Category Management: Beyond the “Strategic” in Strategic Sourcing

By Pierre Mitchell

Executive Summary
Building a category management capability that crosses organizational boundaries puts the “strategic” back into strategic sourcing. Category management fundamentally differs from strategic sourcing and builds on the creditability that strategic sourcing professionals have created for themselves over the years. For the most part, differences between category management and strategic sourcing center on the former’s longer time horizon and the broader scope and scale of its activities. Category management is aligned with the life cycle of the processes which consume the products and services in those categories. It involves not only a more comprehensive internal customer management and supplier management approach, but a broader, more facilitative way of constructing solutions that support both category and business objectives.

Introduction
Procurement executives are looking to provide greater value to the enterprise beyond cost reductions, but, markets can only offer so many savings using traditional ‘strategic sourcing’ methodologies. So, their focus from price reduction has gone towards TCO reduction and spend reduction – but more is still needed. Firms must get more “bang for the buck” (measured by broader business outcomes) as opposed to just reducing expenditures. Safely harnessing supply-market power to create competitive advantage is the mission of a world-class procurement organization. Yet, few companies have the capabilities to make that happen. The primary vehicle for extracting value from the supply base has been the strategic sourcing methodologies pioneered in the 1980s and 1990s. Sourcing managers used it successfully to rationalize suppliers, aggregate buying power, drive down pricing and even improve supplier performance against a contract. Strategic sourcing also proved invaluable during the recent recession to recalibrate pricing to the supply markets when they took a nosedive alongside demand markets1.

However, as companies try to shift their attention toward innovation, globalization and profitable growth, the implication for the Chief Purchasing Officer (CPO), sourcing managers and other staff becomes clear: expand the value objectives of categories beyond purchased cost reduction to provide broader support for strategic business objectives. Otherwise, the runway for savings will exhaust itself, taking procurement’s reason for having a “seat at the table” with it.

**Category Management Is Broader Than Strategic Sourcing**

The strategic sourcing process is typified by a set of periodic processes and projects that seek to reduce purchased costs by aggregating demand and rationalizing the supply base in selected commodities. This n-step process typically starts with procurement-led analysis to identify target commodities and opportunities – and then culminates in a preferred-supplier contract:

1. Profile the category  
2. Develop sourcing strategy  
3. Identify suppliers  
4. Evaluate suppliers  
5. Negotiate and award the contract  
6. Transition and implement the contract  
7. Monitor supplier performance

This price-centric methodology is highly effective for garnering initial savings if implemented well (i.e., a rational and streamlined cross-functional process creating a solid, price-effective contract), but it is still a sourcing methodology and geared toward creating contracts. Category management, on the other hand, evaluates not only the full cycle of a contract or supplier life cycle, but also looks holistically at the life cycle of the value chains which consume the goods and services in the spend categories. The differences between strategic sourcing and category management are shown in **Fig. 1**.

**FIG. 1 Category management: More strategic and holistic than strategic sourcing**

<table>
<thead>
<tr>
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<th><strong>STRATEGIC SOURCING</strong></th>
<th><strong>CATEGORY MANAGEMENT</strong></th>
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<td><strong>Goal</strong></td>
<td>• Reduce purchased costs for a given commodity, most often by selecting lower-cost suppliers through demand aggregation, competitive bidding and negotiation.</td>
<td>• Maximize realized category value to the organization, including total cost of ownership (TCO), risk, operational performance, innovation, etc.</td>
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<td><strong>Frequency</strong></td>
<td>• Periodic and project-based. Triggered over one or more years in the course of managing a commodity.</td>
<td>• Ongoing, day-to-day process. Triggers project-based activities and other operational improvements as needed.</td>
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<td><strong>Approach</strong></td>
<td>• Conducted via an n-step sourcing methodology culminating in transition to a new supplier contract.</td>
<td>• Develops a category strategy and applies appropriate value levers and supporting techniques/tools as needed to meet value objectives (e.g., strategic sourcing, SRM, value engineering, process reengineering, demand and compliance management).</td>
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<td><strong>Results</strong></td>
<td>• Reduced contract pricing translating to actual realized savings hitting the bottom line.</td>
<td>• Category value is targeted, including validated savings and broader value measurement.</td>
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Source: The Hackett Group
Both strategic sourcing and category management organize processes and resources around supply markets, but category management not only sources these market categories, but also manages them on an ongoing basis. Category management involves building a clear understanding of the organization’s key value objectives for the category (themselves based on business objectives) and then developing a set of executable strategies. Procurement’s role is to come to the table with ideas as to what value is possible to capture, even if Procurement might itself not be measured on all those benefits.

**Hitting the Wall**

Unfortunately, Most Organizations Struggle to Break Through to True Category Management. While it sounds straightforward in principle, most organizations struggle to escape the limitations of their sourcing process. One reason is that the strategic sourcing methodologies used by sourcing managers (including those called “category managers”) are, frankly, running out of gas. Sourcing is only one step in a broader value chain, and by definition, can only be as strategic as the process allows.

