

The Evolution of Category Management and the New State of the Art

In the early 1990s, grocery retailers in the United States were ready for a better way to run their business. Margins of about 1 percent at that time were unacceptable. New products were proliferating, while consumers were becoming more diverse and demanding. Other classes of trade such as warehouse clubs were emerging. Wal-Mart was getting ready to roll out its supercenter format that combined the retailer's traditional general merchandise store with a full-line grocery store under one roof.

Clearly, a dramatic change was needed. Retailers sought a way to improve margins and compete more effectively. They wanted to reconnect with consumers and satisfy their needs, or face the prospect of an eroding shopper base. Given the endless variety of new products pouring into the marketplace, retailers wanted to ensure that

their shelves were stocked with products that consumers wanted to buy. Mainly, they wanted to stay in business.

Birth of the Eight-Step Process

Many progressive retailers and manufacturers realized that there was gold in the reams of data available from retail point-of-sale (POS) systems. Was it possible to figure out which products to stock in a certain store? Could analysis of the data tell retailers how to customize the shelf sets in all the stores of a chain according to what shoppers were buying and wanted to buy? Could they attract and retain specific niches of high-value shoppers?

The answer was yes. The way to do it was a process called category management that was developed in the early 1990s by The Partnering Group (TPG), a consulting firm. A few of the larger retailers began testing the process. Soon the manufacturers jumped on board with advice and support. They then started to help other retailers adopt the principles as well. In no time, category management was promoted enthusiastically and became a must-have process for retailers and manufacturers.

TPG's process, which is now considered the traditional form of category management, consists of eight steps:

1. Category definition
2. Category role
3. Category assessment
4. Category scorecard
5. Category strategies
6. Category tactics

7. Plan implementation
8. Category review

Early Practitioners

The retailers that pioneered category management are among the largest chains in the United States. Safeway was one of the original practitioners. Others included Kroger, Albertson's, and Publix. SUPERVALU, the first wholesaler to practice category management, brought the process to small independent retailers.

On the manufacturer side, Phillip Morris and the Coca-Cola Company were early supporters of category management. The latter developed a training program about the process that is still distributed to retailers. It helps them understand what category management is all about and what Coca-Cola's role in the process is.

Some of the early practitioners saw nearly immediate benefits through reduced inventories and increased sales. For others, it took more time. But word soon spread about the potential of this new process.

Evolution of Category Management

The original version of category management started a revolution in the way retailers operated their businesses. More and more retailers built their businesses around its principles through the 1990s.

Eventually, however, the process proved to be too complicated for many retailers to adhere to. There were too many details and variables. It was too cumbersome and unwieldy. Too much coordination was needed from too many departments such as logistics and finance.

Problems even developed on the manufacturer's side when salespeople were asked to learn the intricacies of category management. Their primary job was developing relationships, moving products, and building the top line. They weren't analysts. As a result, many manufacturers created category management departments staffed with analysts to support the salespeople. But even then, training somebody to be capable with the entire category management process remained a daunting task.

Meanwhile, some larger manufacturers came up with their own way to simplify matters.

They restricted their proprietary category management to the larger retailers; that is, they invested most of their time and effort on full-time account teams for their largest customers. Smaller chains received less interest and support.

Role of Technology

The development of technology and its steady growth spurred the use of the process. But the journey from the beginning to today was full of obstacles.

In the early days, the software applications for category management required too much number crunching. Instead of talking to customers, salespeople were sitting behind a personal computer pulling data, putting it on Excel sheets, and then creating PowerPoint slides for a presentation. The process was tedious and time consuming.

The problem of data overload and the time spent crunching numbers led to a major change in category management. Companies were forced to streamline their approach to data analysis and de-

velop appropriate applications for the job. Proprietary systems emerged that simplified and quickened the process for many practitioners. Training focused on working with user-friendly template-based customized software as opposed to a process of pulling data and learning to manipulate it.

Category Management Today

Many retailers and manufacturers refined the process of category management over the years. They still began with the traditional eight steps, but developed processes with fewer steps while keeping to the objectives of the original version. The resulting processes are shorter, tighter, and easier to absorb and act on. Some processes have five steps, others have six. The “standard” eight-step process has become less of a standard and more of a starting point.

