Building a Category Management Capability

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White Paper

Imagine 50 or 100 years ago: The corner grocery store owner knew every one of his shoppers in the neighborhood. He knew their families, as well as their likes and dislikes.

The shift of power to the consumer and the associated economics demand a category management approach that focuses first on the consumer and second on methods to meet consumers' demands, needs and requirements.

He could easily discern shopping patterns, including favorite entrees, side dishes, spices, drinks, health and beauty products, even favorite brands. The owner did not need a loyalty program or frequent shopper cards. He knew all of the important information and either remembered it or jotted it down. Based on this information, the owner could design a store layout that met customer needs, increased sales and maximized profits.

In essence, the corner store owner practiced category management. The store was organized and customized around categories of products that focused on the consumer and were known to sell at a certain rate depending on time of year, special events and personal requests from consumers who were also neighbors and friends.

Obviously, time has changed neighborhoods, consumers, consumer families, consumer habits, manufacturers and the entire retail industry. Tremendous advances in transportation, distribution, manufacturing, product design, retail stores and information technology have changed the shopping experience as a whole. Consumers are presented with many more options than their predecessors were. Product categories and the mix of products can sometimes seem endless.

Power shifts have also been dramatic. Unprecedented transfers of power have occurred from manufacturers to retailers in the latter part of the last century and then, more recently, to consumers.

The consumer has gained power through relentless competition within and across many types of store formats. In the past few years, many dominant formats like the super center, big box and category killer have arisen, as have the "large corner drugstores" that use neighborhood demographics and apply very successful micromarketing techniques, much like the corner drugstores of a previous era.

The very nature of the shift of power to the consumer and the associated economics demand a category management approach that focuses first on the consumer and second on methods to meet consumers' demands, needs and requirements.

Despite general agreement that category management is producing favorable results overall, the term has a negative connotation for some retailers, manufacturers and distributors. In many cases, the whole premise of category management has been compromised by ineffective implementation, lack of education and lack of commitment. As a result, retailers, manufacturers and distributors are not getting an acceptable return on their investments of time, resources, assets and information systems, leading to an overall negative impression of category management.

Changing or even avoiding these impressions for companies just embarking on category management initiatives is critical. The principles of category management and the promising results for consumers and industry alike can be substantial.

Efficient Customer Response guidelines present a methodology for managing complex consumer demands and requirements and include best practices in:

- Continuous replenishment
- Category management
- Direct store delivery
- Purchase order through payment
- Value chain analysis
- Value-added network services

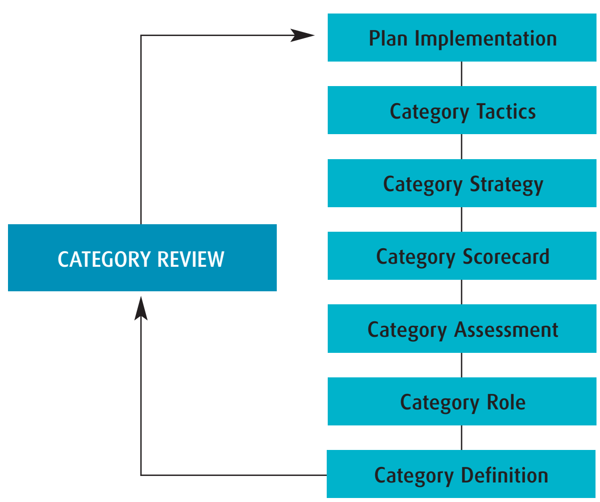
Evolution of Category Management

Today's category management has its roots with the landmark Efficient Consumer Response[1] (ECR) industry initiatives of the 1990s developed by the Grocery Manufacturers of America (GMA) industry association. ECR established industry "best practices" guidelines that have helped to guide countless category management initiatives by individual companies, consortiums, Internet marketplaces and partnerships.