Category management doesn’t start with a corporate procurement group creating ‘waves’ of strategic sourcing projects to support its functional savings goals. Rather, it is tied to the cadence and lifecycle of the primary stakeholders’ processes that consume the products and services in those categories. Therefore, it is not surprising that, while the majority of procurement organizations have at least a basic strategic sourcing process, less than 5% have classified it as truly strategic, and have adopted a truly comprehensive category management process. Most have “hit the wall” in terms of going beyond purchased cost reductions because their current strategic sourcing methodologies inherently let them go only so far. Some organizations even make the problem worse by renaming their sourcing methodologies as category management, without changing the fundamental approach.

**Pulling Back the Covers on Category Management**

When implemented properly, category management is a client-friendly framework. It involves building a clear understanding of the organization’s key value objectives for the category, then developing a set of executable strategies that meet those objectives (Fig. 2). If objectives are defined too narrowly (e.g., hard cost savings and low time/risk to implement), the default will lead down the path of basic sourcing and exclude too many potential opportunities.

Still, identifying and scoping this bigger prize is only half the battle. Companies must actually seize the prize, and that requires capabilities not currently possessed by most procurement organizations. The strategies shown Fig. 2 pull a variety of value levers that are needed to extract that value from the supply markets and inbound supply chains. For most commodities in a category, transformation might start with strategic sourcing to rationalize the supply base. After that, however, some strategic commodities might move toward a strategic SRM and “design for supply” path, while other, less-strategic ones might adopt an outsourcing and integrated supply approach (i.e., using value-added aggregators and/or the suppliers themselves).

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**Strategic sourcing vs. category management**

- **Strategic sourcing** is a methodology and associated techniques and tools to optimally source goods and services to meet business requirements. Includes category sourcing as well as general/tactical sourcing activities and cross-category sourcing support activities (e.g., competitive bidding techniques and e-sourcing tools).

- **Category sourcing** is the use of strategic sourcing processes and techniques to optimally source a category and its constituent commodities/sub-categories. A category is comprised of lower-level commodities/sub-categories, which can be products or services. A commodity (a.k.a. sub-category) is a well-defined product or service bought and sold in a supply market. It is typically characterized by the availability of functionally equivalent substitutes.

- **Category management** is a framework and set of practices used to optimally manage supply categories to meet business objectives. The framework sits above and guides the content and sequencing of lower-level methodologies like strategic sourcing and supplier relationship management (SRM) to satisfy category objectives and business objectives. A category is a grouping of materials or services that have similar supply and usage characteristics to meet business objectives.

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2Source: The Hackett Group Key Issues Study, 2011
The methodologies in Fig. 3 are diverse and it is not advisable to try to force-fit all of them into a sourcing methodology because they are outside the bounds of a sourcing process and part of a life cycle management process (i.e., that of the value chain rather than the sourcing process). However, they must both be pursued vigorously and coordinated explicitly because of their benefits (e.g., world-class procurement organizations deliver over 3.5X the savings from non-sourcing-related supplier collaboration benefits than their peers).

SRM shouldn’t happen in isolation from strategic sourcing. The two should be highly integrated, and category management is the perfect vehicle for doing so when companies haven’t brought them together. So, while it shares many of the attributes of strategic sourcing (e.g., cross-functional teaming, stakeholder alignment, organizing around supply markets, using techniques such as low-cost country sourcing), category management most definitely is not about simply putting a new veneer on the strategic sourcing methodology.
If procurement can be viewed as a service provider, category management becomes the primary service line, and category managers are essentially solutions assemblers who deploy the appropriate solutions/services needed by budget owners (e.g., Tyco International goes as far as calling them “category CEOs”). This professional-services business orientation is the right one. Progressive procurement organizations organize themselves around a customer relationship/account-management structure on the demand side (usually staffed by people who come from that part of the business), and then assembling ‘solutions’ drawn from the horizontal service lines. In some cases, category managers or their staffs personally lead the service delivery (e.g., in strategic sourcing). In other cases, they may play a supporting role and coordinate with other groups to help with service delivery (e.g., bringing in Six Sigma Black Belts from a quality group). Increasingly procurement organizations are establishing formal, internal Centers of Excellence (COEs) that build competencies around the various methodologies, techniques and tools that support the services delivered to clients, more and more via a category management approach.

In general, though, the customer management role tends to align to the hierarchical organizational structure of the business units, and the category management organization tends to report to global procurement, cascading down to the regional level (sometimes to the business unit/site level for truly specialized commodities). In reality, it matters little how the lines are drawn on an organizational chart, as long as the customer management and category management roles are clear and staffed appropriately.