In addition, in some organizations the sequence of steps has been rearranged compared to the original eight. For example, financial targets were originally done after the assessment step. Now some companies are starting off with their financial targets, saying, “Here’s what we want to achieve. Let’s do an assessment of where we are versus those targets. Let’s look at the gaps and then figure out what are the strategies and tactics that we are going to use to meet those targets.”

Many executives start off with the retailer’s goal and financial objectives. “What are we trying to achieve? What margin do we want to hit? What’s our growth rate? What are our shopper goals? How many more shoppers do we want to bring into our stores?” They believe that such variations make a lot more sense than starting off by defining the category and its role. Trading partners

already know that information and skip over these preliminary steps.

Others have dropped the scorecard down in the sequence, arguing that financial targets cannot be set accurately until the other steps are completed.

Today, major manufacturers have a whole suite of applications that any executive can use effectively. Armed with sophisticated tools, salespeople find the process user friendly and easy to implement.

Consumer-Centric Process

In the early 1990s, everyone involved in category management focused on the data and what the numbers revealed about product movement and the category. Surprisingly, they forgot that the consumer drives what happens in the category. While always part of the process on paper, the consumer got lost amid the accumulation of data.

The biggest change in category management over the years has been more of a focus on the consumer. By the late 1990s, manufacturers were giving retailers data that was more consumer oriented. For example, there was consumer data collected from a panel of households. Analysts could work with data on an account-by-account basis, which was not possible in the early days. Other new sources were demographic/psychographic data.

A new chapter in category management was unfolding. It included components designed to make the process less product-centric and more consumer-centric:

- Segmenting and targeting consumers to get the right products in front of the right shoppers in the right stores
- Clustering stores based on the sales potential of brands or categories
- Demand gapping, or determining the difference between existing sales and potential sales in a category
- Developing a marketing plan for each significant customer group

Retailers also jumped on board with the focus on consumers and started looking to incorporate shopper data collected by a store's loyalty card program. While its use is still relatively new, this creates another whole new dimension in terms for category management.

These new sources of information contribute to embedding the consumer as the centerpiece of category management. Today, executives understand that consumer behavior changes the categories. The new mind-set: If we're not getting a fair share of the category, chances are we're not doing a good job of understanding consumers and satisfying their needs.

Beyond Supermarkets

Category management began as a process for supermarket retailers. Before long, it was clear that its benefits were applicable to other classes of trade. Wal-Mart was using the process before expanding from general merchandise into grocery via its supercenters. Drug-store chains adopted the practice, as well. Even Peapod, the online grocer, uses category management.

Today, the practice has expanded well beyond consumer packaged goods. Retailers as diverse as Home Depot (home improvement) and Borders (books) employ category management.

Role of the Retailer

If the consumer is at the center of category management today, the retailer is the linchpin. The retailer sets the overall tone in terms of the objectives, strategy, tactics, and financial goals. What is the retailer trying to accomplish in the marketplace? Does the retailer want to be perceived as a low-price leader, as an upscale purveyor of goods and services, or as something in between? The decision has implications for assortments, category role, strategy, and tactics.

The retailer's role has a number of key components that we discuss in the next sections.

Sets Strategy

The retailer must communicate corporate goals and category strategy to the vendor partners. Without such communication, trading partners may go in different directions rather than effectively working together. A mutual understanding lays a solid foundation for category management.

Determines Process

What version of category management should be followed? How many steps to the process? Retailers proficient in category manage-

ment typically take the lead and inform suppliers. However, some retailers defer to their trading partners and their expertise.

Gathers Data

The retailer gathers relevant data for category management applications. This includes POS data, financial data, and perhaps shopper data gathered from their own loyalty card programs and household panels run by marketing information companies like ACNielsen. From manufacturers, the retailer obtains additional information. In some cases, the manufacturer plays the lead role in gathering data. Mining this data yields significant insights about consumers and their buying preferences.

One of the most underrated measures is called *Buyer Conversion*. Using consumer panel data at the account level, Buyer Conversion says, “Okay, Mr. Retailer, you’ve got 100 shoppers coming into your store every day. Of those 100 shoppers, we know that 80 of them buy soft drinks. And of the 80 who buy soft drinks, 40 buy soft drinks in your store. So that means the other 40 are buying soft drinks somewhere else. But they’re still shopping in your store.”

What a powerful consumer insight! The retailer has category shoppers in the store, but they’re not buying soft drinks there for some reason. They’re buying elsewhere. So the strategy is figuring out how to get those 40 category shoppers to buy the category in the store. This is a targeted strategy because the shoppers are already in the store. The retailer must convince them that buying soft drinks there is a better value for them versus cherry picking elsewhere.

Ensures Retail Compliance

Who is responsible for the execution of the plan in the store? The answer varies according to the retailer. Among those getting involved to ensure retail compliance are a manufacturer's direct sales force, sales agencies representing the manufacturer, merchandising service organizations (MSOs) hired by either the manufacturer or the retailer, and even the store's clerks.

Regardless of who is responsible, here's the bottom line: Category shelf sets are often not maintained in the store, and substandard retail compliance undermines the best-laid category plans across the industry. This problem concerns trading partners, and finding a solution remains a priority.

Ultimate Decision Maker

For category management to be effective, the retailer must make a commitment. Managing categories as independent business units is only part of the process. What does the data reveal? Does it match up with the retailer's goal in the marketplace? If not, what happens?

Retailers determine the destination categories, if any, to promote; that is, those categories that will draw shoppers specifically to the store. Manufacturers can suggest which categories should be destination categories, depending on the number and characteristics of the shoppers in the trading area. But the final decision is the retailer's.

Actually, the retailer ultimately makes all the decisions—or at least should take responsibility for decisions made jointly with a trading partner.

Role of the Manufacturer

Category management gives the retailer a creative and comprehensive way to run a business. The manufacturer can be a valuable business partner by providing support.

How much? That depends on the retailer and the level of expertise in category management.

Retailers with a solid category management process and clear vision for deployment are probably the top volume customers for most manufacturers. They will lead the category reviews and set strategies while manufacturers play a subordinate role, even though they are represented by a full category management account team. For example, grocery chains such as Kroger and Safeway have their own structured category management process. Manufacturers contribute, but they are role players.

Other retailers have a less defined process. They look to the manufacturer, their wholesaler, or a sales agency to take the lead by making recommendations, providing consumer insights, and even actual templates.

For example, among the questions these retailers may have:

- How many people should be covering categories?
- How many categories should there be?
- Are the product mix and the actual category set adequate?
- Are there enough facings to avoid stock outs?
- Should the pack size be increased?

If retailers are not well versed in category management, there is temptation for manufacturers to push their own agenda for the category they're in. A flurry of data will present a convincing case.

What is a 20-store operator to say when dealing with a representative of a strong national brand? Strong-arm tactics should be avoided. Such actions give category management a bad name. Done correctly, the process is about the category, with individual brands supporting the achievement of category objectives.

Regardless of the nature, quality, and amount of support, all manufacturers should come to the table equipped to do the following:

- *Understand the retailer's strategy.* Every retailer has an objective in the marketplace. It may set out to be the low-price leader (Walmart) or an upscale operator with outstanding customer service (Lunds and Byerly's in Minneapolis). The retailer may want to be known for meat (Stater Bros. in southern California), for a full and diverse assortment of products (ShopRite in New York and New Jersey), for ethnic products (Caputo's in Chicago), for organics and healthful fare (Whole Foods), or simply for fun (Stew Leonard's in Connecticut).

The manufacturer needs to understand what the retailer is trying to accomplish and what strategy is used to reach that objective. Such an understanding is the starting point and foundation of category management.

- *Support retail strategy.* The manufacturer presents all of the programs and promotions for the year for evaluation by the retailer. Is there a fit that benefits both parties? Plans that benefit only the brand and not the category and store will be obvious. They should not be considered if the manufacturer wants to remain a valuable partner. The rule is: category first and brand second.

Let's say the retailer wants to increase shopper traffic by leveraging the store as a marketing medium. A manufacturer's promotions should focus on creating in-store excitement while building the retail image. If a promotion deals with, say, *Cinco de Mayo*, the trading partners can both benefit. An elaborate presentation with product samplings and strolling mariachi players—preceded by considerable advance publicity—will create a festive mood, increase traffic, and satisfy shoppers. There will be sales lift in the overall Mexican foods category and the brands in it.

- *Share their own strategy.* Manufacturers should share their corporate strategy with retail customers. They don't always do so. More important, they should determine if their strategy meshes with that of the retailer. Sometimes it doesn't and that can lead to conflict and a breakdown of the trading partnership for category management.

If a salesperson is trying to drive brand volume and a retailer is trying to drive shopper traffic, they have to figure out how to do both together. They should strive for common ground. It may not be ideal, but there must be mutual understanding and shared goals.

In a perfect world, the manufacturer walks into the retailer's office and says, "We understand where you're going. We want to share our strategy and objectives with you. We can work together."

Category Captain

When category management first started in the early 1990s, a retailer would have four or five manufacturers in the same category

rushing in with their programs. Each presentation had a different context, rationale, and recommendation. The retailer rightly wondered, “Who’s right and who’s wrong?” In many cases, the rationale for the plan seemed solid, but in others it didn’t.

Retailers eventually selected one manufacturer as a trusted partner that could be relied on. It was a company they believed had the resources, wherewithal, and commitment to grow the category. That company came to be called the *category captain*.

That didn’t mean that the other three or four manufacturers competing in the same category were excluded from the process. They became category advisors or validators. They cross-checked the category captain’s recommendation. If the captain was doing a good job, the advisor merely provided a little twist or added something that perhaps was missed.

The use of category captains and advisors has increased over the years. Today, most companies use them. The larger retailers typically appoint trusted partners and call them a captain, advisor, valuator, consultant—and sometimes nothing at all. The retailer still has one partner to rely on for advice about the category. Large manufacturers have teams assigned to an account to offer category advice and actually develop planograms, the diagrams that show how and where products should be placed on retail shelves for optimal sales. They sometimes operate out of permanent offices at the retail headquarters.

The largest manufacturer with the largest brands is often chosen to be the category captain, but that’s not always the case. A smaller supplier may bring more resources to the table and earn the title—especially if it is enthusiastic and clearly has the best interests of the retailer in mind.

The choice of this trusted partner should take into account the following:

- *Ability to think strategically:* Retailers should work closely with manufacturers who think strategically. And that goes beyond thinking about the category. It means thinking about the implications for the department, the store, and the retailer's shopper base.
- *Ability to be unbiased:* Manufacturers must be unbiased. Instead of pushing its brands, a category captain must focus on the category. That can be very challenging, especially if the vice president of sales insists on meeting quotas for the month. Under those circumstances, it is difficult to talk strategically about competitive brands. It is more difficult for category captains to delist their own brands for the greater good of the category.
- *Ability to access relevant information:* Captains must bring the retailer relevant information. The kinds of data can include consumer panels, RFID, consumer focus groups, and other research. Their recommendations must be based on solid, supported facts.

To be effective in meeting the needs of retail category managers, the top characteristics of an effective supplier are accuracy, timeliness of the information, responsiveness, and creativity. The best suppliers have an intense focus on supporting the initiatives of their own company while working within the retailer's strategic framework to drive sales and profit dollars in the stores. Suppliers must bring a category perspective and not solely a brand outlook.

Supporting Players

Using the principles of category management to operate a business is not confined to retail chains and consumer packaged goods (CPG) manufacturers. There is a host of other players contributing to the design of category plans and their implementation in the store. Here is a look at their roles and importance.

Wholesalers

The primary business of grocery wholesalers is to warehouse products and deliver them to independent retailers. They also supply advertising and marketing support and marketing advice.

In addition, wholesalers can provide a full menu of category management services to the independents. Manufacturers conduct category reviews with wholesalers on behalf of the small retail customers. The wholesalers send shelf sets to the retailers who modify them, perhaps adding products they receive from secondary suppliers or certain items that their top shoppers request. The retailer receives the manpower to reset shelves from the wholesaler, manufacturer, a third-party service company—or sometimes a combination of the three.

These services are neither mandatory nor free. Independents must sign up and pay a weekly fee for them. Given the complexity of category management and the limited resources of independents, it's hard to imagine deploying the process without this help.

The task calls for dealing with several different formats, retail strategies, and even markets. Because of the number of different retailers served, a wholesaler must have enough room in the distribution center to carry all of the products that different category management plans call for.

Perhaps the biggest challenge for wholesalers is communication. They are always looking to improve and speed up the way information is delivered to their customers. Shelf sets are usually available online, along with any changes that need to be made or suggested.

“We look for input from retailers on a regular basis about how they want to run their operation,” says Michael Terpkosh, director of category management development for SUPERVALU, the country’s largest grocery wholesaler. “We have people in the field calling on them on a regular basis to talk about what’s happening in the store with resets and the category management program. It provides them with the opportunity to give us feedback.”

Sales Agencies

Sales agencies work for CPG manufacturers largely by representing them to retail customers. Sales agencies provide outsourced sales, merchandising, marketing, and promotional services. In other words, they do the work of a manufacturer’s direct salesforce and represent the brand to the retailer.

They also provide a full slate of category management services just like a manufacturer would. But there is a difference. Since they represent many manufacturers, sales agencies are positioned to advise retailers on department or aisle management in which the principles or disciplines of category management are applied to a group of categories, such as dairy. In addition, since they can represent manufacturers in related categories, such as mustard, charcoal, and relish brands, sales agencies can help retailers put together creative merchandising themes for seasonal promotions.

“On an everyday standpoint, we manage our business under basic category management disciplines,” says Michael Bernatchez,

senior vice president of corporate marketing for Acosta Sales and Marketing Company. “Whenever we go in with a business proposition for a retailer, we try to take category management principles into that dialogue.”

Merchandising Service Organizations

Called the arms and legs of manufacturers, they specialize in retail detail. They are merchandising service organizations (MSOs) employed by manufacturers and sometimes retailers to work in the aisles of stores. They reset shelves according to a new schematic, cut in new products, set up displays, and perform related tasks in the store.

MSOs are perhaps the most critical player in the execution of category management. They carry out the category plan in the aisles and maintain the integrity of the shelf. That is where the plan often falls apart—usually because an MSO is not patrolling the aisles.

In fact, their role is probably underutilized in terms of what they can contribute to the category management process. They see things live and in real time that executives at headquarters rarely see. The MSO is a valuable resource with potential that has yet to be fully developed.

Research and Data Providers

Effective analysis of categories, markets, and consumers is made possible by providers of research, demographic/psychographic data, and syndicated data. In fact, they potentially could play a bigger role in

category management by working closer with manufactures to prepare presentations for retailers.

When manufacturers are defining what the category hierarchy is, a data company can provide a perspective organized by category, subcategory, and brand. They can give manufacturers a more in-depth look via examples of the hierarchy. They also provide input about the day-to-day job of category managers. What should they be looking at? When should they consider changing the product assortment? How often should they change the planogram?

With proper information from research and data providers, trading partners gain a unique view of the market. Then, it's a matter of interpreting what the market is saying and reacting to that analysis.

The Promise of Category Management

Category management does more than contribute to the success of a retail operation. It is an essential component. In fact, it is difficult to imagine a retailer winning in the marketplace without relying on the direction that this valuable process provides.

Product categories are the building blocks of the store. Category management leverages them to enable retailers to operate effectively. Some categories may be larger than others and some may contribute more to the bottom line. But all of them must work well individually and must come together to present a cohesive whole to discriminating shoppers.

Expertise in category management is certainly a competitive advantage. It empowers retailers to make better business decisions that help them achieve financial objectives. Well-managed categories

will enable retailers to keep their present shoppers and attract new ones. The nature of the business today demands nothing less.

So, what's next?

A toothpaste manufacturer may be able to help a retailer analyze the category, determine shelf space, and eventually contribute to an increase in sales—for that category. Meanwhile, the two or three categories nearby—say, cold remedies, shaving cream, and analgesics—could be in terrible shape. But the toothpaste manufacturer doesn't know it and doesn't have data to analyze why.

Welcome to the world of aisle management and department management. Helping retailers manage an aisle or department is the next major step forward in category management. Some large manufacturers are already offering these services to retailers. However, it is largely an emerging practice.

The use of shopper data from loyalty card programs and data from RFID systems are also emerging. The former is already being used by such chains as Kroger and Big Y. Both sources of data will contribute to the enrichment of category management as the process continues to evolve.

The industry may have taken its eye off the consumer in the early days of data overload and number crunching, but that time has past. Today, the best practitioners are focused on consumer-centric category management. The consumer now stands at the center of the process and drives all decisions about the category today and its direction tomorrow.

Retailers and manufacturers need to pay attention.