Category Management

Category Management as it applies to Procurement and Supply can be defined as organising the resources of procurement in such a way as to focus externally onto the supply markets of an organisation (as opposed to having a focus on the internal customers or on internal functions) in order to fully leverage purchasing decisions.
Abstract

This CIPS practice guide recognises the importance of Category Management within business. Category management as it applies to Procurement and Supply can be defined as organising the resources of the Procurement team in such a way as to focus externally onto the supply markets of an organisation (as against having a focus on the internal customers or on internal Procurement departmental functions) in order to fully leverage procurement decisions.

Introduction

CIPS Practice Guides are designed to provide awareness and a level of understanding to the reader on selected topics, in this case on Category Management. They are written for use by those with an interest in business issues in general, and procurement and supply management (P&SM) issues in particular. This will include full and part time P&SM professionals as well as individuals interacting with P&SM activities.

The Practice Guide will also include information on the contextual background to the issues, and will give a balanced opinion on issues that the reader may wish to consider. There will also be references to other sources of information. The CIPS ‘Positions on Practice’ cover a range of procurement and supply management issues. The purpose of such statements is, primarily, to provide direction for procurement and supply management professionals on what the Chartered Institute position is on a given subject. They are not intended to be prescriptive, not least because the CIPS recognises that procurement and supply management professionals work in many different environments.

CIPS practice documents are not written to be an end in themselves. They are a collection of views on good practice within a particular subject area, in this case ‘Category Management’. The reader is encouraged to extract those parts of a practice document that they can use for their own particular purposes such as writing and reviewing policy statements, guidance and procedures.

This range of publications is intended to provide direction on good practice along with some guidance for context and interest. Background data and further reading is available from the CIPS.

Practice documents are written for use by anyone associated with, or interested in, the procurement and supply management profession.

This document is one of a series summarising the CIPS view(s) on a wide range of procurement and supply management subjects.

There should always be a comprehensive analysis carried out on how best to deploy the always limited resources of a Procurement and Supply department and Category Management is only one of several basic alternatives available to managers (added to which there are many hybrids giving variations on these themes) which each have their own advantages and disadvantages:-

(a) Firstly, P&SM could be organised by function; where contract negotiation, upstream sourcing, downstream contract management (i.e. Relationship management); even expediting, inventory and clerical activity could be the specialist functions within a P&SM operation. This demarcation of duties by function is much less fashionable nowadays because the P&SM profession is seen to be a narrow enough specialism for a practitioner to be involved in without there being further precision and specialization. However, in the larger departments there is merit in allocation of tasks to individuals where a highly focused approach could be taken. This would achieve a deep skill level through experience in, say, research or in negotiation or in CSR matters, where not everyone in the team will have the same level of expertise.
(b) Secondly, P&S Managers could analyse their supply market using a Purchasing Positioning overview to identify market sectors: high/low risk; high/low value suppliers and allocate their resources accordingly. Thus

- the high risk/high value suppliers could be looked after by the individual or sub-group with highly developed Account Management and Partnering relationship skills capabilities

- the high value/low risk vendors would be handled by the Cost-Cutters who would be targeted primarily on maximising savings

- the high risk/low value group then being attended to by experts in minimising supply chain vulnerability, who would thus be engaged in the active analysis of security of supply (via developing alternative suppliers/materials; identifying weaknesses in the supply chain and building contingencies to manage and mitigate availability risks etc.)

- finally, the low value low risk suppliers which, if not outsourced altogether, would be managed by the short-term, shop-around, bargain-hunters or maybe this could even be the training ground for the junior team. Thus a P&S department could allocate resources according to skill and experience, albeit with the flexibility to rotate roles.

(c) Thirdly, the P&S department could be organised in accordance with the structure of the internal customer base within the organisation. This could be fully implemented to where the members of the P&S team were decentralized and dispersed across the individual locations of the organisation. Indeed most tactical procurement has been dispersed in organisations these days, with very few still seeking to centralize the processing elements of P&S. However, even with only the strategic activity of P&S in the centre there is still a case for organising the department into teams which focus on the specialisms of the business. Indeed business managers will often insist on having dedicated P&S resource identifiably allocated to their specific part of the organisation. This ensures a customer focused approach from the P&S team however; the obvious risk is that it would be easy to miss aggregating common items of expenditure. One would have to ensure that the left-hand knew what the right-hand was doing.

(d) Some departments allocate resource randomly so that no specialism exists and so that no one P&S practitioner becomes stale and over-focused in any one area. Thus the senior people in these departments will do the important, valuable, work and the junior people the less important. The advantage in this is in workload always being evenly shared around the team on a first-in-first-out basis. However, it does depend on the entire P&S team all having similar skill levels and a similar working pace in order to avoid inequalities in outputs, which can be divisive.

(e) Finally we have a Category Management structure where team members specialize according to the supply markets. Here each member of the P&S team will focus on a particular supply market and become the expert in that Category. Thus, over the years, a commodity buying approach has meant that we have had IT buyers, print buyers, engineering buyers etc. etc. This specialisation has tended to limit a P&S professional in their career development. However, category management - albeit still focusing on a particular segment of the supply market or a Commodity - has meant much more is required from the P&S practitioner.

Background

Category management is a phrase that was first coined in the Marketing side of business. Here, just as for Procurement and Supply Management, the Sales Manager has to decide whether to organise his team in one of several ways. One option may be to organise the team geographically where each sales person would support the entire product range in a region, another may be to organise the Sales team by value/risk. However organising by product category, although most prevalent in the retail sector, is now increasingly popular across all marketing activity. What exactly is category management in marketing? At its most
fundamental, category management is a process that involves managing product categories as business units and customizing them on a very focused basis in order to satisfy customer needs. It has been developed as a result of the belief that the massive increase in the introduction of new products in the Retail sector has made strategic management by department too unfocused, too high level. Category management therefore transforms retail "buyers" into entrepreneurs, each responsible for a small business within the larger enterprise.

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

Due to changing business dynamics, there has been an increasing use of allocating goods and services to buyers. Global research organisations, such as the Aberdeen Group\(^1\) apply their Total Cost Management (TCM) frameworks to all categories of spend.

Their research shows that “companies are turning to category management strategies, combining standard sourcing and compliance procedures with process automation and improved data management and spend analytics to holistically manage the total costs of a good or service and its associated supplier relationships”\(^2\).

Important benefits generated include the standardisation of specifications and processes and the aggregation of demand (which is discussed in greater detail). Category management often refers to the methodology by which this ‘portfolio buying’ approach is put into practice. It is usually defined by a number of clearly defined stages or sequences of activities. Within a strategic procurement framework, for maximum effectiveness, category management should be a continuous and embedded process, and yet demonstrate the agility to meet the demands of a dynamic supply market and business.

There are a number of proprietary illustrations of Category Management – but generically there are four common phases which describe the types of activities conducted, the four phases are;

- Initiate
- Prepare
- Deliver
- Maintain and Improve

\(^1\) Website address [www.aberdeen.com](http://www.aberdeen.com)

Sequencing activities in this way makes sure that procurement outcomes are determined by a thorough understanding of business need and full market knowledge. This will give better and more sustainable outcomes.

Features of a structured Category Management approach include:

a) Developing a thorough understanding of third party spend and future demand.
For each category or segment of the supply market the P&S specialist needs to know what’s happening in that market and also in each sub sector. For example:

- what is growing
- what is declining
- what are the new developments and new technologies
- what your competitors are doing
- what the supplier’s competitors are doing
- what are the expected changes in demand from his own company and in that market category
- how to make a projection of what customers will require in the future.

He can glean this information from the major suppliers in the category but, if they cannot, then you will have to commission the major market research agencies (eg. AC Nielsen TNS, Infoscan or IRI) to obtain it. If no information exists then the P&S Category Manager is faced with making some educated guesses based on his own experiences.

b) Segmenting spend into market sectors.
Deciding on what the category should include is not an arbitrary decision at all but it will change from organisation to organisation. There are some generic categories (IT, print, engineering consumables etc.) but deciding what their scope includes has to be based on both the specific circumstances of the customer organisation as well as the market segment the category itself represents. The category is based on a grouping of like products which are compatible and which the internal customer expects to see pulled together and in which a meaningful choice can be made.

Dividing the category further, based not only on product types that the internal customer can relate to but also on the customer decision making hierarchy is the next step.