**Category Management Requires New Processes and Capabilities**

Category management requires a strong customer management competency and is more of a solutions-assembler role rather than just a process executor. The capabilities and skill sets of the category management function therefore become more expansive, especially if the category manager is also playing the primary customer management role as well. The new category management role addresses relationship management, communications, program management, change management (e.g., consensus building and cross-functional teaming) and leadership. As a result, category managers are increasingly hired out of the business to guarantee deep domain expertise. Others use formal cross-functional job rotation programs. Regardless, success also requires strong change management skills to apply that expertise. Strong support from senior management is also mandatory, so that procurement can obtain “credit” for its facilitative approach to steward a broader best-practices based approach (even though many non-procurement resources are used to drive some of the value).
CATEGORY MANAGEMENT DECONSTRUCTED

To implement category management, we have discussed the organizational aspects but not the category management process itself. At this juncture, it is important to touch on the high-level processes and implications. Category management is not so much a perfectly serialized n-step methodology, but rather a five-part framework that segments the spend, determines category strategy, sets up the governance for the category, and then executes and monitors performance against the strategy and supporting projects and processes. The detailed methodology is beyond the scope of this summary paper, but there are a few noteworthy observations:

• A category management strategy is not the same as the commodity strategies that are developed for various commodities in the strategic sourcing process. Rather, it looks at the broader value objectives, required levers and supporting methodologies/techniques/tools that will drive value for the categories individually, as well as across categories.

• Categories are segmented and structured not just in terms of lower-level supply categories, but also organized by demand type. For example, the outsourcing service-provider market may be fragmented under the various spend categories for IT, HR, finance, etc., but a more encompassing category structure and strategy might create a mega-category around outsourcing that aggregates these different categories.

• Category strategy execution consists of nothing more than well-coordinated sets of sourcing, supplier management, supplier collaboration, supply chain redesign and other processes. The difference is on the front end, in terms of the life cycle of this activity, which is tied to the needs of the primary stakeholders who consume the products and services in those categories.

• Category performance management certainly ties into the demand/planning activity that drives the previous category management steps, but it also includes the important topic of how to measure the performance of the category management processes and the stakeholders who participate in them.

• Procurement needs to integrate its services with those of GBS organizations to coordinate its own services with those of the GBS and other internal service partners, such as risk management and competitive intelligence. Category management may also require stronger emphasis on capabilities within existing strategic sourcing processes. For example, further aggregation of commodities/categories into even higher-level categories can unlock additional value, but it requires scenario-building techniques and mathematical optimization tools found in certain advanced e-sourcing applications that help to optimally allocate the expanded market basket to the best combination of suppliers.

3 A detailed discussion is included in the recent Hackett Procurement Executive Advisory Program webcast, “Strategic Category Management,” available for download from the Member Portal.

4 The savings tracking component alone is quite challenging, particularly in the area of indirect spending, as highlighted in Hackett’s “Measuring Realized Savings in Indirect Spending.” As procurement organizations start pulling broader value levers, they also need to create performance measurement systems that recognize the broader value, as discussed in “Lessons from Leaders 2010, Part I: Defining Procurement’s Value Contribution.”

5 This topic was covered in a Hackett webcast, “Sourcing Optimization - Unlocking More Value and Preventing Value Destruction in the Strategic Sourcing Process,” available for download from the Member Portal.
Looking Ahead

Many procurement organizations are at a crossroads. They can either try to stay within their comfort/capability zone for their existing strategic sourcing services or they can broaden their supply management service approach to include strategic category management. In our 2010 Procurement Value, Performance and Capability Study, the largest obstacle to this value evolution was procurement’s limited circle of influence. Over 80% of participants indicated that it would be difficult to change years of perception about what procurement can and should do.

Procurement organizations that want to expand their influence should take care not to use category management as an even more complex version of strategic sourcing. This will just blur the difference between sourcing and category management. Instead, procurement needs to communicate how the inputs are the stakeholders’ business requirements (as opposed to a procurement initiative) and that the output takes the form of improved supply and business performance, not just a new contract.

While the expanded value proposition brings some implementation risk, staying in the comfort zone brings the risk of lost savings, or worse. But implementation risk is addressable, and only lessens as procurement gains credibility with stakeholders through its strengthened capabilities and brand. Category management is a perfect vehicle for this transformation because, although it still generally organizes around supply markets like strategic sourcing, it organizes much more closely to the spending processes of the budget owners.

By staying aligned to demand and crafting flexible supply solutions that deliver value, procurement will be viewed as an enabler rather than just a negotiator, and as a gate-opener to the supply markets rather than a gatekeeper. In the end, enablement and access to supply-market power is what strategic procurement is all about.

About The Author

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Mr. Mitchell is responsible for leading the development of research and other intellectual property within Hackett’s Procurement Executive Advisory Program, where he also serves as an adjunct business advisor. He has over 20 years of industry and consulting experience in procurement, supply chain and information technology. Mr. Mitchell is quoted widely in the press and speaks at numerous industry events on supply management trends and technologies. Previously he was vice president of supply management research at AMR Research and a manager at Arthur D. Little, here he led numerous supply chain and procurement transformations at Fortune 500 companies. Other industry positions include manufacturing project manager at The Timberland Company, materials manager at Krupp Companies and engineer at EG&G Torque Systems.