Consumer lifestyles have changed dramatically since the days of corner grocery stores and corner drugstores. With the shift of power, consumers have become more demanding and want a greater assortment of categories and products from which to choose. Manufacturers and retailers have a great need to know, understand and capture these desires. Through shopper viewing programs, focus groups, point-of-sale (POS) data and loyalty programs, retailers are gaining an understanding of consumer base composition and are categorizing the purchase behaviors associated with these consumers.

Despite the good intentions of consultants, scholars and industry representatives, ECR guidelines have proven to be complicated and restrictive – a by-the-book/one-size-fits-all approach shunned by some companies. The GMA can, however, be credited with developing a category management methodology that has helped to highlight the importance of consumers and their behaviors, the categories they purchase and the demand/supply chain required to support them.

Figure 1: ECR Approach and Guidelines[1]



[1] Grocery Manufacturers of America. Category Management. Joint Industry Project on Efficient Consumer Response, 1994.

Category Management Defined

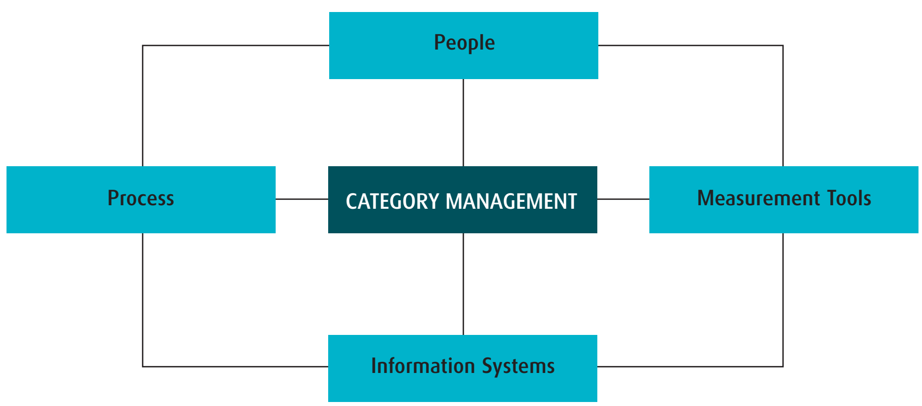
Category management can most simply be explained as follows: Under the leadership of a category manager, using cross-functional teams to identify product categories and drive category performance improvements through the application of categories as strategic business units.

The goal of category management is to improve the operating results of a retailer and its associate partners – including manufacturers, distributors and brokers – by focusing on the consumer. Products are more than just goods being sold; they play an important strategic role as a category or part of a category.

Through the category management approach, a group of specific products are treated as a strategic business unit. A category is a distinct and manageable grouping of products that consumers perceive as interrelated and possibly interchangeable in meeting their needs. Under this premise, category management has some key assumptions:

- **The process involves many interrelated activities**
- **The process must be flexible** in order to fit particular companies and situations
- **The process reaches beyond the retailer** to include its partner manufacturers, distributors, wholesalers and brokers
- **Reducing costs is not the end goal** – goals should focus on the consumer while improving results and simultaneously improving the relationships between trading and servicing partners
- **A solid infrastructure** – including people, process, information systems and measurement tools – is necessary to attain goals

Figure 2: Required Infrastructure



Category management has several key focus areas:

- Efficient product introduction
- Efficient product promotion
- Efficient store assortment

Efficient Product Introduction

Efficient product introduction focuses on efficient and effective launches of new products based on the needs of consumers. Manufacturers primarily concentrate on reducing the number of failures in new-product introductions and associated costs. A secondary goal is to react more dynamically with better data and information related to the supply chain. Only value-added products are placed on the shelf based on consumer demand.

Efficient Product Promotion

Efficient product promotion deals with the efficient and effective execution of promotion strategies, which can have a tremendous impact on the supply chain. Product promotion takes the form of trade promotion, consumer promotion and consumer advertising. Promotion is focused on a particular category and involves:

- Consumer advertising – radio, TV, newspaper, magazine, Internet advertising, etc.
- Consumer promotion – special offers and premiums through gifts and coupons
- Trade promotion – between the manufacturer and retailer involving deals, offers, special discounts, etc.

Efficient Store Assortment

Efficient store assortment targets the development of various groupings of products and services that are profitable and satisfy consumer needs. The goal is to utilize store shelf space more efficiently, appeal to the consumer and eliminate stockouts. POS data is critical to efficient store assortment; real-time consumer preferences are gathered at the cash register and fed back to the category and assortment analysis in order to select and optimally place products on store shelves.

Case in Point: Moving Merchandise Around[2]

Researchers have discovered something that has to rank high on the list of shopping's all-time greatest irritants: a quick trip to the grocery store on the way home that turns into a hunting expedition for ketchup, which has inexplicably moved from aisle 2 to aisle 7. Supermarkets know that moving things makes people mad, yet they do it all the time.

Executives in the grocery business offer two basic explanations. First, they are trying to fit an ever-expanding array of products into a finite amount of shelf space. Second, stores have far more data at their disposal than ever before to help them figure out which products should go where and next to what. In either case, they say merchandise moving is done to improve the "shopping experience."

There is little doubt supermarkets face a dilemma: They are trying to sell things to customers who, by and large, do not want to be there. That fact has supermarket chains constantly experimenting to make their stores work better – and to make customers buy more.

Among the tactics that supermarkets have embraced is the relatively new practice of category management. In the past, a chain would have a soft drink buyer who would keep track of how well Coke sold versus Sprite and place new orders accordingly. These days, however, there is often one person in charge of a whole category of products, such as beverages. That person watches trend data for all drinks and sets up the department's shelves appropriately. If fruit-based drinks start selling more, for example, a category manager may decide to put them in a more prominent place to encourage those rising sales. Like any retailer, grocery stores want to give the best display to hot-selling items.

But category management does not just solve problems – it can create some, too. If sales data show that people are buying more tea than before, then the tea selection needs to be expanded, and it will be – possibly to somewhere else in the store and likely at the expense of another product.

(continued)

[2] Webb-Pressler, Margaret "Moving merchandise (around)." Washington Post, February 3, 2002.

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Indeed, the growing number of stock keeping units (SKUs) a grocery store has to carry these days has affected the entire industry. Over the years, American eating habits have changed; more people buy fresh rather than canned vegetables along with more prepared foods, ethnic foods and organic products. As a result, some goods are not only getting moved around, they are getting pushed out altogether.

For a shopper, this can be maddening. But for a store, it may have a significant side benefit. Many grocery customers are creatures of habit, heading straight for the things they need in each department. When something is not where it used to be, it forces them to wander the aisles and look around. In the process, customers may notice and even buy products they may never have seen otherwise.

This forced march probably has little impact on two of the three classic grocery-shopping types. The first type, the Easy Shopper, spends substantial time cooking and lingers in a favorite store to see what looks good. The second is the Cross Shopper, who splits shopping time among warehouse clubs, drugstores, supermarkets and health food stores. But the sudden change of shelf address has a dramatic impact on the third type of shopper, who hits the supermarket with a limited amount of time, not a lot of cheer and a well-honed strategy for getting in and out as fast as possible. This third type, the Busy Shopper, represents the biggest and fastest-growing segment of the grocery market – the segment supermarkets are likely to target.

The Consumer

Category management begins with the consumer. Companies must determine:

- Who the consumer is – age, economic status, residence, etc.
- What the consumer buys – products, brands, colors, flavors, etc.
- What kind of shopping trip is typical – in/out, convenience, destination trip, etc.
- How the consumer buys – by promotion, price, product, etc.
- How often the consumer buys – daily, weekly or monthly

Developing a Category Management Methodology

Category management is a powerful tool. However, it has traditionally been very expensive to develop, implement and maintain. Full-blown category reviews can require hundreds of hours of work. A retailer could have 200 categories and a consumer goods firm could have thousands of retailers, thus multiplying the overall number of categories that could involve a manufacturer. The key is to streamline the original eight-step process shown in Figure 1.

