



REPORT FOR ACTION

Purchasing and Materials Management Review: Strategy for Category Management and Strategic Sourcing

Date: October 27, 2016

To: Government Management Committee

From: Treasurer

Wards: All

SUMMARY

This report outlines work undertaken in Purchasing and Materials Management Division (PMMD) to investigate category management and strategic sourcing. Introducing category management would change the City's current, primarily transactional approach to procurement, to an approach that adds a strategic element. The Treasurer is including implementation of category management and strategic sourcing as part of the 2017 budget process for consideration, while keeping in mind Council's direction to City divisions to achieve a 2.6% reduction to the net 2016 operating budget.

This report also outlines the work being done to improve PMMD's existing processes through the implementation of the Council approved Supply Chain Management Transformation (SCMT) I&T project. SCMT will modernize the procurement process by leveraging SAP Ariba, a cloud based solution to automate various manual processes, improving many metrics, including the cycle time of procurement calls. The successful implementation of category management and the ability to drive the benefits from category management is dependent upon the successful implementation of SCMT.

The Treasurer and the Director, Purchasing and Materials Management (the Chief Purchasing Official) believe it is essential for PMMD to transform its business practices to play a more strategic role in the procurement of goods and services. Implementing category management and strategic sourcing has the potential to generate significant annual recurring savings, estimated to be approximately \$30 million by 2021.

RECOMMENDATIONS

The Treasurer recommends that:

1. Government Management Committee receive this report for information.

FINANCIAL IMPACT

There are no immediate financial impacts arising from this report. Any future financial impacts are outlined and included in the 2017 Treasurer's Operating Budget, that will be considered during the 2017 budget process.

The Deputy City Manager & Chief Financial Officer has reviewed this report and agrees with the financial impact information.

DECISION HISTORY

At its meeting on June 11, 12, and 13, 2013, in consideration of EX32.3 (Results of the Shared Services Study - City Agencies), Council directed the Deputy City Manager & Chief Financial Officer to begin implementation of various short term shared services opportunities and to report back on a multi-year implementation plan for longer term shared services opportunities. One of the long term shared services opportunities was to implement category management and strategic sourcing.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2013.EX32.3>

At its meeting on June 7, 2016, City Council adopted GM12.2 - Provision of SAP Ariba - Proprietary Software as a Service from SAP Canada for Supply Chain Management Transformation which authorized the Treasurer and the Chief Information Officer to negotiate and execute an agreement with SAP Canada for the use of SAP Ariba.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2016.GM12.2>

COMMENTS

Shared Services Efficiency Study

The City retained KPMG in 2012 to conduct a number of Service Efficiency Studies, including the Shared Services Efficiency Study. As part of that study, KPMG recommended that the City and its agencies implement category management and strategic sourcing as a way to achieve cost savings. This was recommended in a two-step approach consisting of:

1. Development and Implementation of category management disciplines within the City's Purchasing & Materials Management Division (PMMD), whereby PMMD would be reorganized and retrained to manage procurement spend on a category management basis; and
2. Establish the Shared Services unit, delivering services to the agencies, for the common purchases between the City and agencies, once PMMD has demonstrated the savings that can be achieved from Category Management and the appropriate governance structure and service levels is determined.

KPMG suggested that the shared service model could achieve savings in third party spend of approximately \$10 million per year based on an estimated common spend of \$500 million between the City and the agencies. KPMG noted that a more detailed spend analysis needed to be completed to determine the appropriate categories that would be subject to category management and strategic sourcing. Based on KPMG's recommendations, City Council directed the Deputy City Manager & Chief Financial Officer to conduct further due diligence on this recommendation to determine if there is an appropriate business case to implement category management in the City.

PMMD Program Review

To conduct the due diligence required, PMMD launched a program review in 2014 in two phases. The first phase, done by City staff, concluded with the Current State Assessment report.

