KISM AND KASNEB

CPSP

PART 2

CATEGORY MANAGMENT

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TOPIC 1

OVERVIEW

Category management is the process of segmenting the main area of organisation spend of goods and services into discrete groups of products and services according to the function of these goods and services and most importantly to mirror how individual market places are organised.

Using this segmentation an organisation works across functionality on individual categories, examining the entire category, the market place and the individual suppliers. A category has been identified as a group of products or services which are purchased from the supply market and which are used as an element of value proposition that the company offers to its customers or which are to be used in internal company's operations.

Category sourcing plan is a formal plan for certain product categories that explain how the company will deal with the certain supply markets and its key supplier relationships.

Category sourcing as a concept

It includes three stages i.e.

i. Category planning
ii. Category sourcing
iii. Category implementation

Category sourcing plans need to have a strong link to the overall business goals and strategies. Understanding the company's supply market and competitive priorities is important since it will reveal the companies opportunities for competitive advantage. It is important to understand who are the most important stakeholders in order to be able to involve them effectively and in a timely manner in the category management process.

Purchasing vs. Sourcing

There are numerous functions in the procurement process. Some of those are purchasing and sourcing. These two activities are very essential to the procurement process and they make the procurement process more efficient.

Purchasing is a subset of procurement. Purchasing generally refers to buying goods, works and services. Purchasing often includes receiving goods and making payments.

Sourcing is the process of identifying potential vendors, conducting negotiations with them and agreeing supply contracts with these vendors. It generally refers to allocating sources of goods, works and services that the organisation needs. It is a subsection of the procurement process.

Difference: while procurement is concerned with logistics and acquisition of goods, works and services, sourcing focuses on finding the best and least expensive supplier for those suppliers.

Sourcing often includes identifying the suppliers, negotiating, testing for quality and market research. Sourcing is an essential step since the profits of the business can rely heavily in finding the best source of supply.

Examples of categories in an organisation

- Stationeries
- Travel services
- Legal services
- Fuel and lubricants

Reasons for category management

1. Better management of resources.
2. To manage and exploit changing business condition.
3. Supplier consolidation.
4. To enable one to leverage resources e.g. people, knowledge, expertise
5. Minimize supply chain risks.
6. Improved quality and services.
7. Leverage presence in the market place.
8. Drive commodity and service innovation.

Benefits of category management

1. To raise the profile and competency of procurement across the organisation.

2. Savings.
3. Improvement of service levels.
4. Product availability.
5. Value for money is realised.
6. Reduction of risk in supply
7. Delivery of world class procurement solutions.
8. Supplier capability development.

Key enablers of category management

1. Organisation structure –it defines responsibility, authority and power of procurement department.
2. Efficient procurement process –the approvals, conditions, risk, supply chain management process, negotiation, measurement are going to affect the efficiency of the category management.
3. The people.
4. Technology –makes supply chain management fast and efficient
5. Strategic sourcing.

Steps in category management

1. Initiation/ preparation
2. Identification of priorities
3. Preparation of strategy
4. Implementation of the changes
5. Maintain the level of performance
6. Continuous improvement

Strategic procurement and Strategic sourcing

Strategic sourcing

The concept of strategic sourcing was popularized in the 1980s and 1990s and is now considered a standard purchasing strategy used by blue chip companies.

Strategic sourcing refers to the process of taking advantage of purchasing opportunities by continually reviewing current needs against purchasing opportunities.

It was first established by General Motors in the 1980s and is now a common business purchasing tool.

Strategic sourcing is often used for high value services, ad hoc purchases and core large value purchases.

The steps in strategic sourcing are:

i. Evaluating the current organisation’s purchasing cycle.
ii. Evaluate what is currently available in the supply market.
iii. Review the cost-benefit analysis using other suppliers.
iv. Review potential vendors
v. Update current procurement strategy.
vi. Negotiate with potential vendors.
vii. Implement the new vendor relationship.
viii. Review and update the strategic sourcing on a continuous basis.

Strategic procurement

It’s a long-range plans for ensuring timely supply of goods and/or services that are critical to a firm's ability to meet its core business objectives.

Steps in strategic procurement process

Strategic procurements are core acquisitions that could determine organisation’s success or failure; with potential to bind organisations in to long term contractual agreements. As such, they must get input from senior management and all other relevant stakeholders.

Strategic procurement steps are chronological, where each next step is influenced by the preceding one.

The 10 fundamental steps in Strategic procurement processes are: –

1. **Requirement identification**

Business procurements essentially take place in response to market needs or demand. And demands can either be internal -e.g. raw materials for production- or external -e.g. products and services for consumption.

Requirement identification in procurement should lead into determining what exactly is required.

Key performance indicators (**KPIs**) in this step should include: –

-Identification of exact requirements through the use of procurement need analysis.

-Clarity on issues of; type, quality, urgency and total spend against market affordability.

2. Budgeting for the Procurements

Having identified what the market requires, a procurement budget -which is part of the main budget for an organisation- must be drawn.

Strategic procurement 'in collaboration with finance department' should draw up a procurement budget, which would correctively track actual expenditure against the planned acquisition schedule.

