WHAT’S THE FUTURE OF CATEGORY MANAGEMENT?

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INTRODUCTION

The title of this session is “The Return of Category Management”. It’s a good title. The title of my paper is “What’s the Future of Category Management”. I had another title in mind when I first proposed this paper – “Is Category Management Dead? Or Should It Be?” In this paper, I’ll try to answer these questions, telling you that the present of category management is bleak. I’ll also, by implication, tell you that the future of category management is not much better. I’ll tell you that category management, as originally conceived, is pretty much dead. Finally, I’ll suggest that as it is today, we should stick a fork in category management and say it’s done. Having been cynical for most of the paper, I’ll make a quick turnaround at the end and suggest that it is only what we are doing today that should expire – not the idea of category management itself.

If we were to write the sales force bible, we might be tempted to start with, “In the beginning there was chaos. And then came category management.” Category management has existed as a delineated discipline for 5 years now, with initial writings from Brian Harris (1992) and AC. Nielsen (1992) defining the purpose for, the scope of, and the basic techniques to be used in category management. At its heart, FMCG category management has three basic principles:

• Treat categories like they are individual business units, with retailer buyers responsible for category profits and empowered to do what needs to be done in a category. The buyer of old, focusing on getting the best prices for products, and the merchandiser of old, who figured out how to sell them, need to become one person.

• Treat categories within the framework of and in support of a retailer’s strategy. The strategy must pervade every category or consumers will not perceive or appreciate or respond to the positioning. For example, if the strategy is every day low price (EDLP), the store needs to have every day low prices across all of its categories. If it is a best variety strategy, all categories need to excel at variety.

• Manufacturers and retailers need to create an ongoing process of working together, where the goal is category growth and brand growth. By giving the consumer the products and the shopping experience they want, happy consumers will buy more stuff and everyone will make more money.

We tell the story of category management commencing with, “Once upon a time...” It is our opinion that the category management initiative, as a whole, has not unfolded as we had expected 15 years ago. With the benefit of hindsight, it is unlikely that it would proceed in such a fairytale fashion. The road to adoption of category management and the successful application of marketing, sales and research along that road is fraught with obstacles and roadblocks. The purpose of this paper is to discuss those roadblocks, both attempting to identify their causes and propose solutions.

FROM BUYER TO MARKETER

The first roadblock we encountered is when the retailer had to shift its buyers and merchandisers from being just buyers and merchandisers to being category managers. Most retail organizations have accomplished the job transition, although not without some pain and often with less-than-complete success. As with any organizational change, there are challenges. “Old School” buyers used to worry about how to get the best price for a product, negotiating volume discounts and trade promotions, juggling costs of inventory versus savings
and cost of money, and so forth. Suddenly, and with very little training, many of these buyers had to become category managers. Now, they have to worry about the profitability of their businesses and had to think in marketing and merchandising terms as well as cost of goods and money. Category managers need to get the most out of their category, improving profit per square meter as well as maintaining or improving customer satisfaction. Being a good category manager requires different skills from being a good buyer – a good buyer is not necessarily a good merchandiser. How one gets trained in this new process is problematic.

Harder still, category management is an information-driven system; this provides challenges for those not trained to think analytically. Some of the functions associated with data analysis can be automated. For example, many retailers use some form of automatic ordering at both the store, distribution center, and buying office levels. This automatic ordering is data-driven; at certain depletion points, the order is automatically placed without human intervention. Other aspects of data usage are not so simple to grasp – we might speculate that it is the rare category manager that can understand the ins and outs of a market structure analysis.

Until category managers are better trained at category management and in interpreting the variety of data available (both sales-based and consumer-based), we will continue to have a roadblock to effective category management.

RETAILER STRATEGY

A second roadblock occurs when we try to fit category management initiatives to the retailer’s strategy. There are three sources of obstacles here – whether the strategy is accessible, whether the strategy is correct, and whether the strategy creates inconsistencies with a superior category management tactic.

Sometimes, a retailer’s positioning is clear to the consumer. While grocery shoppers may not use terms like Hi/Low, EDLP, or Value-Added, consumers understand which chains have better selections, which have low prices, which have good deals each week, and which have great service. The shopper can decide which factor is most important to them and patronize that store (or stores). Of course, “cherry-picking” is also an alternative – they can buy their meat in one chain, staples in another, something on deal in a third, and so forth. As competition becomes fiercer, we are seeing, in the United States, a blurring of the lines in response to their competitors. It seems to us that retailers are afraid to put a stake in the ground and say, “we claim this segment of the shoppers.” Rather, they are trying more and more to be all things to all shoppers (which of course, creates all sorts of image problems). This positioning has actually opened up the opportunity for a series of higher-end retailers who specialize in upscale groceries, prepared food, and lots of service. Category management should be helping to describe the retailer’s positioning. If that position isn’t clear to the consumer, category management cannot fulfill its full role.