In the second phase, staff retained Ernst & Young ("EY") in 2015 to:

- conduct a spend analysis,
- conduct a leading practice modelling analysis,
- conduct a fit-gap analysis between PMMD's current state and the proposed leading practice model to implement category management, and
- provide an implementation roadmap and business case to support the transition from current state to the proposed leading practice model.

EY's executive summary is attached as Appendix 1. Through the spend analysis and validation with City staff, EY observed that the City in 2014 spent approximately \$2 billion on goods and services, 97% acquired through PMMD. The spend analysis outlined several opportunities to leverage enterprise-wide spend, reducing fragmentation across divisions and vendors. For example, 3% of the City's vendors (124 of 3,927 vendors) accounted for 90% of the total spend through purchase orders or approximately \$1.116 billion, while the bottom 10% of the value of purchase orders represent 85% of transactions.

EY noted that PMMD demonstrated basic to developing maturity across a number of procurement process areas including category management and strategic sourcing, contract management and supplier relationship management, governance and technology enablement. PMMD primarily operates on a reactive basis and is characterized by heavy transactional volume with limited opportunity to provide strategic and value added activities to its clients. As a result, EY's recommendations centre around setting up a strategic procurement unit to separate these staff from the existing transactional unit, and to reorganize PMMD's support functions to focus on value added activities. The strategic procurement unit will be responsible for category management. Once the strategic procurement unit is well established, it will be integrated with the transactional procurement unit to ensure that strategy and tactics for the procurement of goods and services are effective and efficient.

Category Management and Strategic Sourcing

Category management is the process of managing key spend categories (goods and services grouped into categories, for example fuel, software, HVAC services etc.) strategically across the organization to lower total cost of ownership.

Category management is:

- Strategic - accessing data from multiple sources including the market itself, and tracking key performance indicators;
- Collaborative - providing for cross functional teams to work together on the strategy under a defined governance process; and
- Process driven - requiring adherence to robust processes, reviewed iteratively, and subject to continuous improvement.

Successful category management requires close collaboration between PMMD and City Divisions, following a procurement strategy aligned with the City's vision. Category management requires a governance structure and appropriate policies to ensure that categories are analyzed, and appropriate strategies developed and implemented, in a wholesome and consistent manner.

Category management is different and broader than Strategic Sourcing. Category management includes category strategies, category governance, usage and spend management, category spend performance management, and supplier performance management. Strategic Sourcing results from the category strategy and is an event or a series of events to secure a vendor or vendors to provide the goods or services to be managed under category management.

Category Leads will be assigned to specific categories, follow a consistent approach, and develop strategies to lower the total cost of ownership through various means, including:

- aggregating demand;
- managing specifications;
- understanding the suppliers in the marketplace;
- understanding key cost drivers of the good or service;
- timing the strategic sourcing events to take advantage of market conditions;
- negotiating;
- managing contract spend; and
- managing supplier relationships and performance.

Spend Analysis

EY conducted a spend analysis, outlining the City's spending on goods and services. The spend analysis allowed EY to identify categories that could be considered for category management, some of which are listed in Table 1.

Table 1 - Identified Categories for Category Management

Engineering Services	Mechanical and HVAC Services	Building & Facility Construction	Security Surveillance
Cleaning Services	Chemicals	Software	Communication Equipment
Computer Equipment & Accessories	IT Consulting	Landscaping Services	Printing Services
Medical Supplies	Highway and Road Construction	Waste Collection	Fuel
Vehicles	Water and Wastewater Facility Construction	Watermain and Sewers	General Contracting

The spend analysis indicated that there appeared to be opportunities to further improve demand aggregation and leverage greater purchasing power. In 2014, of the total \$1 billion in Purchase Orders, about 20% was made up of transactions that crossed divisions and categories, an opportunity to leverage better prices if demand aggregation and negotiation were used. Nearly half of DPOs were for values less than \$1,000, and almost 50% of vendors received multiple DPOs over the year. This could lead to further opportunities to pool demand, or to turn to different procurement and payment methods, such as Pcards to improve efficiency.