A procurement budget influenced by cost models should achieve the following outcomes:

KPIs:

-Outline total cost of acquisition (i.e. from ordering all the way receiving)

-Prevent unnecessary diversions from the budget schedule.

-Ensure that current procurement costs are less or at least equal to previous ones.

-Enable the achievement of: cost reduction, cost avoidance and return on investment (ROI).

-Provide a cushion for unexpected but necessary expenditure, 20 – 30% of total acquisition value should suffice.

3. Supplier Sourcing and Short listing

Having organised the financial requirements, strategic procurement team should embark on a search for potential suppliers who can reliably provide requirements to the organisation as and when required.

Sourcing is; the identification and selection of the supplier whose costs, qualities, technologies, timeliness, dependability, and service best meet the organization's needs.

The sourcing and short listing step is about identifying and analysing the ability, dependability and reliability of a supplier to provide best value for money and fit for purpose supplies.

At this stage, instruments like; questionnaires, request for proposal (RFP), request for samples, bench marking, bidding or reverse auction could be used.

The sourcing and short listing step should provide a short list of:

KPIs:

-Suppliers who meet qualification criteria.

-Suppliers who rate among the best in what they offer. (Bench marking exercise can apply here)

-Long term-focused suppliers, willing to be bound in to long term and mutually beneficial business relationships.

4. Negotiating and selecting suppliers

Negotiation is applicable where there is disagreement or potential disagreement between suppliers and buyers.

Based on the strategic requirements, shortlisted suppliers or bidders (at least 3 per category) must be invited to a final 'face to face' negotiation. This negotiation approach is preferable; as personal traits and gestures are better observed here than is otherwise the case.

At this stage, ABC Classification of suppliers can assist in categorising and finally selecting suppliers based on their capabilities.

Just as is the case in all businesses, time is money in procurement. Therefore negotiations must not drag on forever.

KPIs:

Negotiations must:

-Bring unity and discipline in pursuit of set objectives.

-Achieve fair terms and conditions that solidify team work.

-Encourage mutual concessions aimed at removing impasse.

-Produce an effective unit that can outwit competition.

In strategic negotiations, parties must pursue a win – win (collaborative) approach. This ensures that; while the buyer gets right quality and quantity at the right price, place and time, the supplier equally makes a reasonable return.

No consistency in performance would prevail where returns do not match the effort.

5. Drawing and signing a buyer – supplier contract

Contractual agreement is the immediate step after negotiations. They take effect between two legal subjects; one intending to sell (offering) and the other intending to buy (accepting).
The core purpose of contracts is to formalise the buy – sale agreements between consenting parties.

KPIs:

Among other things contractual agreements must:

-Be drawn and signed off immediately after agreement.

-Outline the agreed performance, pricing, terms, conditions, rights and obligations for both parties.

-Outline the period (beginning and ending) of an agreement.

-Clarify on how risks and cost of unexpected occurrences will be shared.

-Outline penalties for willful misconduct and remedies for non-performance.

Contractual agreements in procurement professionally address all pertinent issues including survival and nonexclusive clauses.

6. Issuing of orders (the actual buying)

After contractual agreements, the strategic procurement team should issue out a well specified order, a requisition order.
Depending on the agreement, some suppliers require deposits (e.g. a percentage of total cost price) before arranging and dispatching orders.

KPI's:

Orders must be:

-Specific (i.e. quality, quantity, time and place) for easy conformance.

-Cost effective. For instance, 'consignment inventory' and 'bulk purchase' systems significantly minimise storage cost for suppliers and transportation cost for buyers respectively.

7. Receiving, inspecting and recording supplies

All receipts must be well recorded; damages, rejections or returns must be immediately reported to the supplier.

Most delivery documents includes a notice for buyers to notify suppliers on faults, damages or shortages within seven days of receipt; failing which complaints would not be acceptable.

KPIs:

-Receipts (i.e. procured products or services) must meet quality and other agreed performance standards.

-Packaging order and material should respond to the agreed requirements.

-Rejections, shortages and damages must be recorded, returned or reported to suppliers as quickly as the agreement requires. These records must be kept for a final supplier performance analysis exercise.

To simplify stock taking (particularly for transiting goods), bundle receipts should be recorded as packages, while loose items should be recorded by their specific names.

8. Issuing payments to suppliers

Upon receiving, checking and verifying goods or services, procurement departments must notify relevant parties (including remittance teams or paying masters/financial institutions) on the order and condition in which these goods or services are received, effectively authorising payment release or the opposite.

KPIs:

-Early payment terms (e.g. 2/10 net 30) should be utilised for as long as they are worthwhile.

-In the absence of early payments benefits, payment should only be made in the final days of the agreed grace period.

– Account (credit) procurements should be preferred to ’up front’ or ‘cash on delivery’ acquisitions.

-Cash payments should be discouraged; while closed cheques, electronic funds transfers (EFT) and bank’s letter of credit payments must be encouraged.

9. Performance assessment and management

In strategic procurement, performance assessment and management is an ongoing process of ensuring that suppliers meet or possibly exceed performance expectations.

KPIs: