
Category Management: A Different Perspective

Fact-Based Selling at Retail

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J.C. Carpenter & Company, Inc.
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*“Do not seek to follow in the footsteps of the men of old;
Seek what they sought.”*

*Matsuo Basho,
Japanese Poet*

Has Category Management served its purpose?

In the early 1990's, the Grocery Manufacturers of America worked with a consulting organization to develop the best practices model for Category Management. This model was intended to change the way suppliers did business relative to the very difficult business environment they faced in the late 1980's. Essentially, the model involved looking at Consumer Packaged Goods categories as separate business units, developing strategies as such. The intent was to maximize revenues and minimize supply chain costs to achieve profitable revenue growth for BOTH suppliers and retailers. It was a comprehensive model and represented a new “go-to-market” strategy for its time. The model was based upon the Efficient Consumer Response approach to supply chain management:

It is important to understand specifically the tangible and intangible value it has provided suppliers and retailers since its inception. There has been a fair amount of research on the quantitative benefits of Category Management for both retailers and suppliers. According to a recent study by Prasanna Perera that appeared in the Daily News, he indicates that Category Management has achieved the following results in the United States:

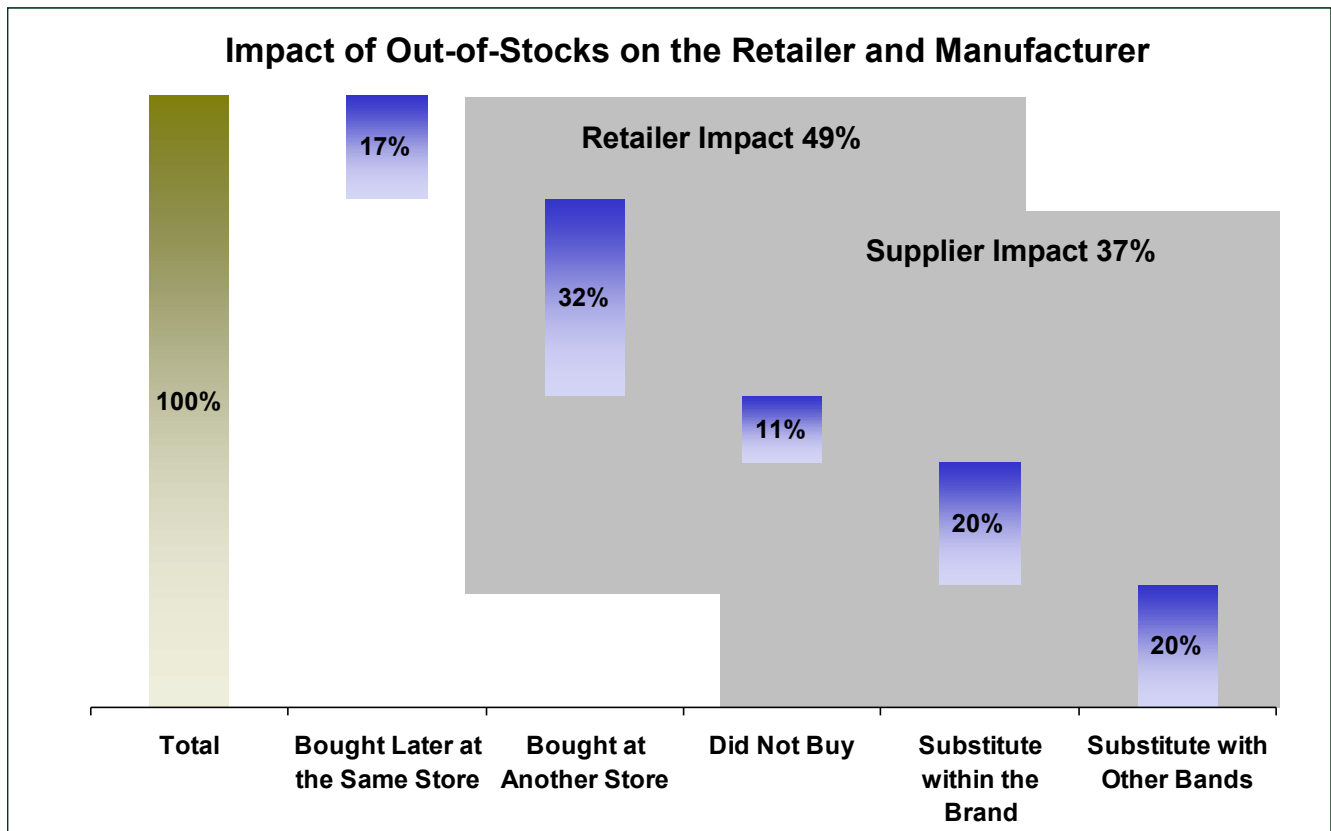
- ❖ Retailer-Specific Benefits:
 - Sales increases have been on average approximately 7% for the total category.
 - Margin improvements for retailers have been on average 5%.

- ❖ Supplier-Specific Benefits:
 - Sales increases have been on average about 5% being achieved for the manufacturer selected as category partner.
 - Margin improvements due to lower cost of sales.
 - The level of improvements varies by category and the level of resources required for their Category Management model.

One key benefit of traditional Category Management has been the reduction in out-of-stocks. A recent survey conducted by IBM Consulting found that a large number of shopping occurrences were changed in a way that was detrimental to suppliers and retailers based upon out-of-stocks (See Chart 1). From a qualitative standpoint, retailer and supplier loyalties have been enhanced based upon the availability of the desired products.

Interestingly, out-of-stocks continue to represent a growth opportunity for most suppliers and retailers. Think about it . . . a 90% in-stock does not only mean a 10% sales loss. Total volume lost is likely well above the 10% when you consider all of the lost demand from an out-of-stock for that item. The lost sales are only compounded when you consider the market basket implications. This has become more of a forecasting issue than supply chain management, but that is a topic for separate discussion.

Chart 1: Impact of Out-of-Stocks



Source: Consumer-Driven Supply Chain Networks; IBM Consulting.

Has Category Management run its course?

Category Management has been re-defined by the marketplace. According to a recent survey by AC Nielsen, retailers and, to a lesser extent, suppliers continue to rate Category

Management as “critically important” (See Chart 2). The variance in relative importance may be due to the perceived benefits of the practice. As retailers are increasingly relying on suppliers to help manage the category, they are gaining significantly more support without having to add headcount.

Chart 2: Stated Importance of Category Management Components

Percentage That Identified Issue as “Critically Important”		
Critical Issues Facing Trade Partners	Suppliers	Retailers
Promotion Efficiency/ Effectiveness	99	98
New Product Introductions / Implementation	91	98
Category Management	89	98
Variety / Assortment	87	98
Understanding the Consumer	84	83
Private Label	81	90
Trade Partners / Vendor Relationships	81	90
Space Management	79	93
Customer Loyalty / Retention	74	90

Source: 14th Annual ACNielsen Survey of Trade Promotions Practices, July 1995.

One particular surprise to the researchers was that understanding the consumer was rated relatively low, particularly given the fact that the traditional Category Management model begins with an understanding of the consumers that the CPG companies are trying to serve. This could be explained by a number of factors:

1. As syndicated data has been mined over the past several years, both suppliers and their key retail customers may believe that they fully understand their consumers. This is particularly true at the retail chain level.
2. Practitioners of the original Category Management model may feel that their consumer research has not yielded the desired results. However, this is not a factor of poor research but rather a lack of clarity with the business questions driving the research.
3. Understanding not only their consumers but the attributes of their consumers relative to other retail and brand competitors is critical . . . the attributes are valuable, the relative attributes are insightful.

When asked which components of Category Management they utilized in 2004, both suppliers and retailers reported decreases in virtually every activity from 2003 (See Chart 3).

Chart 3: Trend in Utilization of Category Management Components

Percentage That Utilized the Stated Category Management Activity						
Included as Part of Its Category Management Process	Suppliers			Retailers		
	2002	2003	2004	2002	2003	2004
Assortment Planning	85%	91%	90%	73%	96%	86%
Promotional Planning	80%	85%	84%	83%	90%	86%
Shelf Management	89%	95%	82%	83%	94%	81%
Category Business Planning	82%	87%	82%	68%	92%	81%
Everyday Low Price	80%	74%	76%	60%	82%	67%
Frequent Shopper /Loyalty Programs	48%	51%	41%	45%	51%	43%
Micro-Merchandising	34%	39%	31%	30%	45%	38%
Micro-Marketing	23%	33%	23%	30%	45%	38%

Source: 14th Annual ACNielsen Survey of Trade Promotions Practices, July 2005.

While it has provided the basis for fact-based selling, one of the criticisms of Category Management best practices is that it is a one-size-fits-all model, which is inappropriate in the current business environment. The rigid, static structure and all-inclusive components of the original Category Management model are no longer conducive to a dynamic marketplace nor true category growth.

Solution: Proprietary Category Development models are emerging!

So an enhanced framework is emerging that is markedly different from the models of the past. This model engenders the primacy of the consumer/ shopper, de-emphasizes the cost containment issues that were the focus of traditional Category Management, and focuses on profitable revenue growth opportunities in addition to near-term performance opportunities.

This new model has evolved as a result of several marketplace dynamics that have impacted the traditional model. Drivers of change include:

- ❖ **Competitive Intensity:** The growth of mass merchandisers such as Wal-Mart and Target, the development of club stores including Costco and BJ's, and the consolidation of key retailers has reduced the fragmentation that existed in the market previously. That is, fewer players are vying for the same market. This has led to greater emphasis on price as the market value proposition.
- ❖ **Technological advancements:** In the early-1990s when the concept of Category Management or Strategic Category Development was first developed, POS information was basic if at all available. If it was utilized, it was used primarily as a source for the store to manage inventory as opposed to a tool to develop insights. Wal-Mart "raised the bar" for the entire industry when it offered store-level detail on the performance of each item by week, day or hour. It further enhanced the capability via its Modular Category and Assortment Planning (MCAPS) capability and Store of the Community database. Performance measurement and analysis has been incorporated into other useful merchandising tools in to develop real-time, fact-based recommendations.
- ❖ **Consumer preferences and trends:** Consumer preferences continually evolve based upon the latest innovations in the market. Advances in research techniques to better identify explicit and latent consumer needs along with technological advances have been the real driving forces in the innovation of many product categories. Product success comes from leveraging these drivers to develop consumer-oriented product "pull" approach as opposed to a supplier/retailer-oriented product "push."

The new framework recognizes the variability that exists between channels, retailers, location in stores, suppliers, categories, brands and consumer/shopper solutions. Suppliers and retailers are experimenting with the development of proprietary Category Management models. Customizing an appropriate framework to develop the most efficient, high-impact approach for optimizing retail and supplier performance is critical. Estimates are that 90% of companies are practicing some form of Category Management, but implementation may be measured different ways. For example, Kraft Foods has a three-step Category Management model that does not fit the traditional eight-step model from the early 1990's This is not an issue of implementation of the original model, but implementation of the underlying components of the model in an efficient manner for the specific organization. According to Kraft, they have been able to generate 80% of the value of the traditional Category Management model for 20% of the effort.

Equally critical in developing a more flexible and efficient model is to address some the acceleration of change for key performance drivers. To look toward the future, let's look at it from the components that shaped change in the past: Technology, competitive intensity and consumer preferences and trends

- ❖ **Competitive intensity:** Price-based value propositions will give way to differentiated and innovative products and retail environments. In addition, the roles of suppliers and retailers are expected to change in response to competitive dynamics (See Chart 4).

