Procurement Outsourcing (PO) has emerged as an efficacious method to generate value for in-house procurement. It started out as an activity focused on cost and spend reduction, but has now evolved into a tool to harness strategic value as evident by the robust growth of this US$2.1 billion market. One of the components of an end-to-end PO strategy is outsourcing of category management, which is a key value lever for any procurement organization to achieve its strategic goals. However, category management itself is an overused term and often misinterpreted not only in terms of what it represents but also in terms of what it aims to achieve. Add to it the concept of outsourcing category management and the story becomes even more interesting.

The objective of this research is to explore the various nuances of category management outsourcing and across the following themes:

- Value proposition of category management outsourcing
- Key market trends
- Current and future landscape
- Emerging opportunities
- Critical challenges and best practices
What is Category Management?

In order to understand the various nuances of category management in an outsourcing construct, one needs to be aware of what category management essentially is. In theory, category management has been around for quite some time; however, it garnered significant attention in the recent past as the role of procurement became more strategic. While there is no universal definition of category management, it can be defined as an approach to procurement by means of a systematic purchasing process that marries organizational strategies with supply market dynamics. Category management views the procurement function not as a single unit but as a composition of smaller segments, or “categories”, each of which is then strategically managed end-to-end. It is analogous to running separate P&L statements for each of the regional units of a global corporation.

Operationalizing category management is a complex task involving several steps and interdependencies. It requires a cross-functional effort encompassing multiple stakeholders both within and beyond the organization. Hence, a robust governance structure is crucial to the success of a category management program. While there is no one way to operationalize category management, a typical approach involves a robust analysis of business needs & the supplier market, a well-defined strategy framework, and regular review and assessment of the procurement process. The following figure illustrates this framework:

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**EXHIBIT 1**

Framework for operationalizing category management

<table>
<thead>
<tr>
<th>Data gathering</th>
<th>Analysis and strategy formulation</th>
<th>Strategy execution</th>
<th>Contract implementation</th>
</tr>
</thead>
</table>
| • Internal data:  
  - Business requirements and needs  
  - Spend data  
  - External data:  
    - Supplier market information  
    - Individual supplier quotes  
  - Best practices and industry benchmark data | • Data analysis  
  - Generating insights from spend data  
  - Assessment of supplier market  
  - Evaluation and comparison of individual suppliers  
  - Strategy formulation  
  - Developing a comprehensive strategy  
  - Classification of categories  
  - Selection of suppliers  
  - Risk assessment | • Internal  
  - Establishing team and selection of category managers  
  - External  
    - Supplier due diligence  
    - Negotiation with supplier  
    - Signing of contract  
  - Contract management  
    - Process monitoring  
    - Tactical buying  
    - Quality/service assessment  
    - Vendor reconciliation  
    - Relationship management  
    - Supplier review and assessment |

Source: Everest Group
Value Proposition of Outsourcing Category Management

The intensifying competition in the global marketplace is creating a web of intricate supply chains which require deft management. Organizations have been increasing the use of procurement outsourcing to ensure sufficient bandwidth for their core strategic processes. However, as the role of the procurement function shifts from operational to strategic, there is also a shift toward expanding the scope of outsourced procurement activities to include more strategic processes. Thus, organizations can realize multifold benefits by outsourcing not just operational procurement but also strategic activities such as category management.

The value proposition of outsourcing category management differs from that of outsourcing operational procurement. While cost arbitrage is the predominant driver for outsourcing operational procurement, the value proposition of category management is driven more by the access to expertise, marketplace insights, and alignment of procurement with organizational goals. In this context, the drivers of outsourcing category management are more strategic than tactical.

Outsourcing category management for non-core spend lends organizations the flexibility to focus more on core procurement activities. Moreover, the outsourcing partner provides access to a wide pool of experts, which at times, procurement organizations lack in-house. Also, procurement organizations can leverage the experience of the outsourcing specialist across multiple geographies and industries to their advantage.

The figure below illustrates the value proposition of outsourcing category management in detail.