It would be good practice to have as many levels as possible in the hierarchy – in retail marketing at least five levels are examined with often up to 10 if possible. Then, starting at the top with basic groupings that tend to be purchased together, for example office supplies, one can then break the category segment down further.
into say furniture, storage, stationery etc. and then further again for stationery into pens, pencils and envelopes etc and then even further for envelopes into internal brown envelopes and high quality pre-printed envelopes etc. Being able to move into analysis of third, fourth and fifth tier suppliers may be the luxury of the super-large P&S departments but the core reason for implementing a category management structure is to allow this level of analysis and indeed familiarity with the supply market.

c) Developing market sector sourcing strategies.
Once comprehensive Market Analysis is completed and all of the category data reports and the market research is available, it can be used strategically to deliver a sourcing strategy taking account of, for example:

- all the latest market movements
- how your suppliers are doing, how your suppliers’ competitors are doing
- compare and ‘league table’ the suppliers in the category
- recommendations for improving the procurement situation
- your category aims and objectives: will you partner or double-source or vertically integrate etc.
- how far can the suppliers in the category be developed (and have you the resources and capability to do it)?
- Delivering other business objectives, for example CSR

d) Supplier selection and segmentation
The P&SM practitioner will need to decide on who is the best supplier to fit with the business ideals; find out all the products they supply to identify any synergies and then, using the knowledge gained from the market research and analysis, the perfect scope range for the category and decide who are the best suppliers to deliver strategically.

e) Supplier performance management, including strategic supplier partnering.
Category development uses all of the knowledge gained from the market research and analysis to create a Category Development Plan. Considering what the situation may be in 5 years’ time will provide the focus for decisions on the type, style and number of suppliers and on the sourcing processes to be. It is here where vitally important issues such as a decision to Partner in this particular market will be effected and then tested. Each category will have its own timetable but at least annually this whole process should be completely reviewed.

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

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

Another generic framework is given by Umicore, a materials technology group. They define category management as ‘a concept in which a team (headed by a category manager/product co-ordinator) is responsible for all procurement aspects of a specific product/service or a group of products/services, for more

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than one Business Unit and/or one site. Umicore’s activities are focused on four business areas: advanced materials, precious metals products and catalysts, precious metals services and zinc specialities. Each business area in turn is divided into market-focused business units.

Category Management should not be confused with expenditure segmentation. It is a structured framework of activities that is designed to deliver superior procurement outcomes.

Figure 1 A typical commodity based organisational structure (drawn from the manufacturing sector).

Case Study 1

Category Management and Rolls-Royce Aerospace

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

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<table>
<thead>
<tr>
<th>Material Code</th>
<th>Concept Code</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>191339101</td>
<td>M1L</td>
<td>Machined Forging Other Met Irregular shape 0-75mm cube</td>
</tr>
<tr>
<td>191339202</td>
<td>M1M</td>
<td>Machined Forging Other Met Irregular shape &gt;75 - 250mm cube.</td>
</tr>
<tr>
<td>191339303</td>
<td>M1N</td>
<td>Machined Forging Other Met Irregular shape &gt;250 - 550mm cube</td>
</tr>
<tr>
<td>191339414</td>
<td>M6O</td>
<td>Machined Forging Other Met Irregular shape &gt;550 - 750mm cube</td>
</tr>
<tr>
<td>191339435</td>
<td>M6P</td>
<td>Machined Forging Other Met Irregular shape &gt; 750 - 1500mm cube</td>
</tr>
<tr>
<td>191339436</td>
<td>M6Q</td>
<td>Machined Forging Other Met Irregular shape &gt; 1500mm cube</td>
</tr>
<tr>
<td>191339507</td>
<td>M1R</td>
<td>Machined Forging Other Met Pred. Round 0-75mm dia</td>
</tr>
<tr>
<td>191339618</td>
<td>M1S</td>
<td>Machined Forging Other Met Pred. Round &gt; 75 - 250mm dia 0-15 long</td>
</tr>
<tr>
<td>191339629</td>
<td>M1T</td>
<td>Machined Forging Other Met Pred. Round &gt; 75 - 250mm dia 15 - 75 long</td>
</tr>
<tr>
<td>191339632</td>
<td>M1U</td>
<td>Machined Forging Other Met Pred. Round &gt; 75 - 250mm dia 75 - 250 long</td>
</tr>
<tr>
<td>191339713</td>
<td>M1V</td>
<td>Machined Forging Other Met Pred. Round 250 - 450mm dia 0-15 long</td>
</tr>
<tr>
<td>191339724</td>
<td>M1V</td>
<td>Machined Forging Other Met Pred. Round 250 - 450mm dia 15 - 75 long</td>
</tr>
<tr>
<td>191339735</td>
<td>M1W</td>
<td>Machined Forging Other Met Pred. Round 250 - 450mm dia 75 - 250 long</td>
</tr>
<tr>
<td>191339736</td>
<td>M1X</td>
<td>Machined Forging Other Met Pred. Round 250 - 450mm dia 75 - 250 long</td>
</tr>
<tr>
<td>191339747</td>
<td>M1Z</td>
<td>Machined Forging Other Met Pred. Round 250 - 450mm dia &gt;250 long</td>
</tr>
<tr>
<td>191339818</td>
<td>M1A</td>
<td>Machined Forging Other Met Pred. Round 450 - 750mm dia 0-15 long</td>
</tr>
</tbody>
</table>
In this example, category management has enabled the following:

1. **The product commodity/category**
   As part of the order fulfilment process, generation of the customer order sets in motion a series of processes including generation of a ‘bill of materials’. This is a list of all the assemblies and sub-assemblies required to make the product for the customer.

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

   - The quantity of the material required for production
   - The type of material required
2. Assessing the supply situation
Information from all the material codes will help in the assessment of the supply situation. Potential issues affecting delivery of the product can be identified at an early stage and resolved.

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

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

- The type of commodity being bought
- Which suppliers, under what contract terms
- What duration and over what frequency.

Knowing and understanding the cost drivers enables resources to be allocated against activities, and supply chain process improvements to be developed, implemented and monitored. The company has been able to take advantage of the benefits of scale generated by using category management. The aim is to sustain and enhance customer service level agreements, thereby generating greater value for the customer. This is particularly important in a retailing environment, which forms the basis of the second case study.

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

- Pareto/ABC analysis
- Supply positioning/portfolio analysis
- Evaluation of suppliers’ performance, as part of a way of managing the market
- The general identification of future product development (based on real time information of what is selling and what is not)
- Enabling leverage in the marketplace
- Ways to improve the total supply chain
- It is increasingly seen as a way of segmenting workloads and resources into business streams
- A vehicle to influence change within the organisation and industry.

5. Category Management as a means of generating specialist skills amongst the procurement workforce
The increasing sophistication of the procurement business discipline has led to the requirement for specialised competencies. The use of category management in the retail environment is a good example of this.

6. Category Management to aggregate knowledge within the category
There is also a benefit in terms of aggregating knowledge within the category to applying consistency and focus to the category. For example ‘consultancy services’ would be a part of ‘professional services’, but could be further sub-divided into ‘legal services’.
The Benefits of Category Management
The CIPS Supply Chain Group identified several benefits gained by aggregating the procurement of similar goods and services. The most obvious of these are using category management according to the different modes of segregation.

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

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

Case Study 2
Category Management in the Retail Environment

The retail industry is among the pioneers of category management. Category management is viewed as an integral commercial function involving the buyer and sales departments within the organisation. As has been mentioned, in retail companies the buying decisions may, to a large extent, determine the sales potential for a specific product (and vice versa).

In relation to the product management process, a customer led focus has resulted in the category manager interfacing with both customers and suppliers. In effect this is the management of a greater part of the supply chain than previously .......The category manager must therefore exhibit personal and professional skills in being a marketer, a buyer and a sales person; in essence, a true cross-functional role. In retailing the term merchandiser is commonly given to those undertaking this task. This restructuring of the organisation to operate on a commodity basis has delivered tangible benefits.

Arjan J van Weele refers to this integrated commercial function as category management, and links it to Porter’s value chain.

Implementing Category Management

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

- Conducting a pareto analysis to ensure the correct commodities are targeted first
- Ensuring that a managed internal and external communication process is in place

Linking category management to strategic sourcing and the wider corporate strategy

- Involving the use of cross-functional teams

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• Using appropriate information technology to manage the categories

• Bearing in mind that a change in business direction will impact on the sourcing strategy

• Ensuring the supplier base can meet the needs/demand of the new strategy

• Considering the impact on the supplier base of implementation failure

• Not underestimating the length of time required for successful implementation of a sourcing strategy

• Recognising that the strategy will evolve over time and will require periodic maintenance

• Continual analysis of demand to cover medium and long term timescales. This would incorporate new technologies and skills to meet market demands, for example, as part of a CSR programme.

Conclusion

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

Further information is available from the CIPS Knowledge or the CIPS website (www.cips.org).