Chart 4: Trends and Implications in Supplier/Retailer Competitive Intensity

Component of Change	Projected Trends	Implications for Suppliers	Implications for Retailers
Competitive Intensity	❖ Store differentiation will be key to win in this environment	❖ Exclusives, either in the form of branded or private label products, will increasingly be used to differentiate stores	❖ Out-of-the-box thinking will have to be considered by retailers to gain a competitive advantage in terms of the shopping experience.
	❖ True innovation and first-to-market emphasis will drive a significant competitive advantage.	❖ Consumer insights must extend beyond usage, behavior and attitudes. Progressive organizations are already employing ethnographers to identify unmet needs or product re-design opportunities.	❖ Most suppliers already share their research findings. However, retailers must begin sharing shopper research, or providing suppliers access to the shoppers, to identify truly innovative solutions
	❖ Retailers will begin to assume more control over category management in the future.	❖ Suppliers must entrench themselves as key components of retailer strategy development	❖ Suppliers must maintain some ability to direct category strategy or their incentive to continue providing resource to retailers will go away
	❖ Supplier sales team leaders will increasingly be looked upon by retailers as customer business advisors.	❖ Key Account Managers will have to adjust their traditional measurement approaches . . . Market share/growth will be replaced by customer P&L	❖ The ability to fully utilize the skills and talents of supplier Key Account Managers will require sharing more than simply POS and performance data

Source: IBM Business Consulting Services, "Consumer Products 2010: Executing to Lead in a World of Extremes," April 13, 2005; JCC Insights.

- ❖ Technological advancements: Information ubiquity and the increasing ability to manage messaging clutter will drive shopper decisions (See Chart 5 on the next page).

Chart 5: Trends and Implications in Technology

Component of Change	Projected Trends	Implications for Suppliers	Implications for Retailers
Technology	❖ The proliferation of mobile devices will provide shoppers the opportunity to get real-time product research assistance in stores	❖ Understand the primary sources of online consumer product research and begin establishing a presence within those sites	❖ Understand the specific information that shoppers look for ❖ Develop unique tools to capture the mobile technology trend
	❖ Increasing viewer utilization of TiVo and other television technologies that allow viewer to bypass commercials ...selection of products at the shelf will remain high	❖ Selection of products at the shelf will increase even further ❖ Assessing advertising ROI will focus investments on the most fruitful opportunities	❖ In-store communications will be critical to provide shoppers key information

Source: IBM Business Consulting Services, "Consumer Products 2010: Executing to Lead in a World of Extremes," April 13, 2005; JCC Insights.

- ❖ Consumer preferences and trends: This is perhaps the most dynamic trend. Everyone knows that there are major shifts occurring in the demographics of the U.S.:
 - The Hispanic population is growing faster than any other ethnic group. It is expected to become the second-largest ethnic group behind the Caucasian group.
 - Boomers are entering their "Golden Years". This age group will be among the fastest in the U.S. over the next several years. But these new seniors choose to continue working longer, thus the term "the graying of the American workforce." Continuing their professional pursuits longer affects both their attitudes and economic buying power.
 - The attitudes of the demographic groups vary: Boomers want it all; Gen X'ers want it all, just not at the same time; Gen Y'ers believe Boomers and Gen X'ers are both crazy. With the differing attitudes, differences are also emerging in desired product attributes and value sought.
 - More people are starting their own businesses or working for smaller companies . . . the perceived security and benefits of working for a larger corporation and virtually non-existent.

Another key trend that is expected to continue is the phenomenon of shoppers "trading up" to premium products, such as Starbucks coffee, and "trading down" to value priced items and private label brands. These changes are among some of the demographic trends that will shape the way shoppers purchase in the next several years. The market as we knew it will become increasingly fragmented, thus the suppliers and retailers should be prepared to anticipate or, at the least, respond to these changes (see Chart 6).

Chart 6: Consumer Trends and Supplier/Retailer Implications

Component of Change	Projected Trends	Key Implications for Suppliers	Key Implications for Retailers
Consumer Preferences / Trends	❖ Shift away from relative homogeneity of consumers/shoppers	❖ Market segmentation will be important to understand the needs and preferences in changing demographics/psychographics.	<ul style="list-style-type: none"> ❖ Store clustering will have to be more detailed to satisfy shopper demands and fully capture market opportunities ❖ Retail execution will be more complex, but will be critical to the success of any clustering. ❖ Two-way, formal communication between buyers and store managers will enhance optimal merchandising
	❖ Retail price points are beginning to polarize. That is, the traditional demand price points are changing (See Chart 8)	❖ Developing products that are perceived as “premium” will require alternative approaches to enhance the power of the brand.	❖ A category assortment needs to have a representative assortment of products at the “premium” and “value” price points.