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**EXHIBIT 2**

Value proposition of category management outsourcing

| Source: Everest Group |

<table>
<thead>
<tr>
<th>Total Value Equation (TVE)</th>
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<tbody>
<tr>
<td><strong>Strategic impact</strong></td>
</tr>
<tr>
<td>- Strategic alignment</td>
</tr>
<tr>
<td>- Market intelligence</td>
</tr>
<tr>
<td>- Innovation</td>
</tr>
<tr>
<td>- Standardization</td>
</tr>
<tr>
<td><strong>Process/business impact</strong></td>
</tr>
<tr>
<td>- Flexibility</td>
</tr>
<tr>
<td>- Visibility</td>
</tr>
<tr>
<td><strong>Cost impact</strong></td>
</tr>
<tr>
<td>- Cost reduction</td>
</tr>
</tbody>
</table>

- Align procurement with organizational objectives
- Adopt to supply market dynamics to cater to organizational imperatives
- Leverage service providers to gain category-specific intelligence
- Empower supplier as agents of change to drive innovation
- Streamline procurement operations by standardizing processes and workflow to increase response time
- Effectively manage demand variations
- Access people, process, and technology expertise offered by service provider
- Gain control on the overall spend profile of the procurement organization
- Spend reduction and harmonize realized and contracted savings
- Rationalize supplier base

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Outsourcing category management helps procurement organizations realize multifold benefits; however, the most tangible outcome is cost and spend reduction. By including category management as a part of procurement outsourcing contracts, procurement organizations can realize significant bottom-line impact. In fact, category management accounts for nearly 35% of overall savings that can be realized through an effective procurement outsourcing program. The overall savings which are realized through category management are attributed to three primary modes:

- An enhanced visibility on spend through systematic procurement enables organizations to effectively manage demand. This results in a year-over-year spend deflation
- Procurement organizations become more nimble in their operations, driving efficiency benefits such as faster procurement cycles, which result in significant cost reduction over a period of time
- End-to-end view of the procurement cycle ensures enhanced compliance, which prevents leakage of savings

An important aspect of category management is that it is not a one-off activity. The benefits elucidated above are only realized if a continuous category management program is in place. If procurement organizations disengage a category management program, then spend will start to inflate over time. It is also important to note that category management is a highly expertise-driven activity, hence, leveraging the right outsourcing provider is paramount to success.

### Adoption of Category Management Outsourcing

With procurement organizations increasingly opting for the outsourcing route to create strategic value, inclusion of category management in PO contracts has increased significantly in recent years (Exhibit 4). Moreover, depth and frequency of inclusion of category management is higher in renewals as compared to new contracts. This can be attributed to first-time outsourcers who become aware of the finer aspects of outsourcing, hence enhance scope of PO relationship during renewals.

There are five major indirect spend categories that are mostly outsourced. These are IT/telecom, marketing, operations, facilities, HR-related, and industry-specific. The degree of outsourcing in a particular category is a function of the value and criticality of the category. Typically low-value and
non-critical categories, such as operations and facilities, have witnessed the highest inclusion. Since each category comprises various subcategories of varying degrees of complexity, there is a difference in adoption of subcategories as well.

The adoption trends of category management outsourcing can be analyzed across the following three parameters:
**Geography:** The overall adoption of category management outsourcing across geographies is correlated to the adoption of PO – North America and Europe have the highest adoption, with emerging geographies such as Asia Pacific and Latin America joining the fray. However, meaningful differences in the categories which are outsourced across geographies do not exist. It is more dependent on the nature of the industry than a particular geographic region.

**Industry:** Adoption of category management outsourcing has a strong industry flavor to it. There exist variations in the propensity of a particular industry to outsource category management as compared with others. It can be attributed to two main factors:

- Industries mature to outsourcing are more amenable to outsourcing category management as well
- Industries in which bulk of spend is non-core, such as financial services and travel & logistics, category management outsourcing provides a strong proposition to focus on core organizational activities

**Type of buyers:** There are subtle differences in the adoption levels of category management outsourcing by buyer size. The SMB and mid-market segment, especially has a relatively higher degree of adoption when compared with the large buyer segment. The value proposition of category management for the SMB segment is driven more by the need to access expertise than to reduce spend. Moreover, due to their small scale of operations, a lift-shift-fix model is easy to implement as compared with large buyers, who typically outsource larger spend than the SMB segment.

