well-organized means of connecting a client with multiple marketplaces. The actual marketplaces here are ‘air travel’, ‘hotels’, ‘hire cars’ and so on. ‘Travel agency’ is a marketplace but only for the process of matching a requirement with available travel options in different marketplaces, making the booking and providing support to the traveller. Failure to appreciate this could lead to the development of a sourcing strategy for travel as a package, perhaps with an outsourced arrangement with a single travel agency. This might initially appear to be a good approach but the price paid will depend on the deals the travel agency has negotiated with different carriers and hotel chains, many of which will be influenced by partner relationships and rebate arrangements that often remain hidden. With such significant spends on each of the travel components here, undoubtedly there are greater opportunities by working on each individually. Airlines will offer greater discount structures to high-spending customers on specific ‘city pair’ routes (for example, between office locations), so that they can maximize aircraft yield on those routes. Similarly, global or regional hotel chains rarely provide significant across-the-board discounts for all their locations but will agree preferential rates for specific hotel locations where there are significant bed nights for a particular customer, again perhaps reflecting office locations.

The optimum category segmentation here would therefore be to work on each of the market-facing travel components as categories but with ‘travel’ as the overarching area. One category manager might typically work on travel as a whole but be responsible for five or six subcategory projects within it. This overarching view is important, as it allows the category
manager to identify and act on any synergies or issues between individual categories.

There may even be more synergies or opportunities further afield which should be considered; for example, if the same organization has a high spend on the category ‘marketing events’, involving the staging of large events attended by many customers or potential customers, there will be a significant travel requirement here also. Suggesting that the travel categories be expanded to include this additional marketing spend on marketing events is likely to create a tension, and marketing may feel under threat if their work with events providers is scrutinized. Furthermore, there will almost certainly be a backlash from the marketing suppliers, who will argue that it is better if they have the freedom to provide the entire event using their own arrangements with travel providers (often with hidden rebates!).

Structuring the segmentation of spend into categories is an exercise that usually only needs to be done once at the outset when an organization is about to deploy category management. Determining the right list of categories makes it possible to work on the entire organizational spend in each marketplace, which will then maximize the potential returns for each category. This process of segmentation may well introduce tensions with other functions who feel they are responsible for certain areas of spend and the associated sourcing decisions. Strong executive leadership is required here, otherwise the segmentation activity may fail to develop the optimum list or break down as a result of appeasing the concerns of other functions.
Defining category segmentation

So in summary category segmentation is about identifying what the market-facing categories are, considering the widest possible market boundaries and seeking to match as much as possible of the aggregated spend of the entire organization against this market. However here we are also making a clear choice about how wide we want to go. There may be a good business reason not to attempt to widen market opportunity and to deliberately source from a very small or even single supplier market. In this case category management can help to verify this choice, but it might be more appropriate to switch to a Supplier Relationship Management (SRM) approach. We will cover this in Chapter 8 and it is expanded in full in my third book Supplier Relationship Management.

A useful test question to verify if category segmentation has been successful is therefore:

Are we confident that the entirely of spend in a discrete area reflects a specific, identifiable marketplace with the widest possible or appropriate market boundaries to maximize our potential opportunity?

Once we are clear about category segmentation, wherever possible categories should be defined based upon their boundaries as this then defines the scope for individual category project, eg European fleet, Global telecoms, bottles (European), PCB assemblies (global) and so on.

THE BENEFITS POSSIBLE

There are two questions I frequently get asked; first, what benefits will category management deliver; and second, can you guarantee a certain return on investment if we do it? Reasonable questions, and what might be expected of a CPO or CFO contemplating adopting such an approach. It seems there is a commonly held belief that there is some standard answer to these questions – a magic number, substantiated by experience that can help justify a business case for action. There is not and the answer to both question is ‘it depends’.

Category management is not something that can be simply be bought in, acquired or bolted on; just like so many other business initiatives, in fact, attempting to implement category management with such a mindset will most likely doom it to failure. The benefits of category management, whilst potentially dramatic and game changing, 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, organizes and aligns itself for strategic procurement intervention using a category management framework, perhaps together with other strategic procurement initiatives. The philosophy cannot reside in the procurement function alone but must become significant business wide and demand the winning of hearts and minds beyond the bounds of the procurement team.