Source: IBM Business Consulting Services, “Consumer Products 2010: Executing to Lead in a World of Extremes,” April 13, 2005; JCC Insights.

Both suppliers and retailers are recognizing the one-size-fits-all Category Management best practices developed in the early 1990s are cumbersome, resource prohibitive, and not necessarily applicable to the business questions at hand. Certainly, the factors that are expected to impact the industry moving forward will require an agile framework that can efficiently identify and capture opportunities. The original Category Management model components that sought efficiencies through automation are still valid but have limited added value. Consider the following comment:

“Information technology . . . is essential to competition, inconsequential to strategy.”

Nicholas Carr
 Harvard Business Review
 October 2003

True Category Development is evolving, where there is a dual emphasis on monitoring and optimizing day-to-day performance while efficiently identifying and assessing real growth opportunities (See Chart 7 the next page).

Chart 7: Category Development Framework

Key Questions	Routine Category Development Activities	Project-Oriented Category Development Activities
Why do it?	❖ Near-term growth through operational enhancements	❖ Intermediate to longer-term growth bases upon strategic opportunities
What is the typical application of the effort?	❖ Operational, though has strategic implications	❖ Strategic, though has operational implications
What is the primary resource of the effort?	❖ Technology-driven	❖ Human capital-driven
How do the analytical approaches vary?	❖ Comprehensive review of POS data to identify performance issues and opportunities	❖ Identifying insights and developing hypotheses that will focus the analytical effort . . . not “boiling the ocean.”

By no means are these activities mutually exclusive! Both should be part of the Category Development process and will undoubtedly impact many functional organizations within the company. To see how this integrated framework works, let’s look at a series of Category Development activities and how they would fit within an organization’s sales support activities.

Chart 8: Illustrative Positioning of Selected Category Development Activities

	Routine Category Development Activities	Project-Oriented Category Development Activities
Strategic	<ul style="list-style-type: none"> ❖ Analyze POS purchase trend ❖ Assess POS performance variances from pricing and promotional activities ❖ Review SKU rationalization by integrating POS, planogram and consumer/shopper data 	<ul style="list-style-type: none"> ❖ Monitor attitudes and behaviors of: <ul style="list-style-type: none"> ❑ Consumer attitudes/usage ❑ Shopper decision factors/behaviors ❖ Develop and update, as needed, predictive models for pricing, promotions and advertising strategies ❖ Create differentiation programs for the shopping environment
Day-to-Day/Operational	<ul style="list-style-type: none"> ❖ Assess item, brand and (as possible) category performance and productivity ❖ Review supply chain effectiveness: <ul style="list-style-type: none"> ❑ Out-of-Stocks ❑ Days of supply ❑ Etc. ❖ Determine execution and effectiveness of merchandising implementation 	<ul style="list-style-type: none"> ❖ Share best practices across accounts (suppliers) and categories (supplier and retailers) ❖ Assess drivers of performance variables

As you can see, each quadrant provides distinct value to a supplier and/or retail organization. Of course, the ultimate beneficiary will be the consumers and shoppers

Further, this will optimize the productivity and value associated with investments in Category Management. There are numerous software packages that allow a company to slice and dice the data. The cost savings from automation will yield a positive return on investment in a short time. But there are also several progressive organizations that use insight and hypotheses to drive the project-oriented analytical effort (e.g. inductive reasoning) in contrast to an unfocused, “boil the ocean” approach that attempts to look at everything (e.g. deductive reasoning). The results for these organizations have been remarkable. . . A handful of personnel are delivering the same value as other companies with several times the number.

A concerted effort to understand your business questions will drive you to the most effective Category Development approach for your company. No one model or framework will work for all companies, but the right model will work for your company!

J.C. Carpenter & Company, Inc. develops the fact-based solutions to both tactical and strategic issues. J.C. Carpenter & Company, Inc. can provide the necessary information and analytical support, from both a qualitative and quantitative perspective, to enable clients to quickly address changing market conditions and leverage all of the relevant market information to benefit client performance. Industry experience, which includes consumer packaged goods, is varied and allows the company to think beyond conventional industry dynamics and achieve profitable revenue growth.

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