CFR Teaching Note #004: Category Management

Brand and Category Management (NDH105), 2021

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Category Management play an important role in retailing to organize customer offerings and implement new strategies (Gooner et al 2011). Why is that? As retailers offer large assortments with numerous promotions running simultaneously, they need to organize their work in an effective way. Therefore, they sort their assortment into meaningful categories and allocate managers and responsibility to these categories. Most retailers use "category organizations" as strategic business units (Alan et al 2017). Thus, Category Management has become a widely used framework and mindset and is now a central and important function for defining the offering in most retail companies (Holweg et al 2009). Category Management is indeed a key component in the retailing ecosystem.

The Category Management framework was developed in the grocery retail sector, why it is actually not a model brought to retail – but invented in retail (Dhar et al 2001). Core *activities* are performed within the category management domain by the essential *actors* in the retailing world. *Activities* are typically assortment planning, assortment development, and planning of promotions. Main *actors* are retailers and suppliers that are supposed to collaborate to fulfill the needs and goals of consumers (Holweg et al 2009).

A brief history of Category Management

Retailers historically organized all activities on a brand-by-brand basis which led to severe suboptimization as assortment plans and promotions were not coordinated at the category level. During the 1970's and 1980's American retailers in the grocery sector experienced a stagnated market with decreasing profitability. The reasons at that time carry echoes of what we experience today, where some of the reasons identified were pressure from new channels, competition from discounters, and more demanding consumers.

Also, "category killers" were growing – these were companies specialized in certain profitable categories, and as such eroding profitable sales from the more generalized grocery stores and chains. Other challengers like department stores and discount specialists sold certain parts of the grocery assortment at lower prices. In addition, wholesale Club Stores where you could become a member, focused on big packs of popular products.

All this pressure initially led traditional grocery retailers to focus on aggressive pricing and promotions. Not surprisingly, this did not solve the problem. Instead, it even worsened it since the grocery margins fell even lower. This, in turn, led to a very tough climate between retailers and suppliers, which mainly consisted of pricing discussions.

A new way of thinking emerged that was based on cooperation between retailers and suppliers, spearheaded for example by Walmart (Rucheva 2019). The idea was to focus on understanding the end customer, work with a category focus, and aim to drive growth and profitability for the entire category rather than specific brands. This was the birth of Category Management. The actual term was formally coined around 1990 when the industry gathered best practices in the area and developed the first Category Management report, presenting new methods and tools for both retailers and suppliers and with a high focus on joint business planning. At the same time, much higher capacity of managing data enabled new ways of identifying and storing products, but also data and statistics that was more detailed than possible before.

In the initial phase of Category Management, most organizations worked on specific projects that aimed at reorganization of the business and that would then be manifested in future activities in marketing and management. Such Category Management projects had a set finish date. However, soon managers realized that categories evolve over time and that effective category management needs to be looked at continuously.

Today, Category Management is perceived by most organizations as an ongoing business process where category-related activities occur as a fundamental part of the business. Category Management has also moved beyond the grocery industry and is used across the entire retailing ecosystem. It is popular in pharmacies, DIY, electronics, cosmetics, and convenience. There are serval good examples of Category Management being applied to durable goods and B2B areas, which likely will grow even more. Another driver of the development into new areas is that key people from the grocery industry leave for senior positions in other retail industries, bringing their Category Management experience and practices with them.

Category Management defined

There are several definitions of Category Management, which are a different from one another but share the most important elements. The ECR organization, which can be said to be the founders of the official framework, define it as "a process for retailers and manufacturers by whom categories are used as strategic business units. Categories are used to improve business volume by increasing customer usage" (Holweg et al 2009). Other definitions in the industry have somewhat different wordings, but three areas can be said to be common for all definitions:

1) Work is based on consumer & shopper understanding
2) Work with categories of products, instead of single brands or items
3) Drive long term growth and profitability.

Categories are based on consumer & shopper behavior. Products in same category should answer the same need or be used in the same situations. The category is defined in each instance of using the framework. There is not an overall definition of the hierarchy that stipulates what is a category and a sub-category.

A few key principles are usually included in Category Management. The analyses should be based on facts, not subjective beliefs. Moreover, Category Management is focused on cooperation between retailers and suppliers. There is also a long-term focus, on real growth and profitability and not on short term sales effects.

A Category Manager is responsible for improving the retail business along three lines (Holweg et al 2009): effective assortment, effective new product introductions, and effective promotions. *Effective assortment* is centralized around the retailer's overall strategy where emphasis is on creating an assortment that reflects and supports the overall brand position of the specific retailer. *Effective new product introductions* focus on revitalizing the assortment with relevant products in existing and new product categories and serves both a short-term purpose (enhance traffic to the store) and a long-term purpose (create relevance for the retailer and energize the overall retailer brand). *Effective promotions* are part of the category managers toolbox for short term activation purposes and are highly important for retailer profitability as a lot of sales in retailing are for items that are on promotion.

Strategic objectives of Category Management for retailers and suppliers

There are three overall strategic objectives of Category Management from a retailer perspective: *increase traffic* (more customers), *increase sales,* and *increase profitability*. The Category Manager is responsible for these marketing and financial outcomes that are the result of the work in the category. Note that retailers must find a balance between sales and profitability – heavy promotions will often increase sales dramatically but may at the same time reduce profits.

For a retailer, Category Management applies to the entire offering and a key success factor is to identify how important the different categories in the assortment are based on their overall potential to drive customer traffic, sales, and profitability. In Category Management, all categories are assigned roles that define the overall focus and direction of the category. The roles have an impact on every single decision in shaping the category offer: assortment, pricing, promotion, placement in store, placement in shelf and so forth. It also has a clear impact on the allocation of resources and investments, a high priority category should have more investments into such things as business development projects, store environment, design elements, and customer service (Gooner et al 2011). Category roles should reflect the retailer's business and although the names of category roles may vary across retailers. One example of category role structure that is often used in grocery retail is Destination, Routine, Seasonal, and Convenience (Dhar et al 2001).

For a supplier, Category Management play a different role. Suppliers usually focus on one or a few categories within the overall retail offer. Suppliers are advised to think in terms of the retailer's total offering and how the retailer is defining the role of the specific category of interest for the supplier. A leading supplier sometimes has a responsibility to drive the development of their category and provide expert insights to the retailer (Alan et al 2017). This provides an opportunity for suppliers to shape the future of a category, instead of just receiving the strategies and tactics from the retailer. Today, this kind of expertise is expected from the leading suppliers, and not working with category management would be perceived as very negative in the retail ecosystem. Some retailers use the term "category captains", naming a leading supplier to be the champion of a category, and assigning them to a more strategic partnership.

For many suppliers, the importance of category management is growing (Alan et al 2017). Initially it consisted mainly of giving expert advice on shelf layouts, add insight to assortment analyses, and negotiate on promotions. Category Management was used primarily as a sales tactic and to strengthen the retailer relationship. While working with retailers on category management issues, many suppliers discovered that category insights, analyses, and strategy can have implications also on the supplier's branded offering. Category management is not only important for the supplier's sales department but is increasingly used also by the marketing department. For example, the role "Category & Marketing director" is being increasingly common.

In short, Category Management defines the role and strategy for the category – and as such defines the potential for the branded articles in the category. Because retailers use categories as building blocks in their overall strategy, Category Management becomes a key method also for suppliers when they are defining brand strategies, for example in New Product Development processes and brand positioning. If a retailer decides to promote a certain category, the suppliers that offer products in the category can allocate much more resources to brand development compared to categories that retailers downplay.

How to work with Category Management

There are numerous models of Category Management that aims to describe processes involved. The models have been criticized by practitioners of being too theoretical and to provide few business results. However, some of the key elements that usually exist across Category Management models are the following:

a) Category Definition: defining what is included in the category, and how it should be structured into a categorization (product segmentation). This has a huge impact not only on business planning, but also on how systems and database hierarchies should be structured.
b) Category Role: defining the role of the category for the specific retailer, providing direction and priority for operations.
c) Category Vision: defining a vision for what the category should become in a number of years, setting ambitions for the future, and obtaining a common mindset in the organization.
d) Category Strategy: defining key strategies and initiatives for driving traffic, sales and profitability for the category.
e) Category Tactics/Guidelines: guidelines and actions into assortment, pricing, promotions, store layout, shelf layout and other related areas.
f) Implementation plan: a plan for implementation and follow up.

The future of Category Management

There are very different views of Category Management in the retailing industry, and not everyone is positive. One reason is that collaborations fail when/if one actor is primarily focused on short term gain for itself. However, most actors agree that there is a need to examine assortments and allocate roles to categories so that investments can be prioritized – this is a key strategic issue for all retailers. Category Management provides a framework for analyses and decisions regarding assortments. Also, Category Management may connect higher-level strategies with actual implementation at point of purchase. Research shows that companies that follow the Category Management framework outperforms their competitors (Alan et al 2017, Gooner et al 2011)

An interesting current development is the application of Category Management to online channels and to the omnichannel landscape. There are no specific models established yet to adapt the thinking and the models to online retailing. Instead of working with a physical environment, the store usually becomes a two-dimensional website with different capabilities and challenges. Still, the main strategic objectives of Category Management (i.e., increased traffic, increased sales, and higher profitability) and the principle to use consumer and shopper behavior as insights into decision making and to promote categories of products is highly relevant in this channel.

The new retailing landscape also clearly shows the need for omnichannel strategies in Category Management, for example allocation of category roles differently for the same category in physical stores and online stores. The fields of omnichannel retailing and Online Category Management are likely the next development phases of category management.

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