Sometimes the retailer’s strategy is a bad one – and category management is not going to save a bad strategy. In the United States, many retailers’ strategies are being diverted or distorted by the specter of Wal-Mart. Many grocers are pushing the “lower prices” button as a way to keep grocery business from migrating to Wal-Mart. In trying to compete with Wal-Mart on price, they find that the equity from their previously successful positioning dissipates and the new strategy fails (because nobody can do it as cheaply as Wal-Mart does in the United States). Adopting a weak strategy will make category management practices irrelevant – the stores will be fighting for survival, not SKU optimization.

Sometimes the obstacle to category management and strategy harmony arises when a superior category management solution is in conflict with the retailer’s strategy. Let us consider an example from a study we ran a few years ago. The retailer is an EDLP shop, aggressively promoting itself as the lowest prices around. The manufacturer is the category captain for the analgesics category at this retailer and markets one of the leading brands of pain relievers. The manufacturer became concerned that lower prices (and
prices that were continually being lowered) were eroding the equity of their brand. With another price reduction pending, they wanted to show the retailer that this was not a good idea for them or for the retailer. We conducted a study using the 4D Shopper virtual reality system (Needel, 1995, 1998) to test the new price levels, using regular shoppers of this category at this retailer. The results, shown in table 1, show a reduction in category and brand sales with lower prices, both for packages and for dollars.

In a pure category management inquiry, the actions to take would be obvious; there is no reason to take the price down, there is every reason to leave it where it is, and there is ample reason to investigate increasing the price. However, the retailer rejected the implications of the finding because, in their minds, the lower price better supported their retail strategy.

The category manager is caught in a bind here. There is a clear, simple action that will improve category sales and profits (the factors on which the category manager is evaluated), yet not having the "absolute" lowest price might conflict with the chain’s strategy. From the manufacturers’ perspective, they’ve been tasked with providing recommendations for brand and category growth. Now they are constrained in how they achieve that growth (and, as we’ll discuss below, restricted from the only way to achieve that growth). At best, there is less willingness on the part of the manufacturer to continue to research new options. At worst, they’ll take their solutions to other retailers. Situations like this will prevent category management from being effective.

In the absence of a clear, viable strategy from the retailer, category management will fail as an enterprise endeavor. The category manager will be looking for solutions that may or may not be acceptable, rather than providing guidance on what types of initiatives will be considered. The manufacturers will continue to produce solutions that are unconstrained, suggesting initiatives that have little chance of implementation.

PLAYING NICELY TOGETHER

One of the revolutionary aspects of category management was the idea that retailers and manufacturers should turn their adversarial relationship into a cooperative partnership. Being named a category captain meant a commitment to be a part of the retailer’s team. The payoff was simple – help the retailer grow the category and the manufacturer got preferential treatment. Promotions schedules favored the category captains, new items were more readily accepted, and retailer-decreed de-listings occurred less often. Access to the planogram provided an early warning system for new competitive items and many retailers provide their category captains with access to proprietary POS and cardholder data. This utopian principle of category management have, however, fallen prey to a number of roadblocks.

### TABLE 1
RESULTS OF A PRICE REDUCTION ON BRAND AND CATEGORY SALES

<table>
<thead>
<tr>
<th>BRAND</th>
<th>PACKAGES PER SHOPPER</th>
<th>DOLLARS PER SHOPPER</th>
</tr>
</thead>
<tbody>
<tr>
<td>CURRENT PRICE</td>
<td>0.59</td>
<td>$5.03</td>
</tr>
<tr>
<td>LOWER PRICE</td>
<td>0.54</td>
<td>$4.47</td>
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</table>

<table>
<thead>
<tr>
<th>CATEGORY</th>
<th>PACKAGES PER SHOPPER</th>
<th>DOLLARS PER SHOPPER</th>
</tr>
</thead>
<tbody>
<tr>
<td>CURRENT PRICE</td>
<td>1.83</td>
<td>$14.05</td>
</tr>
<tr>
<td>LOWER PRICE</td>
<td>1.74</td>
<td>$13.47</td>
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</table>

Note: all differences significant at least at the 80% confidence level
The first impediment to the success of category management initiatives is intrinsic. Many (if not most) FMCG categories (as opposed to brands) are demand-driven and hence inelastic – you only need so much dishwashing detergent and nothing the retailer or manufacturer does is going to increase that need. In a category where consumer use-up rates are (relatively) fixed, the only way to get category growth is to trade shoppers up to more expensive products. How do we accomplish category growth with inelastic demand? From a category management perspective:

• We can reduce variety at the low price end of the brand spectrum, hopefully causing brand-switching to higher end products (rather than store-switching).
• We might sacrifice own-brand sales through SKU reduction, which could grow retailer revenue, but perhaps at the cost of retailer profit.
• We might change the assortment to better match consumer preferences.
• We might raise category prices.

Reducing variety may carry with it a loss of shoppers, either to the category or to the store and may conflict with the retailer’s strategy. The same can be said for raising category prices – no chain wants to be known as the high-priced outlet. