

# Improving Procurement Competence

## Advanced Segmentation Tools for Category Management & Strategic Sourcing

Having benchmarked hundreds of organisations globally it is clear that there is considerable disquiet amongst those funding PSCM Training Courses and Qualifications for their staff. They consider this training:

- Too theoretical and not practically relevant
- Too focused on best practice in industries/sectors that are not relevant to the issues facing their organisation
- Too focused in training on case studies that are irrelevant to the needs of their organisation
- Provides limited evidence of heightened skills and capabilities relevant to their organisation amongst staff after training
- Often leads to the loss of the most able staff after advanced training, with no real tangible value for money or ROI benefits being provided to their organisation from the training

Perhaps the easiest way to demonstrate the need for advanced competence development is by explaining the strengths and weaknesses of two commonly used tools for identifying strategic sourcing options.

### The Kraljic Positioning Methodology

Purchasing Portfolio Analysis, developed in 1983 in Peter Kraljic, is used widely by academics, managers and consultants to determine sourcing options. Given this, manag-

ers must find it useful, and perhaps its greatest practical strength is its simplicity.

The methodology reduces the sourcing decision for managers to the identification of one of four basic choices, as explained in a simple matrix (see Figure 1).

The Kraljic methodology analyses the nature of the supply market (Easy/Difficult) and the relative importance of the purchasing item to the buyer (High/Low). This provides for four alternative sourcing strategies, as follows:

- Long-term alliances (Strategic)
- Short or long-term buffers against supply shortage (Bottleneck)
- Short-term regular market testing (Leverage)
- Internal functional efficiency, with very short-term competitive sourcing (Non-Critical)

Despite its simplicity there are a eight major practical weaknesses with this approach:

1. **Limited analysis of purchasing value** – it is simplistic to segment items of spend into just high or low criteria; their relative criticality to the business must be identified with much more clarity and sophistication.
2. **Limited analysis of evaluation criteria for supply market complexity** – there are far more than six evaluation criteria (i.e. monopoly, oligopoly, technological change, barriers to market entry, logistics costs & complexity, and relative scarcity) for identifying supply market complexity.
3. **Limited range of strategic & tactical options** – there are far more than 4 options (i.e. long-term alliances, competitive tendering, reduction of transaction costs, and contingency planning) available.
4. **Limited number of relationship and performance management options** – there are more than two basic choices (i.e. between collaborative or arm's-length ways of working) available.
5. **The methodology is descriptive and static** – while allusions are made about the need to diversify and exploit power situations, it is relatively silent about how to

FIGURE 1

		PURCHASING PORTFOLIO ANALYSIS	
		Bottleneck	Strategic
Complexity of Supply Market	High	High Complexity / Few Suppliers Low Value/ Non Critical / Scarce Items Ensure Short-term Availability	High Complexity / Few Suppliers High Value / Critical / Scarce Items Long-term Collaboration / Strategic Impact
	Low	Low Complexity / Many Suppliers Low Value / Non-Critical / Abundant Items Short-term Functional Efficiency	Low Complexity / Many Suppliers High Value / Critical / Abundant Items Short-term Cost Leverage & Bidding
		Low	High
		Importance of Purchasing	

adopt the first principle of leverage (i.e. to move out of high supply market complexity to supply markets with lower complexity).

6. **Lack of rigorous analysis of buyer and supplier power & leverage scenarios** – the methodology does not fully explain all of the evaluation criteria required to identify buyer and supplier power scenarios.
7. **Inappropriate sourcing recommendations** – long-term collaboration is normally recommended in the *Strategic* quadrant (and it may sometimes be used in *Bottleneck*), while regular competitive market testing is recommended in *Non-Critical* and *Leverage*. These recommendations are sometimes highly questionable. The *Strategic* quadrant is the worst position for a buyer because they are dependent on dominant suppliers (who can fix quality and prices) for critical supply requirements. Recommending a collaborative partnership, rather than seeking all opportunities for dynamic movement to more congenial power and leverage positions (i.e. with low market complexity), is to suggest the acceptance of dependency. Ironically, the same mistake is made when only regular market testing is recommended in the *Leverage* quadrant. It is in this quadrant that best practices in long-term collaboration are normally located (as in the automotive industry).
8. **Incoherence in exclusivity of options** – the desire to develop unique alternatives for specific portfolio positions leads to incoherence in option recommendations. This is because many of the tasks identified for

buyers in a specific quadrant are not exclusive to that quadrant, and can be used in others (i.e. in the *Non-Critical* quadrant the following non-exclusive tasks are recommended – product standardisation, order volume monitoring/optimization, efficient processing, inventory optimisation etc.).

For these reasons, and despite its extensive use in the profession, this methodology (and all others built on the Krafcik approach) falls short of the rigour and robustness required for a comprehensive guide to sourcing option selection.

The same conclusion can be made for the Purchasing Chessboard, a more a recently developed positioning methodology.

### The Purchasing Chessboard

In 2008, AT Kearney developed *The Purchasing Chessboard* by linking together the Krafcik approach with The Power Matrix, originally developed by academics at the University of Birmingham in 2000 (see Figure 2).

The Purchasing Chessboard is created by linking the four quadrants in the Krafcik methodology with the four power positions identified in The Power Matrix (Leverage & Buyer Dominance, Strategic & Interdependence, Non-Critical & Independence, and Supplier Dominance & Bottleneck). In each of the four Krafcik/Power scenarios four purchasing strategies, with four levers and 16 methods are then identified to create a Chessboard of 64 potential options (see Figure 3).

**FIGURE 2**

		THE POWER MATRIX	
		Buyer Dominance	Interdependence
Buyer Power Resources	High	<ul style="list-style-type: none"> <li>Few buyers/many suppliers</li> <li>Buyer has high % share of total market for supplier</li> <li>Supplier is highly dependent on buyer for revenue with limited alternatives</li> <li>Supplier switching costs are high</li> <li>Buyer switching costs are low</li> <li>Buyer's account is attractive to supplier</li> <li>Suppliers' offerings are commoditised and standardised</li> <li>Buyer search costs are low</li> <li>Supplier has no information asymmetry advantages over buyer</li> </ul>	<ul style="list-style-type: none"> <li>Few buyers/few suppliers</li> <li>Buyer has relatively high % share of total market for supplier</li> <li>Supplier is highly dependent on buyer for revenue with few alternatives</li> <li>Supplier switching costs are high</li> <li>Buyer switching costs are high</li> <li>Buyer's account is attractive to supplier</li> <li>Suppliers' offerings are not commoditised but customised</li> <li>Buyer search costs are high</li> <li>Supplier has significant information asymmetry advantages over buyer</li> </ul>
	Low	<ul style="list-style-type: none"> <li>Many buyers/many suppliers</li> <li>Buyer has relatively low % share of total market for supplier</li> <li>Supplier is not dependent on buyer for revenue and has many alternatives</li> <li>Supplier switching costs are low</li> <li>Buyer switching costs are low</li> <li>Buyer's account is unattractive to supplier</li> <li>Suppliers' offerings are commoditised and standardised</li> <li>Buyer search costs are relatively low</li> <li>Supplier has limited information asymmetry advantages over buyer</li> </ul>	<ul style="list-style-type: none"> <li>Many buyers/few suppliers</li> <li>Buyer has low % share of total market for supplier</li> <li>Supplier is not at all dependent on buyer for revenue and has many alternatives</li> <li>Supplier switching costs are low</li> <li>Buyer switching costs are high</li> <li>Buyer's account is not attractive to supplier</li> <li>Suppliers' offerings are not commoditised but customised</li> <li>Buyer search costs are very high</li> <li>Supplier has very high information asymmetry advantages over buyer</li> </ul>
		Low	High
		Supplier Power Resources	

**FIGURE 3**

<b>THE PURCHASING CHESSBOARD</b>			
<b>Bottleneck &amp; Supplier Dominance</b>	<b>Strategic &amp; Interdependence</b>	<b>Non-Critical &amp; Independence</b>	<b>Leverage &amp; Buyer Dominance</b>
<p><b>STRATEGY = CHANGE NATURE OF DEMAND</b></p> <p>4 Levers = Innovation Breakthrough, Re-specification, Risk Management and Technical Data Mining</p>	<p><b>STRATEGY = SEEK JOINT ADVANTAGE WITH SUPPLIER</b></p> <p>4 Levers = Value Chain Management, Value Partnership, Integrated Operations Management and Cost Partnership</p>	<p><b>STRATEGY = MANAGE SPEND</b></p> <p>4 Levers = Co-Sourcing, Commercial Data Mining, Demand Management and Volume Bundling</p>	<p><b>STRATEGY = LEVERAGE COMPETITION AMONG SUPPLIERS</b></p> <p>4 Levers = Tendering, Supplier Pricing Review, Globalization and Target Pricing</p>
<p><b>16 Potential Methods</b></p> <ul style="list-style-type: none"> <li>1 = Invention on Demand</li> <li>2 = Leverage Innovation Network</li> <li>3 = Functionality Assessment</li> <li>4 = Specification Assessment</li> <li>5 = Core Cost Analysis</li> <li>6 = Design for Sourcing</li> <li>7 = Product Teardown</li> <li>8 = Design for Manufacture</li> <li>9 = Vertical Integration</li> <li>10 = Intelligent Deal Structure</li> <li>11 = Composite Benchmarking</li> <li>12 = Process Benchmarking</li> <li>13 = Bottleneck Mgmt</li> <li>14 = Political Framework Mgmt</li> <li>15 = Product Benchmarking</li> <li>16 = Complexity Reduction</li> </ul>	<p><b>16 Potential Methods</b></p> <ul style="list-style-type: none"> <li>33 = Value Chain Reconfiguration</li> <li>34 = Revenue Sharing</li> <li>35 = Profit Sharing</li> <li>36 = Strategic Alliance</li> <li>37 = Supplier Tiering</li> <li>38 = Sustainability Mgmt</li> <li>39 = Project Based Partnership</li> <li>40 = Value Based Sourcing</li> <li>41 = Collaborative Capacity Mgmt</li> <li>42 = Virtual Inventory Mgmt</li> <li>43 = Total Lifecycle Concept</li> <li>44 = Collaborative Cost Reduction</li> <li>45 = Visible Process Organization</li> <li>46 = Vendor Managed Inventory</li> <li>47 = Supplier Development</li> <li>48 = Supplier Fitness Program</li> </ul>	<p><b>16 Potential Methods</b></p> <ul style="list-style-type: none"> <li>17 = Sourcing Community</li> <li>18 = Buying Consortia</li> <li>19 = Cost Data mining</li> <li>20 = Standardization</li> <li>21 = Procurement Outsourcing</li> <li>22 = Mega Supplier Strategy</li> <li>23 = Master Data Mgmt</li> <li>24 = Spend Transparency</li> <li>25 = Compliance Mgmt</li> <li>26 = Closed Loop Spend Mgmt</li> <li>27 = Supplier Consolidation</li> <li>28 = Bundling Across Generations</li> <li>29 = Demand Reduction</li> <li>30 = Contract Mgmt</li> <li>31 = Bundling Across Product Lines</li> <li>32 = Bundling Across Sites</li> </ul>	<p><b>16 Potential Methods</b></p> <ul style="list-style-type: none"> <li>49 = RFI/RFP process</li> <li>50 = Expressive Bidding</li> <li>51 = Total Cost of Ownership</li> <li>52 = Leverage Market Imbalances</li> <li>53 = Supplier Market Intelligence</li> <li>54 = Reverse Auctions</li> <li>55 = Price Benchmarking</li> <li>56 = Unbundled Prices</li> <li>57 = Make or Buy</li> <li>58 = Best Sourcing</li> <li>59 = Cost Regression Analysis</li> <li>60 = Factor Cost Analysis</li> <li>61 = Global Sourcing</li> <li>62 = LCC Sourcing</li> <li>63 = Cost Based price Modeling</li> <li>64 = Linear Performance Pricing</li> </ul>

Major weaknesses with this approach include:

- The power resources that guide positioning in the Chessboard (unlike those identified in The Power Matrix) are extremely limited and never fully clarified.
- The importance of specific power resources for particular sourcing selection decisions is not explained.
- It is argued incorrectly (following Krajić) that collaboration is only feasible in Strategic & Interdependence scenarios, even though collaboration is feasible in two other scenarios (Leverage & Buyer Dominance and Supplier Dominance & Bottleneck).
- The methodology is also silent (like Krajić) about the fact that market contestation is feasible in all of the four power scenarios.
- The four purchasing strategies and 16 levers identified are feasible options in each of the four boxes, and not at all mutually exclusive.
- Most significantly, none of the 64 methods identified is uniquely appropriate to any one of the four purchasing strategies and 16 levers identified:

**Usable Methods in All Four Scenarios:**

2, 3, 4, 5, 8, 10, 12, 13, 14, 15, 16, 18, 19, 20, 21, 22, 23, 24, 25, 26, 28, 29, 30, 31, 32, 33, 37, 38, 41, 42, 45, 46, 49, 50, 51, 52, 53, 54, 55, 56, 57, 58, 59, 60, 61, 62, 63 and 64.

**Usable Methods in Two or More Scenarios:**

1, 6, 7, 9, 11, 17, 27, 34, 35, 36, 39, 40, 43, 44, 47 and 48.

**Usable Tactics in Only One of the Four Scenarios:**

None

Given this, it follows that The Purchasing Chessboard is also neither fully rigorous analytically and nor is it fully robust in identifying appropriate sourcing options.

**What Next for the Procurement Profession?**

If two of the major positioning methodologies are neither fully rigorous analytically, or robust in clarifying appropriate sourcing options, then a significant competence gap must exist in the profession. And this is why IIAPS was originally created, to provide advanced tools and techniques, that provide more comprehensive analysis and options, while not making the same errors outlined above—the IIAPS Green & Red Belts teach 8 strategic sourcing options and over 100 tactical methods.

In offering the new ExDip and Green & Red Belts programmes, the goal of CIPS and IIAPS is to support those in the profession who wish to understand what are the most rigorous and robust methodologies and advanced ways of working available. These individuals will also want to demonstrate their superior professional competence by objectively testing their skills and knowledge against best practice.

**References**

1. P. Krajić, "Purchasing must become supply management" *Harvard Business Review* (September-October, 1983)
2. A. Cox et al., *Power Regimes* (Earlsgate Press, 2000)
3. C. Schuh et al., *The Purchasing Chessboard* (Springer, 2008)