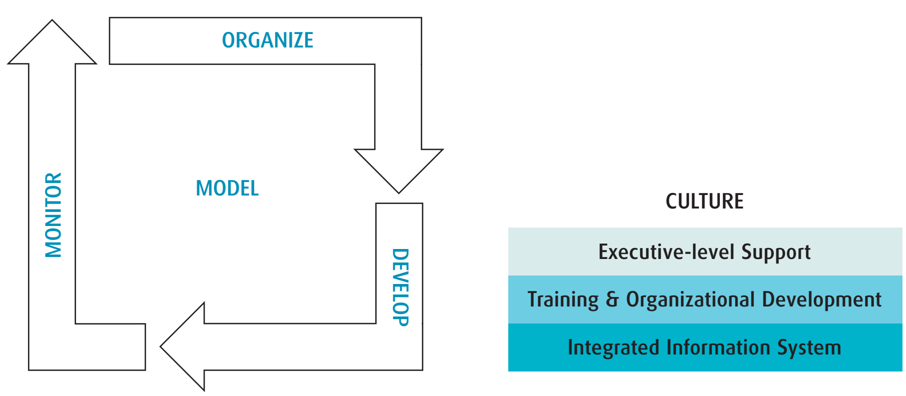
To streamline the process, reduce investment costs and help companies realize benefits faster, a four-step process supported by a required infrastructure can be a powerful tool.

Organize

The first step involves the development of a category management strategy and the organization of resources – people, assets, information, etc. Companies need to take stock of needs, resources, priorities and overall business strategy:

- **Talk to Sales and Marketing –** what are customer needs, what are consumer needs and what are the roadblocks?
- **Communicate with Senior Management –** understand the business strategy, goals, key initiatives, growth plans, strengths, threats, opportunities and weaknesses
- **Examine Current Organization Resources –** look for information in existing areas of the organization (R&D, operations, store operations, supply chain, fulfillment, manufacturing, etc.)
- **Begin Initial Training –** develop training materials in a modular format to introduce the company to category management and then build upon the initial education with more rigorous analytical training
- **Develop the Core Category Management Team –** select or acquire key team members – who will eventually become category managers, data warehousing managers, etc. – to manage the initial category management program
- **Develop a Communications Program –** develop communications vehicles (meetings, newsletters, status reports, etc.) to communicate at all levels from senior management to analyst

Figure 3: Category Management Methodology



Case in Point: Ocean Spray[3]

Ocean Spray is working on not only the systems but also the business processes and cooperation needed to accomplish effective category management.

Communication between marketing and sales has changed significantly over the years. Ocean Spray's former silo approach has been transformed, and now interaction is much greater across all facets of the company.

Ocean Spray also ensures that brokers are very involved in category management plans because they are an extension of the company's sales force and category management group. Brokers implement the day-to-day plans, so they have to believe in the plans for them to fully work.

The company has invested heavily in category management tools and has not been afraid to try new technologies. Ocean Spray also uses category management as an internal function by not only looking at the category as it appears at a retailer's doorstep but also throughout production, management and sales processes. The company continuously puts itself under the category management microscope to see where it can reduce costs.

For space management, Ocean Spray uses Intactix's InterCept software, which translates easily into tools used by retailers and brokers and makes it easier for Ocean Spray to interact with the broker community. The company can access planograms and view, work with and email them back to brokers in the format they need.

Develop

The second step begins the core category management process after plans and organization are in place. This step will become the foundation for ongoing category management.

- **Build a Consumer Attributes Map –** develop and seek answers to the fundamental questions associated with how consumers make buying decisions in categories:

  – What is the current shelf configuration/planogram?
  – Are category subsegments shelved properly?
  – Is a better response to promotions achievable by promoting with other categories?
  – Does the assortment scheme meet consumer needs?
  – Do local neighborhoods or regional factors affect categories and products?
  – What are the dynamics of price points and merchandising in categories?
  – What are the purchasing patterns of products and categories?
  – What other items are purchased along with specific categories?
  – What are the demographics of the customer base?