**Scale and nature of benefits possible**

So if benefits can be game changing, to what order of magnitude? Category management can deliver many types of benefits. Look around and you’ll find all sorts of claims. For hard savings alone the range is huge. I’ve been part of category teams that have achieved 10, 20, 30 or even 40 per cent savings. One project, addressing a category where a single supplier had enjoyed a comfortable position in a changing marketplace, delivered 98 per cent savings yet other projects have struggled to find just 1 or 2 per cent. The consultancy ADR (2011) suggest 10–30 per cent is possible, Future Purchasing (2014) place the figure at between 10 and 15 per cent, but crucially make a clear link between the return and degree of procurement maturity. This is supported by KPMG (2012) who state there is a direct link between cost savings and maturity in category management as well as strategic sourcing and SRM. The Hackett Group (Flores, 2011) 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. They suggest that organizations that are world class achieve nearly a 12× return for savings vs cost compared with a non-world class function that achieves on average 3.45×.

There is a direct correlation between the ‘quality’ of category management and the return on investment. I have worked with firms that are proud to tell me they have implemented category management; however, when the ‘category management label’ is peeled back it soon becomes apparent that they are doing little more than tendering and contracting under a category framework. They may even have a good process but are either box ticking or skipping over key steps. Such an approach 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.
Introducing Category Management

Generally, if the category teams are not finding and realizing game-changing benefits, chances are they are not actually practising category management effectively.

So what is possible with quality category management? What is that magic savings number? Based upon what we have seen so far it might seem that we can simply pick a number here, but in fact the level of benefit and return on investment is, in fact, more predictable once we have identified a market-facing category, and depends upon:

1 Category opportunity – determined according to market difficulty, degree of ‘added value’ or scope for price flexibility and how mature or immature a category is (ie how much has it been worked on to date).

2 Quality of deployment – the effectiveness of category management including capability, process, available resources and governance.

3 Procurement maturity – the degree to which procurement has evolved in the organization and is effecting planned and systematic supply base interventions that make a strategic contribution to the business.

4 Organizational readiness – the degree of alignment, participation and buy-in of the wider organization to the cause of procurement, and the ability to drive change in the organization in support of implementing new sourcing strategies.

With these things in mind, it is possible to gauge with some confidence the likely outcomes of any category management project; it is possible to identify that magic number and later I will outline an opportunity analysis approach that can help here!

The potential for hard savings will always secure the attention of the executive team and, however, category management can in fact deliver a range of benefits both hard and soft. Post global downturn it is these other benefits that have become more relevant. Fifteen years ago the primary reason for embarking on a category management project was typically to yield breakthrough savings and cost reduction. Today, as marketplaces have changed and become more volatile, and security of supply has become a bigger issue, it is much more being seen as an enabler to provide assurance of supply, improve efficiency and effectiveness, and reduce supply chain risk with savings becoming a secondary consideration in some instances. As such the relationship between category management and SRM has strengthened, with organizations now recognizing that the benefits they seek require both approaches working alongside each other.
At a strategic level, category management can help create competitive advantage and find differentiators that can contribute directly to brand equity or stakeholder value. A key contributor to this is innovation – not solely that from a marketing or R&D team, but won from the supply base where we can find a rich treasure trove of future possibilities if only we figure out how to tease it out to our future benefit. Category management provides the means here and in doing so can demolish the ‘virtual brick wall’ I described earlier, enabling us to connect end-customer needs and desires with supply chain possibilities.

There are soft benefits too, which are both benefits and enablers in themselves. Category management requires some form of spend analysis, which in turns helps drive greater transparency of spend. Category management demands cross-functional working, which once established yields the great results that come when people get together, share and work towards a common goal. Similarly category management both demands and yields common language and ways of working together with knowledge sharing. Finally category management is a strategic approach and needs to be approached and positioned as such; however in turn, if it is well deployed it also drives more strategic sourcing within an organization. Table 1.3 summarizes the hard and soft benefits possible through category management.

There is much here we can do to directly influence and determine the potential benefits we can realize from the supply base and chances are they will be significant. It is possible to effect interventions to secure and sustain these benefits. Category management provides the framework to do just this but demands a quality deployment in order to do so – the rest of this book outlines how.