Performance Metrics

As part of the review, EY looked at performance metrics that would be appropriate for PMMD. They noted that PMMD was collecting significant volumetric data but needed to focus on identifying a smaller subset of performance metrics to provide better information to divisional clients. They provided a list of performance metrics for PMMD to consider implementing, highlighting the average cycle time by call type, as longer than other public sector benchmarks, with the time for divisions' conducting evaluation of bids and providing the recommendation letter, as the longest component.

As part of the implementation of category management, PMMD will identify the appropriate performance metrics to implement and report on. PMMD is currently developing performance metrics around the average cycle time by call type, and will be reporting new service level standards for cycle time as part of the 2017 budget process, ensuring realization and tracking of available improvements from implementing SCMT.

Recommended Implementation Roadmap to Implement Category Management

As part of the Final Report, EY provided a recommended implementation roadmap with four work streams to be done concurrently from 2016 to 2020. As part of the Treasurer's 2017 Operating Budget submission, the Treasurer and Chief Purchasing Official will recommend a modification to the roadmap to apply from 2017 to 2021.

1. Strategy & Enablement

The Strategy & Enablement work stream consists of the Treasurer and Chief Purchasing Official setting up a temporary Project Management Office (PMO) to oversee the implementation of the overall project and hiring an external consultant to ensure the implementation is successful. The PMO and the external consultant, under the direction of the Treasurer and Chief Purchasing Official, would jointly develop the appropriate metrics to: track benefits from category management, improve the other metrics for PMMD as a whole, develop policies for strategic sourcing, and develop reporting systems.

2. Process and Operating Model

The Treasurer and the Chief Purchasing Official with the PMO and the external consultant will work with the appropriate Divisional stakeholders to develop the governance structure for category management, develop the appropriate policies required to enable category management, and determine categories to be part of the initial wave of category management and strategic sourcing.

Once the first wave of categories is identified, the PMO and external consultant will form the appropriate sourcing teams to develop the category profiles and the strategic sourcing approach for each category. The first wave of categories chosen will be those quick wins that will demonstrate the savings achievable.

The Treasurer and the Chief Purchasing Official will also work with Human Resources to set up the category management unit in PMMD, with category leads and sourcing specialists. Over the two to three year implementation plan EY recommends that the City hire approximately sixteen (16) category leads and three (3) or more sourcing specialists. It is expected that ten (10) category leads will report into PMMD and six (6) will report to specific Divisions (Solid Waste Management Services, Toronto Water and Fleet Services all with one category lead and Transportation Services with three category leads). Solid Waste Management Services, Toronto Water, Fleet Services and Transportation Services were all identified as being able to support a category lead, as those Divisions purchase goods and services in categories that no other Division purchases.

In addition to implementing category management, PMMD's existing Corporate Purchasing Policy & Quality Assurance (CPPQA) unit will change to focus more on procurement enablement. Certain functions currently performed by CPPQA will be transitioned to other units including: processing non-competitive procurement, overseeing the auction function, and conducting market analysis. CPPQA will be renamed Procurement Enablement and will focus primarily on policy development and

compliance, continuous improvement for PMMD, supplier engagement, performance management and procurement support.

3. People and Change Management

In order to transform the City's procurement processes, a robust change management and communications strategy is required to prepare for the changing knowledge requirements and roles, and resultant impacts on staff in PMMD and in the divisions. This consists of identifying all the stakeholders, developing the communications plan, the change management plan and the staff training plan.

Anticipated Benefits from implementing Category Management

The primary benefit from implementing category management and strategic sourcing is improved prices through contracts. The anticipated net benefits are set out in the EY's report, and are based on additional spending on people to manage the strategic approach to procurement, more than offset by lower spending on the City's contracted spending. EY's report indicates that the net benefits from sourcing improvements will be approximately \$30 million annually.

