

# WHITE PAPER

## Reinvigorating Procurement Strategies – to deliver ongoing category management benefits in consumables categories



– Chris Moorman

### Abstract

Cost reduction and supplier rationalisation benefits delivered by strategic sourcing initiatives are large and highly visible. However, without ongoing category management, it is widely accepted that the headline cost reductions are unlikely to be fully realised over time. It can also be difficult to justify category management resource allocation unless the organisation can see return on investment year on year, which requires incremental category benefits to be delivered in years 2, 3, 4 and beyond.

In order to assist with the business case for further resourcing, this paper classifies different levels of category management in terms of the relative maturity of the procurement processes being employed. It also identifies the typical levers that can be deployed to maximise the incremental value to the organisation at each stage which provides the support for appropriate resourcing.

The general medical consumables category of a medical services provider operating in 150+ clinics across Australia has been selected to demonstrate the approach. However, the tools and techniques outlined in this white paper are equally applicable to other consumable categories such as office supplies, PPE or maintenance spares.

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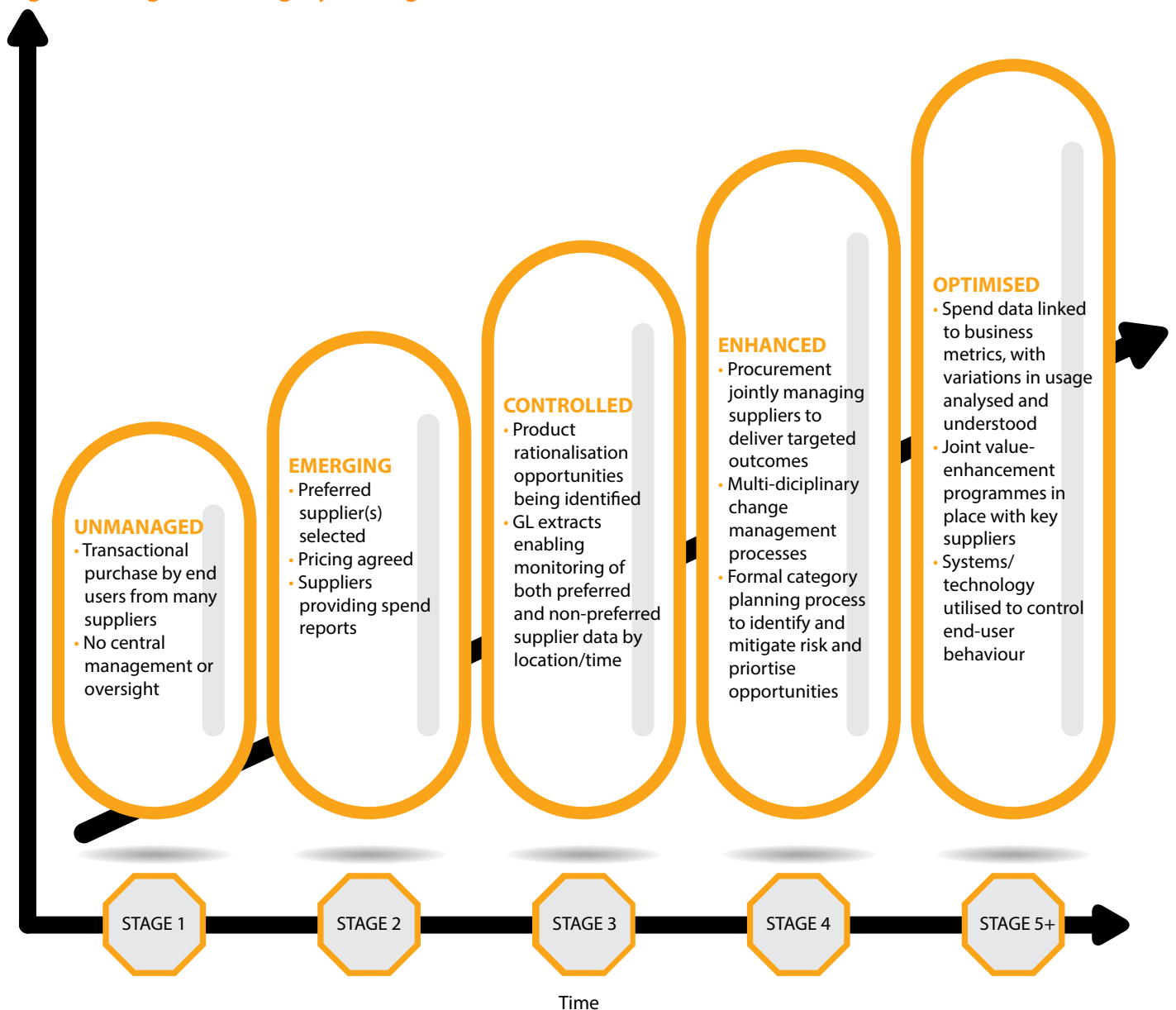
## Development stages and value generating processes for category management