**Surely someone has already thought of this?**

With such dramatic benefits possible from category management, why is it only now that this concept is beginning to be recognized as essential by many global organizations? The answer is that in many companies these benefits have remained hidden, with executive teams failing to see the opportunity. Indeed, there has often been a commonly held view that there was little remaining opportunity in the supply base – if there were, ‘someone would have spotted it’. There are two main reasons for this view: one, this is how your suppliers want you to feel, and they do a remarkably good job of ensuring you do; and two, to unlock the hidden benefits of category management you need to do something fundamentally different across the entire organization.
**TABLE 1.3** Hard and soft benefits possible from category management

<table>
<thead>
<tr>
<th>Benefit type</th>
<th>What is typically possible</th>
<th>What is required in order to realize these benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Hard, tangible benefits</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost reduction</td>
<td>10–20 per cent reduction in the price of bought in goods and services</td>
<td>• Business must organize itself so as to implement category management effectively</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Low category maturity</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Non-difficult market</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Ability to drive organizational change</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Category is generic – low differentiation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Category has ‘added value’ components</td>
</tr>
<tr>
<td>Improved value and effectiveness</td>
<td>• Improved efficiency</td>
<td>• Cross-functional working</td>
</tr>
<tr>
<td></td>
<td>• Reduced waste</td>
<td>• Means to identify and pursue opportunities (eg Lean or Six Sigma approaches)</td>
</tr>
<tr>
<td></td>
<td>• Additional value (more bang for the buck)</td>
<td>• Active supplier involvement</td>
</tr>
<tr>
<td></td>
<td>• Sustainable results</td>
<td></td>
</tr>
<tr>
<td>Innovation</td>
<td>• Improved value proposition to our customer using supply base innovation</td>
<td>• Reason for suppliers to share or work on innovation (mutual benefit)</td>
</tr>
<tr>
<td></td>
<td>• Process improvements</td>
<td>• Shared understanding and sharing goals or needs</td>
</tr>
<tr>
<td></td>
<td>• Synergies from collaboration</td>
<td>• Collaborative joint working with key suppliers</td>
</tr>
</tbody>
</table>


### Table 1.3  
**Benefit type** | **What is typically possible** | **What is required in order to realize these benefits**
--- | --- | ---
**Reduced supply chain risk** | • Greater security of supply  
• Reduced risk of brand damage (e.g., through poor practice upstream in the supply chain)  
• Reduced risk of loss (e.g., of IP) through increased supplier and supply chain understanding | • Risk assessment  
• Market and supplier understanding

**Competitive advantage, differentiation, and improved offering to customers** | • Improved value proposition to our customer  
• Increased profit margin  
• Differentiation or offer or delivery mechanism | • Cross-functional working – connect ‘sourcing’ with ‘satisfying’  
• Reason for suppliers to contribute (mutual benefit)  
• Collaborative joint working with key suppliers

**Soft benefits** |  
**Total spend under management** | • Greater transparency (especially relevant for public sector)  
• Improved accuracy of spend breakdown  
• Ability to prioritize resources  
• Better framework agreements through improved market understanding (public sector) | • Robust spend analysis  
• Robust category segmentation
**TABLE 1.3 continued**

<table>
<thead>
<tr>
<th>Benefit type</th>
<th>What is typically possible</th>
<th>What is required in order to realize these benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cross-functional working</td>
<td>• Augmentation of results (through sharing and interaction)</td>
<td>• Organization-wide approach to category management and mandate to participate</td>
</tr>
<tr>
<td></td>
<td>• Alignment to a common purpose</td>
<td>• Executive buy-in</td>
</tr>
<tr>
<td></td>
<td>• Ground swell of effort to deliver results</td>
<td>• Active promotion of initiative through the organization</td>
</tr>
<tr>
<td>Common language and ways of working</td>
<td>• Faster results</td>
<td>• Single process and toolkit accessible and utilized by all – common templates</td>
</tr>
<tr>
<td></td>
<td>• Increased organizational capability</td>
<td>• Common learning and development programme</td>
</tr>
<tr>
<td>Knowledge sharing</td>
<td></td>
<td>• Language and process rigour expectations reinforced by senior team</td>
</tr>
<tr>
<td></td>
<td>• Increased organizational capability</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Organizational learning</td>
<td></td>
</tr>
<tr>
<td>Strategic sourcing</td>
<td>• Procurement as a strategic contributor to business success</td>
<td>• Means to sharing key information (category strategies, market insights, success factors etc)</td>
</tr>
<tr>
<td></td>
<td>• Customer value proposition shaped by supply chain possibilities</td>
<td>• Actively making time to share key learnings</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Procurement embraced as a strategic function</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Procurement ‘C’ level/executive level representation</td>
</tr>
</tbody>
</table>
Suppliers’ salespeople are often competitive and driven individuals whose living, or at least the bonus they’ve come to expect, depends on persuading you and your organization to buy and continue to buy, and to buy more. Suppliers are often better resourced, better funded and receive more training than the buyers they interface with, so the starting point is one where the supplier has a distinct advantage.