**Evolving Dynamics of Category Management Outsourcing**

In recent years, global business services have undergone a massive shift due to various macro and microeconomic forces. Technological developments are shaping the core fundamentals of how organizations function. On one hand automation is making manual labor redundant, while on the other, digitization has created an ocean of information to be analyzed and interpreted. Such changes have affected procurement organizations as well. As mentioned earlier, they are undergoing a transformation to adapt to changing business imperatives causing procurement outsourcing to evolve into a cost-plus-value model. Arising from such transformative efforts are some key themes in category management outsourcing:

- **Commoditization of categories are influencing end-to-end outsourcing:** Globalization is creating a singular economy, due to which, procurement of various goods and services — earlier deemed complex — has rapidly become commoditized. The global supplier base is expanding and international borders are becoming permeable, resulting in a mass market of easily available, highly commoditized goods. Hence, outsourcing decision for such categories has become relatively easy for procurement organizations. They are able to clearly identify their goals and define SLAs for service providers. End-to-end category management is becoming the new norm in procurement outsourcing.

- **Increasing role of technology:** It is perhaps the most influential force driving change in the global services realm. Technology has become vital to category management throughout the lifecycle of the program. Advanced spend analytics tools are enhancing the effectiveness of category strategy. Sourcing events have become simpler through e-sourcing tools. Vendor monitoring tools help to successfully operationalize supplier management. With increased visibility gained through technology, category management significantly reduces tail-end or maverick spend. To realize such benefits, procurement organizations are partnering with service providers who can offer an adequate blend of category and technological expertise.
Creation of value by driving supplier-led innovation: Being the market-facing entity, suppliers have access to a wealth of knowledge which not only sharpens a particular category strategy, but also influences the overall organizational strategy. Procurement organizations realize that significant value can be garnered by leveraging suppliers, hence are engaging service providers to effectively tap into their supplier base. As a result, a supplier relationship management program has become pivotal to category management outsourcing. Besides organizing forums and interactive sessions with the supplier community to drive innovation, category management is also responsible for ensuring appropriate assimilation of ideas into the procurement ecosystem. The role of category management is thus evolving into an influencer of innovation.

Emerging Opportunities in Category Management

With the expanding influence of procurement in an organization, the breadth and depth of categories managed is also rising. This has created new opportunities for outsourcing as well. The shift here is two-fold — some of the complex categories are getting outsourced to a greater degree and some niche subcategories too are emerging. Let us look at these in detail:

- Outsourcing of complex categories: Although direct spend is mostly managed in-house because of its proximity to the core business, organizations are also increasingly outsourcing certain non-core direct spend categories such as Maintenance, Repair, and Overhaul (MRO). More than a tactical advantage, procurement organizations are able to benefit from the expertise of external specialists gained through dealing with multiple buyers across geographies. Another area is the HR-related category, specifically around contingent labor and professional services. Unlike others, these categories present some unique challenges. Quality of services and professionals sourced is highly critical. Moreover, employment regulations vary significantly; hence, executing an effective category strategy requires a unique skill set. Service providers are leveraging the opportunity to carve out niche offerings in such areas. An example is the Managed Service Provider (MSP) program to cater to end-to-end management of contingent labor category, which has gained significant traction in recent years as a separate offering.

<table>
<thead>
<tr>
<th>EXHIBIT 6</th>
<th>Category scope of PO contracts</th>
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</thead>
<tbody>
<tr>
<td>Growth of HR and industry: specific category outsourcing</td>
<td>Percentage of inclusion in contracts signed till date</td>
</tr>
<tr>
<td></td>
<td>Contracts signed till 2012</td>
</tr>
<tr>
<td>HR-related</td>
<td>65%</td>
</tr>
<tr>
<td>Non-core direct spend</td>
<td>66%</td>
</tr>
</tbody>
</table>

Source: Everest Group
• Niche opportunities: The market is also witnessing a rise in some niche subcategories as separate offerings. These subcategories were earlier traditionally managed as part of a larger category, however, now are increasingly turning independent due to evolving market conditions. An interesting example is fleet management. With rising challenges, such as costs of maintaining a private fleet, emergence of multi-geography fleet companies, and government regulations, to name a few, organizations are now rapidly adopting the outsourcing route through procurement. Earlier procurement involved the sourcing aspect of fleet, however, it is now managing the entire category end-to-end. Some service providers have tailored niche offerings around fleet, and are also leveraging proprietary technologies for effective management of this category.