Medical consumables is a complex example of a consumables category where buyers (doctors, nurses) may have strong preferences for particular products and it is important to invest time and resources into change management in order to gain consensus and build support for change. Other consumables categories, such as office supplies or MRO, might lend themselves to a more directive approach where staff are directed which pen or ball bearing to use and have limited right to appeal.

The steps involved in progressing through the maturity curve will be broadly the same, however the rate at which the organisation can transition towards an optimised state of category management can be accelerated. Where it would typically take an organisation 4-5 years to achieve an optimised state for specialised consumables, transition of a generic commoditised category could be delivered much more rapidly (e.g. 2-3 years).

The level of development can be classified into 5 stages as depicted in figure 1.

Figure1: Stages of Category Management



These 5 stages are now reviewed in greater detail to showcase the process enablers that have delivered greater value to our client using a number of brief case studies.

## Stage 1 – Unmanaged category

Maturity stage	Characteristics	Activities to maximise value
Unmanaged	<ul style="list-style-type: none"><li>• End users purchase from many suppliers</li><li>• No central management of price</li><li>• No oversight of purchasing patterns</li></ul>	<ul style="list-style-type: none"><li>• Strategic Sourcing<ul style="list-style-type: none"><li>- Aggregation of demand and selection of preferred supplier(s)</li><li>- Basket of goods defined and leveraged</li></ul></li></ul>

For those who are just starting on the journey, the first step towards wresting control of a consumables category is to undertake a strategic sourcing exercise. It is important to identify the key suppliers and release a request for information (RFI) to identify the quantity purchased and current cost of each item. This will act as a baseline to measure any benefits derived from the sourcing exercise as well as providing the basis of the bid-sheet to use to get competitive quotes and select preferred supplier(s).

Process complexity is driven by the thousands of distinct products that are typically required, so a key step is to seek to rationalise the range of products purchased by the organisation and define and agree a standard basket of goods. The suppliers engaged in the sourcing event should be used to identify rationalisation opportunities and these can be prioritised based on ease of implementation and estimated benefits. Medical consumables products will often be subject to clinical preference and the price difference between, for example, two brands of

sterile gloves will become irrelevant if doctors complain there is insufficient “feel” in a selected glove to perform a clinical procedure. Therefore, end-user trials are normally required before product substitutions can be recommended, and this in turn is likely to lead to either a multi-supplier supply model or the use of a comprehensive distributor. However, in simpler consumables categories (and less emotive sub-categories), you may be able to proceed more quickly, and mandate the use of a particular brand of band-aid, dressing, marker pen or ball-bearing.



## Stage 2 – Emerging category management

Maturity stage	Characteristics	Activities to maximise value
Emerging	<ul style="list-style-type: none"> <li>• Preferred supplier(s) selected</li> <li>• Pricing agreed</li> <li>• Suppliers providing spend reports</li> </ul>	<ul style="list-style-type: none"> <li>• Implementation               <ul style="list-style-type: none"> <li>- Supplier set up</li> <li>- Communicate new processes to relevant staff</li> </ul> </li> <li>• Supplier Performance Management               <ul style="list-style-type: none"> <li>- Adherence to agreed terms</li> <li>- Simple product selection/substitution opportunities</li> </ul> </li> </ul>

During implementation of a preferred supplier arrangement, it is important to develop a mindset of continuous improvement. Ongoing support from key suppliers will be needed to manage the category over time, and assist in driving mutually beneficial change.

Key suppliers cannot be allowed to lapse into an adversarial mindset once they have won the business, with an internal objective to identify justifications for future price increases to improve

margins over time! Instead the category manager should seek to inculcate the key behaviours that will underpin an ongoing collaborative partnership from the outset.

The development of a balanced scorecard supplier assessment framework with elements focussed not just on whether the supplier is delivering on-time and invoicing correctly, but also covering product rationalisation and substitution proposals and risk mitigation strategies, is a good platform to ensure this balance is achieved.

Internally, if end-users have been accustomed to a degree of local autonomy over the selection of consumables, it will be important to communicate procurement's expectations under the new supply model from the outset. As well as providing direction, it is also important to set up a feedback mechanism to enable staff to advise procurement of any issues, concerns or problems that arise during mobilisation.



## Stage 3 – Controlled category management

Maturity stage	Characteristics	Activities to maximise value
Controlled	<ul style="list-style-type: none"> <li>Procurement working with preferred suppliers to identify rationalisation opportunities</li> <li>General Ledger extracts enabling monitoring of both preferred and non-preferred supplier data by location/time</li> </ul>	<ul style="list-style-type: none"> <li>Manage compliance to preferred suppliers</li> <li>Identify rationalisation opportunities and manage compliance to preferred products</li> <li>Utilise supplier reporting to ensure rich data on end-user purchasing behaviour</li> <li>Manage purchases through the use of catalogues</li> </ul>

As with all category management, the key is to have access to good spend data, and be able to act on that data. Medical consumables can be subject to a high level of tail spend from non-preferred suppliers. Some of this non-compliant spend will be justifiable, relating to essential products that are not available from preferred suppliers, but some could be converted to preferred supplier products at lower cost. Often the incremental costs associated with this tail spend is not just embedded in the unit price difference, but also relates to the logistics/supply chain costs of maintaining a multi-supplier model. These will include the direct cost of freight charges, but also indirect costs of receipting and invoice approval/processing.

Monthly data-downloads from the accounts payable system enable review of non-compliant spend by General Ledger category, location and supplier. The objective is to reduce cost by maximising spend with the preferred suppliers. An assessment can be made of which suppliers are likely to be substitutable. Depending on the size and scale of the supply, the category manager or analyst will either be able to get details of the specific products being supplied from invoice or by raising a data request on the supplier in question.

Talking with the staff who use a non-preferred supplier will help the category

manager to understand their rationale, and enable her to address the real/perceived roadblocks to transitioning to the preferred supplier. Staff may need the flexibility to order supplies to meet specific site needs, but should only use non-preferred suppliers if there is no cost effective option with the preferred supplier. Contact from the category manager querying the use of non preferred suppliers will in itself provide a deterrent to use of non-preferred suppliers, as it sends a message that procurement is monitoring their behaviour and will take action if they do not conform to company policy.

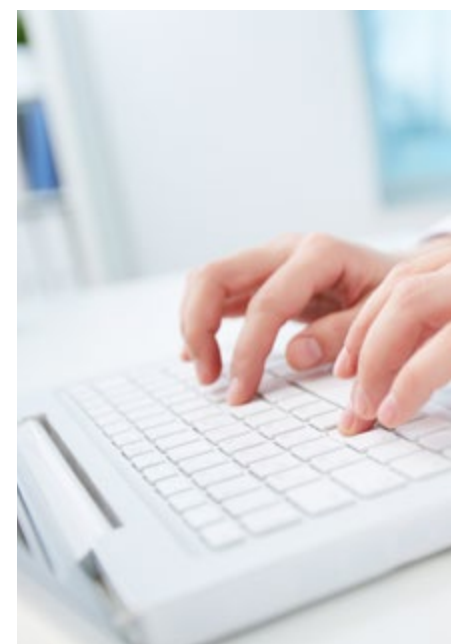
The medical consumables category is characterised by a natural resistance to change. Procurement professionals are unlikely to have the technical knowledge about the products that are being supplied, and will not be in a position to make judgements as to whether an objection to a proposed product is justifiable. There are obvious issues to address such as the effectiveness of a product to meet all intended uses, its efficacy when compared to the alternatives and compatibility with existing equipment.

However, there are also softer constraints such as whether medical staff have been trained to use specific (higher cost) consumable items. It is difficult to force a doctor to change if she believes (rightly or wrongly) that the proposed product could compromise patient care. So it is essential

that procurement have access to clinical experts who:

- are able to evaluate alternatives on an impartial basis
- can undertake clinical trials if necessary
- provide credibility to the recommendation
- operate as a conduit for feedback from any clinician who has concerns about the proposed changes

Depending on the sophistication of the organisation's purchasing/ERP system, consideration should also be given to the introduction of catalogues to further control end-user choices prior to purchasing commitments being made.



