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Consulting

Category Management: Taking a Comprehensive Approach

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Category Management is a process. While most companies will use some sort of category management "program" or "study" to start the process, thinking in terms of category development is really a new approach to doing business. Taking a truly comprehensive approach will have both internal and external ramifications.

Internally, the ramifications will center around developing initiatives with an eye toward their impact on the category's productivity. For example, one manufacturer recently developed a new entry into the Wholesome Snacks category. The new product passed the up-front consumer testing with flying colors; the product was great, consumers loved the advertising and volume testing showed it would grow the category. Then the company ran the package through a model developed to measure shelf productivity against the category averages. Because the package design was inefficient in using space, the item would reduce shelf productivity even though it sold faster than other items on the shelf. As a result of this finding, the decision was to redesign the package.

Externally, the ramifications are even more apparent, particularly in how the company approaches retailers. New item presentations, trade promotions and business reviews will all take on a new focus. Each of these initiatives will be presented in light of what they will do to improve category productivity.

The Category Management "Program"

Comprehensiveness is also the key to an effective launch of this process through the initial category management program. At Dechert-Hampe, we characterize program development as a funnel. In broad terms, the top of the funnel represents the distillation of information that generates category learning and analysis. The waist of the funnel indicates the point through which those learnings which improve category performance may pass to generate a category strategy. The expanding base of the funnel depicts the increasing breadth of communication of the category management program.

Trade Probes

The comprehensive approach to developing a category management program begins with learning what retailers now think about your category. This is critical from two perspectives. First, knowing these perceptions will point out areas of opportunity and improvement that the program should address. Second, knowing retailers' perceptions (or misperceptions) of your category will influence how your final program is presented to them.

Key areas to explore are:

- How do retailers define the category in which your brand(s) compete?
- What is their perception of category growth? Profitability? Productivity?
- What are the key issues facing the category from their perspective? Why?
- How do they use the category now – traffic builder? Ticket builder? Profit builder?

Use the answers to these questions to structure hypotheses for testing against the consumer and market facts you will gather later.

Consumer Learning & Retail Translation

Every company studies their consumers. The information gathered is usually relative to their brands and those brands that the company perceives to be directly competitive. The information is usefully applied by marketers to brand positioning, advertising and new product development. But when that information is offered up to retailers, manufacturers sometimes feel it receives little attention. There is a reason.

Retailers are interested in their consumers – not yours. Granted, at the time a consumer is in the store buying your brand, your consumer and theirs are the

 www.dechert-hampe.com | Tel: 949-429-1999 same. But their consumer also buys other brands in your category (sometimes more than one at a time), shops other categories to build a market basket, and also shops in competing stores and trade classes. The crux of the delineation for category management is that the retailers' consumer buys the category – then brands. This is where the "retail translation" of consumer learning becomes important.

Retailers are very interested in consumer information that helps them maximize category sales and profits in their stores. Where this most often impacts the category management program is in defining the category. Retailers want to define categories in terms of substitutable versus complementary products. All substitutable products constitute a "category" that must be managed (and maximized) as a unit. Complementary products can, of course, be maximized independently of one another or through cross-category efforts. That sounds simple enough, but let's look at an example.

Peanut butter and bread are classically complementary categories. But are all forms, packs and brands of peanut butter necessarily substitutable? If we look at consumer purchase data, we will find some households buying crunchy, some smooth and some both. If the percent of households buying both is low, we could say there are two categories, crunchy and smooth, and that they are not substitutable. If cross-purchase is high we might conclude that crunchy and smooth peanut butter are substitutable and that, for example, retailers would be wasting efforts by promoting both at the same time.

This is usually as far as category definitions from a consumer basis are taken, but let's back up to that "substitutable" scenario. Suppose we go one step further than consumer purchase data to consumer usage data. We might find that, within heavy peanut butter consuming households, there are some family members with a preference for crunchy (Dad?) and some for smooth (Junior?) In that case, crunchy and smooth are really complementary products after all, not substitutes as the purchase data would indicate.

The point is this, retailers need and want to know how their consumers define and use categories. And they want this information in a way that tells them how they should merchandise to maximize category profits.

Retail Distribution and Conditions Study

Most manufacturers collect some form of data on distribution of their products. Whether syndicated data, salesforce self-reporting or some more sophisticated tracking method is used, the information is typically analyzed from the perspective of "Do I have complete distribution?" or "Do I have fair share of shelf space?" Again, the perspective the manufacturer should adopt in a category management program is, "What can I learn and share with retailers that will help them grow the category?"

Two obvious examples of this are category size and location. Do stores with larger salty snack sections sell more product? If so, is it because they have greater assortment, or more facings (and fewer out-of-stocks) of best sellers? Do stores that locate salty snacks in the beverage aisle sell more than those with salty snacks in a perimeter location?

Once an accurate picture of category location and size is established, learning with real value can be returned to retailers. This will benefit them, the category and your business as well.

Market by Market or Store Cluster Analysis

Regional development is an important factor in many businesses. Often, however, retailers move through the stages of regional development of a category in a vacuum, forced to feel their way through each stage anew, retracing steps already experienced by retailers in other areas. This is one area where manufacturers can provide major value through the category management process. For example, a manufacturer will be able to tell what demographic changes indicate that a business like Mexican foods is ready to evolve to the next stage. Manufacturers can also help retailers identify which segments of the category should be featured at each stage of development, and when the assortment for the category should be expanded.

The advent of more sophisticated geo-demographic mapping techniques has added another dimension to what manufacturers can do to maximize a retailer's business. Although a category may not be regional, it may be skewed urban/up-scale versus. suburban/middle-class. Or certain brands may do better in certain areas such as super-premium beer versus value-brands. Geo-demographics allow manufacturers and retailers to "cluster" stores that have similar types of consumers shopping there. Shelf sets, pricing and merchandising programs can then be tailored to maximize the category across the accounts' different stores – no more "one size fits all" solutions!

Store Testing

The limiting factor in any program based on analysis of pre-existing conditions is that it can only describe what has happened. Describing the results of different conditions and explaining what those differences are is very valuable in and of itself. But to say with certainty what the results will be when a given recommendation is implemented by a retailer requires that we test that change in the store. The decision of whether to test a particular hypothesis or recommendation before taking it to retailers can be influenced by how dramatic the change is, or how much impact the change is expected to have.

Ultimately, the best and most pragmatic approach is to work with key retailers to implement changes based on the initial learning of the program. Once this is accomplished, the implementation should be followed by a second analysis of the retailers' business to give feedback on results. This approach accomplishes two key aspects of a comprehensive program. First the manufacturer and retailer must act in partnership to implement the change. Second, the follow up analysis forces the process to be iterative. Establishing this ongoing dialogue is critical to having category management be a process by which the organization does business as opposed to just a "project" for this year.

The Profitability Study

"Retailers don't want more partners – we want more profits."

Gary Smith, Senior Vice President, strategic planning SAFEWAY

This quote from a speech at an FMI convention encapsulates the importance of a profitability study to the category management process. Although the systems to measure it are still emerging, profitability is ultimately the key responsibility of the category manager role at retailers.

Determining the profitability of a category with a credible degree of accuracy is a daunting task. The data collection and manipulation is complex because actual data for cost and revenue must be collected and analyzed at the SKU per store level. To determine productivity, shelf space (either linear, square or cubic) must be factored in. Then the data must be re-aggregated on a comparable basis to allow for analysis and learning to be developed. This process, although arduous, is imperative to a truly comprehensive category management program.

If it is to be meaningful, all of the learning from consumers, syndicated data, retail conditions studies, etc. must be recast in the light of what it does for the retailers' profit productivity.

"Best Practices"

The most value is derived from a category management program when the transition from "descriptive" to "prescriptive" information is made. Descriptive information is the result of all the analysis done to this point in the program. Prescriptive information is sharing with the retailer fact-based observations and recommendations on how to improve category profitability.

Developing prescriptive information from the analytical steps involves an examination of the actual performance of various retailers. Through this process, hypotheses are developed as to what conditions may cause better or worse performance in a given category. Stores are then segregated into these groups and tested to see if a particular condition is statistically significant in generating greater profits. Those conditions that prove to have a significant impact can then be incorporated into a "Best Practices" recommendation for the retailer.

Let's look at an example. The hypothesis is that the category is driven by variety, and this is supported by our consumer learning that says consumers like multiple flavors of jelly. We segregate the stores by number of SKUs carried.

SKUs by Store

- 20 SKUs
  15%
- 20-25 SKUs
  65%

- 25+ SKUs
  20%

When we add the profitability study results to the analysis we find the following:

SKUs by Store

- 20 SKUs
  $3.50 DPP
  Per Foot
- 20-25 SKUs
  $6.27 DPP
  Per Foot
- 25+ SKUs
  $4.76 DPP
  Per Foot

Clearly, the hypothesis that variety drives performance in the jelly category is true. All stores that carry more than 20 SKUs are more profitable than those that carry less than 20. But there is also a point of diminishing return where the added system costs of additional SKUs are no longer justified by the volume they add. This type of prescriptive information represents the ultimate in value that the manufacturer can bring to the retailer in the category management process.

The Communication Tools

The translation of the learning that takes place into communication tools for the salesforce is a critical step in making any category management program effective. The key things to remember are that the tools must be:

- Developed from the retailers' perspective
- User friendly for the salesforce
- Action oriented
- Developed with a focus on category productivity
- These tools can take many forms. The emerging "state of the art" is interactive electronic delivery via the salesforce's laptop computers. There are many advantages to this method including automated update capabilities, the ease of tailoring presentations and the impact of an interactive computer presentation in the field.
- The majority of salesforces today are not adequately equipped and trained to handle interactive video in the field however. As a result, most programs will be communicated via hard-copy presentations and this method can be just as effective.
- The sales tools for a typical program may consist of a nationally or regionally focused presentation deck, a sales fact book, a retail or account "leave-behind" piece and the account specific presentation which we will cover later.
- The national presentation deck should be viewed as a library of the category management program learning. It should consist of or be organizable into modules that cover key issues for the category. These modules may range from a descriptive overview of the category (used to educate a new buyer or category manager) to a specific problem/solution set such as maximizing the profitability of the holiday merchandising effort in drug chains.

The sales fact book is the field salesperson's "user guide" to the program. It should cover everything from suggested presentation location and attendees to how to marshall your company's resources to implement a particular recommendation. The feature section of the fact book should explain every page of the presentation deck in detail and answer the following types of questions: What is the background? Why is the page there? What are its key points? When and how should it be used? What is the source data to support the conclusion or recommendation the page makes? In short, the sales fact book should be the field salesperson's "bible" of the category management program.

Account Specific Analyses

The rubber meets the road for a category management program when the learning and "Best Practices" developed are applied to an individual retailer's own situation. The focus of the analysis should be on quantifying the account's performance in terms of profit productivity (NOT just sales volume) for the category versus the marketplace. The analysis should pinpoint why this is happening and explain the benefit of making the recommended changes in terms of potential profit dollars the account could realize.

Three keys to why these presentations have a high impact.

1. The account analysis should be done after the account has seen the "National" presentation and agreed that the principles established there make sense.
2. This analysis is performed with the account's own data, so questions of relevance and applicability are moot.
3. The pay-out for the account is quantified in "available" profit dollars versus what others are actually achieving – not based on "we project the incremental sales volume to be $XX MM nationally" kinds of statements.

The account-specific analysis is the key to effecting change in the marketplace with a category management program.

Delivering the Category Management Program

Unless your organization is very exceptional, your entry into category management will be something of a shock to the system. To begin with, category management is a cultural change from maximizing brand shipments. A cultural change that not every organization should necessarily try to make.

Assuming category management is the right approach for your organization, the salesforce must then be educated as to what the process is and what the company's goals are for the program. Certain skill sets should be in place for the program to be effectively implemented. The catch-all term currently popular is the "transition from sales manager to business manager." More specifically, areas like key account penetration, consultative selling and understanding the terminology of trade mathematics are critical.

Assuming the basics are in place, the roll-out of the program can then focus on developing an ownership and understanding of the material itself. This step is critical to generating significant utilization and results of the program. A good category management program is a very, very expensive "book to sit on the shelf." Not so much because of the outlay for the program – but because of the tremendous potential to impact your business and your relationships with retailers.

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