Key Challenges and Best Practices in Category Management Outsourcing

Operationalizing a successful category management program in an outsourced environment is fraught with various challenges. Moreover, the complexities faced also keep evolving with the maturity of the program. Since category management includes cross-team efforts, it is important to be cognizant of the repercussions which may affect other functions. Let us look at some of the challenges that organizations face while implementing category management and the best practices that can remediate those challenges:

• Implementing in a decentralized environment: A decentralized structure poses significant challenges in implementing category management. Regional strategies will differ, and so will procurement's objectives. Aligning a category strategy in a decentralized structure will require a review of objectives and a possible organizational restructuring. Procurement organizations and service providers will need to establish a robust governance structure to ensure that there is no misalignment. Moreover, category strategies will need to take into account local business environments as well and establish protocols that ensure compliance to local rules and regulations.

• Inertia to change: Implementing category management involves revamping existing processes and frameworks. As such, there exists a certain degree of reluctance to change. Moreover, new processes will be implemented across functions beyond procurement and organizational boundaries. Hence, to effectively execute category management, a change management process is a quintessential necessity. Service providers will need to phase out the implementation and educate stakeholders — both internal and external — of the changes in advance. This will ensure minimum impact on the procurement process and result in maximum benefits.

• Communication gaps: Category management involves joint efforts across multiple stakeholders in an organization. Communication gaps, hence, are difficult to avoid and can significantly affect execution. Also, sometimes there is lack of clarity on the roles and responsibility as well, which can widen the communication gap. Category managers need to establish adequate communication protocols and processes to prevent such gaps. Moreover, roles and responsibilities need to be clearly articulated during the implementation phase itself.

• Data sanity: The foundation of a successful category strategy is robust analysis of historical and current procurement data. At times, such data is not effectively captured and structured, which can hamper meaningful analysis. Moreover, large volumes of data can be difficult to analyze. Procurement organizations need to work in close coordination with service providers to identify potential gaps and issues. Leveraging appropriate spend analytics tools will help overcome such challenges.
Conclusion

Procurement organizations worldwide are increasingly looking at a category management approach to drive higher savings and better performance for the enterprise. Moreover, as more and more procurement organizations opt for procurement outsourcing to create greater strategic value, there has been a significant increase in the inclusion of category management in PO contracts.

Effective category management is a highly expertise-driven activity and requires specialized skills and capabilities that most procurement organizations lack in-house. By partnering with a PO service provider who has end-to-end category management capabilities, enabling technology, and strong category expertise, procurement organizations can successfully operationalize category management and drive significant value across the enterprise.

Recommended reading for sourcing and procurement professionals

Epic Fail: 5 Proven Ways to Botch Your Supplier Relationship Management Program

More than half of leading global enterprises do not have an effective supplier relationship management (SRM) program in place, studies say. Why do so many otherwise successful organizations founder on SRM? And how can your team avoid the same fate? In this paper, GEP alerts you to the five key reasons why many enterprise SRM initiatives fizzle out or fade into ignominy. The paper also provides real, immediately useful strategies to overcome each challenge and succeed where so many others have failed.

Combat Risk with Supply Market Intelligence

In this paper, experts from GEP and Procurement Leaders demonstrate how global enterprises can better use information to mitigate hitherto risks, with a more fact-driven, more proactive approach to supply risk. The paper also includes practical advice from enterprise CPOs, independent risk analysts and supply chain experts to help you better deflect or mitigate the presently unknown, but virtually certain, mayhem headed your way.

More on Category Management

For more white papers, research reports, case studies, webcasts and other resources on category management, please visit the GEP Knowledge Bank.
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