

Supplier Adoption and Economic Development (Strand 5)

Procurement Classification from the Buyer's and Supplier's Perspective

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KEY QUESTION 7: Procurement Classification Issues

What are the issues around coding and classification when embarking on an e-procurement programme?

1. Summary

The purpose of this short guidance paper is to help organisations undertaking procurement classification as part of their move to e-procurement to:

- Understand the differences between classification for identification and classification for procurement analysis and management
- Define who should be responsible for the different types of classification
- Highlight some of the risks and issues, seen from both the buyer's and supplier's perspectives

2. 1. Introduction

This guidance has been produced to supplement work already undertaken on the issue of procurement classification. It should be read in conjunction with:

- **Maximising Returns from Purchasing Data - Informed Business Decisions from Coding and Classification** (www.CIPS.org)
- **Towards a Standard Procurement Classification for Local Government**, reproduced as a Detailed Guideline on this site.

For the purpose of this paper, the term “coding” means a value that unambiguously identifies a specific product or service, while “classification” means a value that groups related products or services together for analysis purposes.

This guidance does not attempt to interpret or add to the work already available in the public domain as referred to above.

KEY QUESTION 7: Procurement Classification Issues

2. Classification Types

Buyers and sellers typically will be familiar with two types of classification:

Identification codes are used for recording and tracking items and are used for inventory management, point of sale transactions or historical record keeping. An identification code can also identify other information such as:

- Address/Location identifiers
- Language identifiers
- Unit of measures or issue
- Currency identifiers
- Country identifiers
- Price/cost identifiers

This type of classification is normally the concern of the supplier and commonly manifests itself as a catalogue number, part number or a bar code. It may not mean much to the buyer, but it is crucial to the supplier who uses it to identify the exact nature of the commodity or service being provided and to track it through internal systems.

Procurement classification for analysis uses a structure to logically group similar products or services together into classes or families for the purpose of analysis. Hierarchical classifications allow analysis to be done at macro or micro levels, depending on business need. The need may be overall financial reporting, budgetary control, project reporting, product costing or purchasing performance review. There are likely to be different levels of classification from a procurement perspective to reflect issues such as the value, complexity and risk associated with the product or service being purchased. The following table illustrates how an organisation may decide to implement a procurement classification hierarchy following a review of its expenditure profile.

Product / Service	Assessment			Classification Level
	Value	Risk	Complexity	
Stationery and office consumables	L	L	L	High level or 'bucket code' approach
IT	H	M	M	Break down into categories, maybe splitting out software, hardware, communications, maintenance, etc
Consultancy	H	M	H	There are many different types of consultancy with some suppliers offering many of them. Break down into as many sub-categories as possible
Social Care packages	M	H	H	Break down to lowest level allowing the organisation to look at different types of client categories

Table 1: Illustrates examples of how differing levels of procurement classification could be used

KEY QUESTION 7: Procurement Classification Issues

3. Suppliers and Identification Codes

Identification codes are the responsibility of the supplier unless the buying organisation is specifically involved in the manufacture and sale of products and services. These identification codes should not be used for procurement classification purposes, as they are specific to suppliers and do not contain hierarchies which will allow groups of products and services to be related together.

Buyers need to be aware of the following issues if seeking to keep records and information in their systems on suppliers' identification codes:

- The codes can change quite regularly for a variety of reasons, which can cause problems for IT systems around audit trails and the need to maintain continuity of supply
- Identical products and services from different suppliers can, and often do, have different codes
- Attempting to maintain lists of identification codes on systems can be a significant overhead to carry. Some electronic catalogues can contain thousands of codes and these can change regularly
- Most suppliers expect the buyer to quote the supplier's own identification code on a purchase order.

KEY QUESTION 7: Procurement Classification Issues

4. Suppliers and Procurement Classification

Contrary to some rumours, suppliers will have little or no interest in procurement classifications used by their customers. The main reasons for this are:

- Many customers will not use a procurement classification hierarchy and those that do will tend to use different ones
- A procurement classification hierarchy does not provide any added value for the supplier, unless the supplier uses it specifically for their own procurement purposes (which is rare). Suppliers will use their own identification code to monitor sales, stock movements and delivery performance
- There are no standards that have been universally adopted and organisations have a tendency to change strategy (e.g. central government moving from NSV to UN/SPSC in 2001)

A few organisations have been tempted to put the onus of cross-referencing their chosen procurement classification hierarchy onto the supplier. Apart from the fact that the supplier will pass the cost of this overhead back to the buyer by way of higher costs, buyers need to be aware of the following:

- Procurement classification is an acquired skill requiring specific processes and quality standards, not one that most suppliers have in-house
- There is no guarantee that the supplier will do the job properly, especially if they have been told to “contain it within existing costs”. In carrying out a random sampling exercise, one company recently found that compact discs had been classified under agricultural machinery
- Two of the three most commonly used procurement classifications on the market have developed from a manufacturing base (UN/SPSC and CPV), meaning that many products and services feature in more than one part of the hierarchy
- The buying organisation will need to have its own strategy and implementation standards for its chosen procurement classification if it is not to end up with meaningless data
- At the time of writing this guidance, one of the main standards (UN/SPSC) is producing a new version of the database every 4 – 6 weeks. Which version is going to become standard?
- The ability of the e-Procurement and/or procurement system to support more than one classification standard and handle regular updates of new codes from suppliers as well as changes to the classification itself
- The only codes many suppliers will understand may be *Thompson* or *Yell* in which they have classified themselves
- A ‘black box’ translation capability is the ultimate goal. A number of third parties may be able to help you (please see other guidance referred to in the introduction)

KEY QUESTION 7: Procurement Classification Issues

5. Issues and Risks

Most of the issues and risks associated with procurement classification are covered in the papers referred to earlier. There are, however, some issues that either need to be re-stated or which are specific to this guidance paper:

- Do not ignore the procurement classification issue and assume that reporting is possible through an organisation's financial system. Procurement facing analysis needs a specific structure
- Resist the temptation to hold suppliers' catalogues on procurement systems – this can turn into a big overhead. Look at other options to solve the problem, particularly “punch out” or buying on-line
- Always have your own policy and standards for procurement classification, regardless of who does the classification work
- Do not rely on suppliers to do the work, even if they offer to do the work for nothing, as this will lead to poor and inaccurate data. Certainly do not force them to do your classification for you free of charge, as your problems will really begin
- Wherever possible use an independent classification / coding service to do the work for you, as they are experts at it and will maintain quality standards and consistency. This does not have to be an expensive option
- If you use a third party classification hierarchy (e.g. UN/SPSC or NSV) always join and participate in the User Group and work with other organisations to influence the standard to your advantage
- Assume that there will never be a universal procurement classification standard for local government and develop your strategy around that
- Market Places, web catalogues and other procurement solutions may use one classification today, but future solution providers may use different versions or alternative classifications