- **Develop an Analysis Capability –** large amounts of data will need to be analyzed, categorized and synthesized:

  – Sales/POS data
  – Item assortments
  – Shelf placements
  – Pricing
  – Promotions

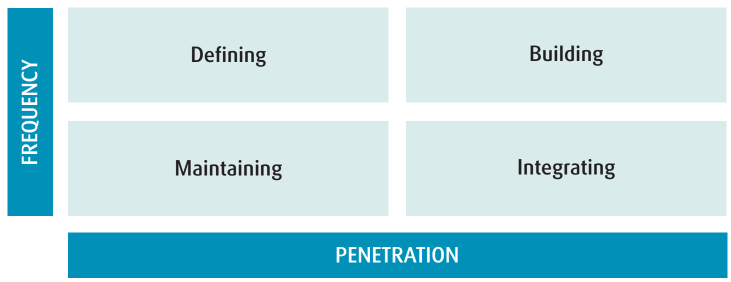
[3] Nelson, Kristi "Category & space management connect," Consumer Goods Technology, March 2000.

- **Perform Key Analyses –** analysis will need to be done at various levels (category, market, store cluster, individual store and SKU) to develop the base data for category development

- **Develop Categories –** by performing the analysis, consulting external industry data and comparing competitors' categories:

  – Staples: high penetration/high frequency
  – Niches: low penetration/high frequency
  – Varieties: high penetration/low frequency
  – Fill-ins: low penetration/low frequency

Figure 4: Category Classifications[4]



Monitor
Monitoring can be thought of as "filling in the scorecard." This step is critical to maintaining category management, identifying trends, measuring results, making modifications, reporting to senior management and ensuring long-term success.

In order to monitor effectively, quantifiable implementation goals and metrics need to be established. Companies must continually monitor and measure results against these predetermined metrics. Clear goals and metrics also enable the administration of incentive programs and mid-course adjustments throughout the category management product cycle.

Implementation and financial goals for each individual category must be analyzed to measure category manager performance and ensure category business plans are being met at all levels:

- Category
- Chain
- Region
- Store

[4] Hoch, Steven. "Effective category management depends on the role of the category." Journal of Retailing, Babson College, Summer 2001, volume 77, issue 2.

Model
This last step enhances the category review step from the original eight-step process. The category review process has typically involved perhaps hundreds of work hours to complete. This step needs to be backed by decision support and modeling capabilities. Category managers need to be able to simulate category performance results from changes in various inputs – category strategies, definitions, roles and tactics.

Case in Point: Kraft Foods[5]

Kraft believes that not all category management steps are equal. Based on that belief, Kraft has streamlined the traditional ECR eight-step category management approach to just three steps, which enables field-service personnel to create category plans rapidly. That three-step approach reportedly gains 80 percent of the value for 20 percent of the effort. Kraft's three-step model requires only 25 to 40 hours, and it achieves nearly the same results: 5 percent to 8 percent category sales growth.

Benefits

Productivity
Establishing category management with the optimal tools, processes and information systems will help assemble category plans in a much shorter time frame.

Resiliency
Category managers possess the tools, processes and information to accurately develop and manage categories as well as model changes for ongoing improvement.

Precision
Data integration, collection and warehousing techniques are established to provide reliable, precise, real-time data to category managers, who can then model real situations with real data.

Responsibility
Automating the scorecard with application tools and data integration with ERP, store and manufacturing systems supports the critical requirements of a scorecard. With a trusted scorecard, incentive programs are easy to monitor and are trusted at all levels.

Revenue and Performance
Revenue and performance are the critical benefits that senior management will measure and by which the category management process will be considered a success or failure. This process focuses on:

- Cost reductions
- Increased sales
- Improved margins
- Improved profits
- Increased market share
- Improved consumer satisfaction
- Improved in-stock conditions
- Improved return on assets

[5] "Category management & retail CG linkages." Consumer Goods Technology B2B supplement, June 2000.

Conclusion

Category management is a major investment in terms of dollars, time and assets.

It is also a personal investment on the part of everyone involved to commit to the process and implement the required change management.

We have discussed qualitative and quantitative benefits of category management throughout this paper. We believe the benefits are quick, substantial and long term.

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