## Stage 4 – Enhanced category management

Maturity stage	Characteristics	Activities to maximise value
Enhanced	<ul style="list-style-type: none"> <li>• Procurement jointly managing supplier relationships with functional managers to deliver targeted outcomes</li> <li>• Changes are approached in a multi-disciplinary fashion and communicated through both business and subject matter expert (SME) channels</li> <li>• Formal category planning process identifying and mitigating potential supply risks and prioritising opportunities</li> </ul>	<ul style="list-style-type: none"> <li>• Enhanced Supplier Performance Management focussed on delivering continuous improvement</li> <li>• Targeted cost-down/ process improvement initiatives (including proactive supplier development)</li> <li>• Complex multi-disciplinary product selection/ rationalisation process</li> <li>• Periodical market testing of pricing with alternative suppliers</li> </ul>

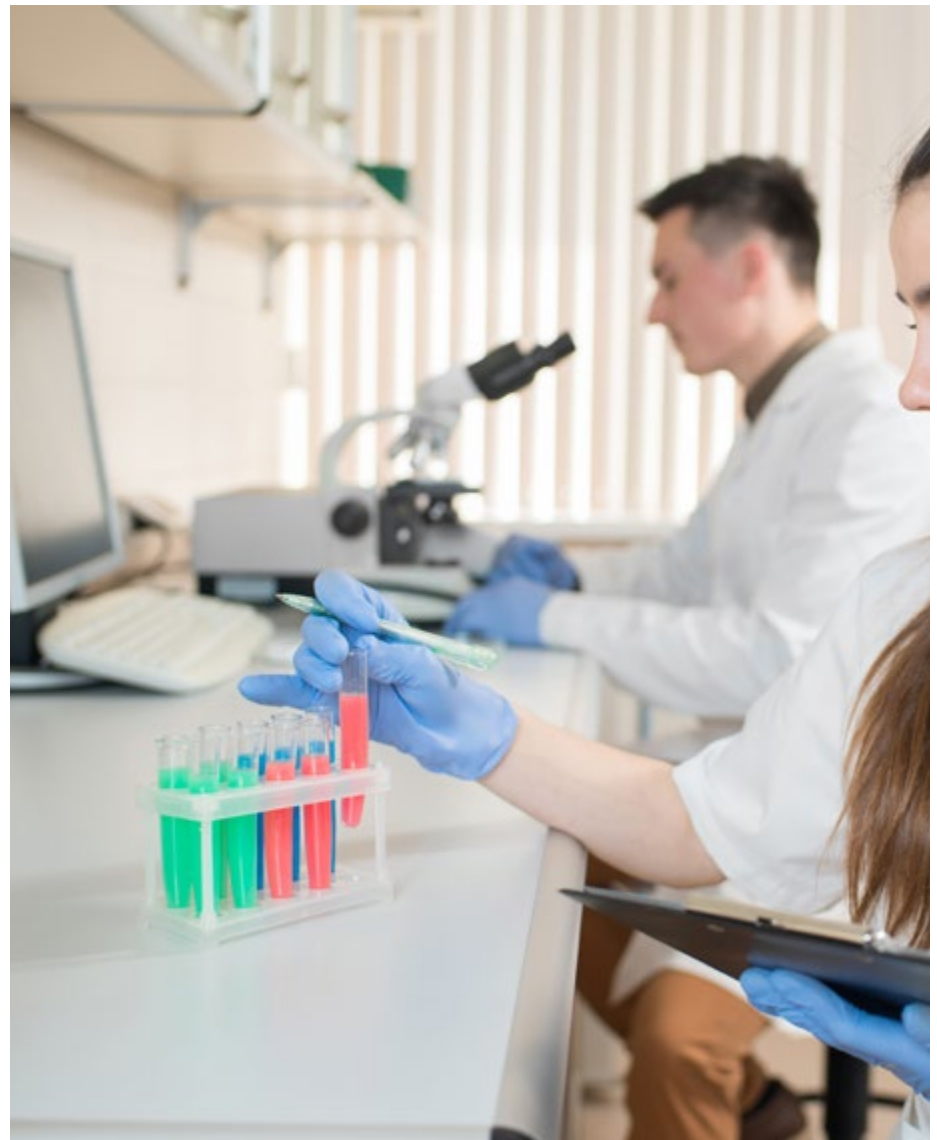
Supplier performance management processes are now focused on targeted product development and more complex product rationalisation. Both parties need to be jointly focussed on developing and maintaining a pipeline of ideas/ opportunities, identifying the potential benefits associated with any proposed change and prioritising activity based on the estimated cost/benefit of the initiative.