If the suppliers have been outwitting us, why hasn’t anyone noticed? The reality here lies in why the potential benefits in the supply chain are hidden. For the supplier to continue to enjoy the advantage, they have to ensure buyers believe they hold all the power, even if that is not the case; so the supplier will work hard to maintain this illusion, offering concessions carefully to project a sense of ‘best possible deal’. Suppliers also use clever tactics to maintain their position beyond their relationship with the buyer. It is war out there as far as the supplier is concerned, and their goal is to win. For the supplier it is all about seeing information as power, nurturing relationships through the rest of the business to gather information, dividing and conquering to disarm purchasing, questioning the buyer’s technical team about the ‘available budget’, and so on.

Buyer–seller relationships which are equal or balanced are entirely possible and there are many good examples where this is the case. It is equally possible for a buyer to gain advantage and have leverage over certain suppliers. However, neither eventuality will happen unless there is solid purchasing intervention to counter efforts on the supplier’s side. Category management provides a robust solution and, if well executed, can bring about a reversal of the balance of power in a buyer–seller relationship. However, this is only possible if the organization fully embraces category management, frees up the required resource and establishes cross-functional teams to work through the process towards implementing breakthrough sourcing strategies.
Chapter 1 summary

Recap on the key points from this chapter:

1. Category management is a strategic approach that focuses on the vast majority of an organization’s spend on goods and services with third-party suppliers.

2. It is the practice of segmenting the main areas of organizational spend on bought-in goods and services into discrete groups of products and services according their market-facing nature.

3. Great opportunity lies within the supply base, and as our world changes around this so too does the nature of this opportunity, and what is important to organizations. Category management is a proven approach to realize this opportunity.

4. Category management holds the potential to secure game-changing value including significant price reduction but also improved value and effectiveness, and reduced risk, but can also help build the value proposition to our end customer through supply base innovation or collaboration to create new differentiators or competitive advantage.

5. To unlock these benefits a ‘quality’ deployment of category management is essential.

6. Success also depends upon robust category segmentation – prioritizing the categories we will work on at the outset based upon addressable spend so a category faces out to the widest practical marketplace.
“Far from being a re-run of old information, this third edition of Category Management in Purchasing includes significant new sections that make it relevant for a larger audience, including governance and category management information for small to medium-sized enterprises. The book also includes compelling new looks into the future, one of which – on the trends of greatest concern for procurement – is worth the purchase all on its own.”

Kelly Barnes, Editor, Buyers Meeting Point.

Category Management in Purchasing is a comprehensive guide to strategic category management which provides a step-by-step guide to its implementation and use, and enables readers to deliver value and cost savings when sourcing and purchasing.

The third edition of Category Management in Purchasing has been rigorously updated to reflect the latest thinking in the field. Jonathan O’Brien shows how a strategic approach needs to work effectively together with other approaches, such as supplier relationship management. The book also examines governance in more detail, and includes pragmatic guidance and detailed advice for smaller businesses.

Through real company case studies including Ikea, The Body Shop, NHS, Heinz and GlaxoSmithKline, Category Management in Purchasing connects theory and practice and provides readers with the tools to analyse complex sourcing situations quickly and clearly, and so develop innovative and creative proposals for sourcing.

JONATHAN O’BRIEN

is CEO of the international purchasing consultancy and training provider Positive Purchasing Ltd. With over 25 years’ experience in purchasing, he has worked all over the world to help global organizations increase their purchasing capability through training and education, working directly with practitioners and executive teams to drive the adoption of category management and other strategic purchasing methodologies. He is also author of Supplier Relationship Management and Negotiation for Purchasing Professionals (both also published by Kogan Page).

Category Management in Purchasing is a clear and in-depth guide to strategic category management when buying goods or services. From defining category management through to providing a step-by-step guide to the tools, techniques and application of category management, Jonathan O’Brien gives readers the tools and understanding to help them to analyse complex sourcing situations quickly and clearly and to develop innovative and creative proposals for sourcing.

This updated edition includes information for small to medium-sized enterprises and demonstrates current best practice in the field. It is an essential tool for every purchasing professional.