A number of assumptions were made in the development of these anticipated benefits, to be validated during implementation. The assumptions include:

- Investments will be made in program management, change management, process reengineering and technology enablement;
- Change management will be supported throughout the entire project;
- Waves of implementation will be considered over a 3 to 5 year period;
- Implementation planning begins in late 2016;
- 30% of the City's spend will be subject to category management and strategic sourcing by 2020;
- External consultants will assist in the implementation; and
- Savings are expected to be up to 6% of spend subjected to strategic sourcing.

Transforming CPPQA to Procurement Enablement will focus staff's efforts on overall continuous improvement for PMMD, including policy development, maintenance and compliance, supplier engagement, performance management, training, and procurement support.

Relationship to Supply Chain Management Transformation

SCMT is an important transformational project where the City will be implementing SAP Ariba, an end-to-end integrated cloud software as a service for purchasing, materials management and account payable functions. Implementing SAP Ariba will modernize the City's procurement processes and lead to efficiencies by: introducing automation and elimination of manual tasks such as receiving physical bids, handling bids and entering data into various databases; improving the number of compliant bids; improving the ability to analyze data in the procurement process; improving the capture

of early payment discounts; and laying the technological ground work to help move to shared services with the City Agencies.

During the program review, EY noted that SCMT was an enabler of category management and that SCMT and the implementation of category management must be considered together, particularly since the benefits of improved contract pricing from SCMT and category management are linked. The implementation of SAP Ariba contains key modules including spend analysis, contract management, supplier relationship management, and vendor performance management. These modules are the underlying tools to ensure a successful application of category management.

As a transformational project and as noted in GM12.2, SCMT will also address current issues in the procurement process, including improving the City's procurement cycle time, leading to service efficiency for staff, and decreasing the number of non-compliant bids. In 2015, PMMD's average cycle time was 125 working days from requisition to the issuance of the purchase order. Using SAP Ariba's Sourcing module, PMMD is expecting considerable improvements in cycle time, especially with respect to the time it takes divisions to conduct the evaluation of the procurement submissions. For example, when the Province of Ontario implemented an eSourcing module, it saw a reduction in the procurement cycle by approximately 65%, primarily by reducing the amount of time taken during the evaluation of the submissions.

Further, using SAP Ariba's Sourcing module, it is anticipated that PMMD staff will be more efficient as it will reduce the administrative and manual effort in the current procurement process. The initial estimated service efficiency benefit was approximately 126 hours per FTE, or equivalent of 2.6 buyers. The efficiency comes from activities such as no longer needing to handle paper files, not needing to conduct public openings, not needing to enter information contained in paper bid submissions into a database and being able to evaluate bids and conduct analysis faster.

In addition, SCMT will also help prevent bidders from submitting non-compliant bids, as it will be designed to prevent the bidder from submitting a bid without including all the requisite information. In 2015, the City received an average of 4.2 compliant bids. By decreasing the risk of bidders submitting non-compliant bids should increase the average number of compliant bids to 5 or 6.

Overall SCMT provides the technological tools to improve the existing transactional procurement processes and to enable the implementation of category management and strategic sourcing.

Next Steps

The Treasurer, as part of the 2017 Operating Budget submission, has included a business case on the implementation of category management, while still keeping in mind the overall direction to City divisions of achieving a 2.6% reduction to the net 2016 operating budget.

If the business case is ultimately approved by City Council as part of the 2017 budget process, next steps would be for the Treasurer and the Chief Purchasing Official to set

up the PMO and hire the external consultant through an RFP to guide the implementation. At the same time, the Treasurer and CPO will ensure that the implementation of category management is aligned with the implementation of SCMT.

CONTACT

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SIGNATURE

Mike St. Amant
Treasurer

ATTACHMENTS

Attachment 1 - Ernst & Young's City of Toronto Purchasing and Materials Management Program Review Final Report - Volume A - Executive Summary