Opportunities will increasingly arise from proactive supplier development, which can be directly driven by procurement, by a key stakeholder or by a preferred supplier. In each case, focus will be on creating alternatives to high-volume products with perceived high-margins, or to develop products where the current needs are not fully met by existing products (eg. the organisation needs a 2% chlorhexidine single-use swab that has a visible dye once dry). The threat of new supply alternatives can also be used to introduce competitive tension for existing products thus leading to cost reduction without the need for product transition.

An organisation needs to weigh up the cost of running a fully competitive sourcing event against the expected value to be derived from the event. It is good practice to explore alternative mechanisms to verify current pricing against alternative suppliers before embarking on such an event. By engendering a culture of continuous improvement through working closely with

a preferred supplier, the category manager will create an environment that delivers the lowest long-term cost structure, based

around a deep understanding of each other's needs.



## Stage 5 – Optimised category management

Maturity stage	Characteristics	Activities to maximise value
Optimised	<ul style="list-style-type: none"> <li>Spend data linked to business metrics, with variations in usage analysed and understood</li> <li>Joint value-enhancement programme in place with key suppliers</li> <li>Systems/technology utilised to control end-user behaviour</li> </ul>	<ul style="list-style-type: none"> <li>Usage analysis underpins demand management initiatives</li> <li>Work with SMEs to agree optimal policy settings</li> <li>Conduct competitive sourcing event every 3-4 years</li> <li>Catalogue implemented with strict purchasing controls</li> </ul>

The team has now moved beyond the selection of the lowest cost product to meet pre-defined needs, and are starting to identify lowest total cost procedures to deliver a desired clinical outcome. They need to identify centres of excellence that deliver the same outcomes as other sites but at lower costs, or alternatively identify parts of the business that appear to consume far more of a particular item than other clinics. The key is to identify variations in usage and investigate what is behind them.

A simple example would be variations in the use of gloves. One business unit that performed 10% of the client's surgical procedures were found to be consuming 25% of their sterile gloves. The category manager highlighted the anomaly to their operations manager and then worked together with him and his clinical practitioners to identify activities that other teams were performing with lower-cost non-sterile gloves. The review resulted in a change to their procedures that directly led to a reduction in their use of sterile gloves.

The fundamental characteristics for delivery of these enhanced savings is that procurement need to act in concert with subject matter experts and have developed the respect of the wider organisation, with access to rich data covering not just details of purchases but also underlying business metrics.

Once policies have been developed, control of end-user behaviour can be further aligned through the tightening

of the controls embedded in the organisation's P2P system, directing purchases to preferred products and preventing non-compliance before it occurs.

For some regularly used items, consideration could be given to the use of vending machines operated by swipe cards to manage the issue of consumables and drive down purchase volumes through a reduction in overuse/wastage.

It is also important to periodically refresh and renew supplier relationships through

formal competitive sourcing activities. The use of a multi-stage negotiation process is recommended to ensure maximum value is extracted from the activity. This process will also deliver valuable market intelligence from a range of suppliers about potential opportunities to either reduce cost or improve outcomes. This is also an ideal opportunity to contractually commit suppliers to aligning their resources to meeting your future business needs – and setting the relationship up for additional "soft benefits" throughout the life of the contract.



## Conclusion

A staged progression from the initial sourcing of the medical consumables category through various levels of category management has been outlined.

In an organisation spending \$5-10 million on general medical consumables, this approach delivered 20-30% savings over a 6 year period, with two sourcing events delivering 6-8% each, combined with incremental cost reduction of 2-3% pa from category management. Plans are in place to ensure that savings are sustained and costs continue to reduce for many years to come.

## About the Author



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Chris is a procurement professional with extensive (20+ years) senior management experience and a track record of delivering multi-million dollar cost savings and simplifying processes without adversely impacting product/service quality. He has led managed service and consultancy engagements across multiple clients in various sectors to deliver procurement sourcing, category management and process improvement outcomes. Chris has managed an engagement with a medical service provider to embed procurement best practice and ensure savings in 10 diverse categories were realised. As a result of this engagement, the client received a commendation in the category of most improved procurement operation in the 2009 CIPSA awards, and since then, he has led a range of continuous improvement programmes that have cumulatively delivered a reduction in addressable spend of over 20%.

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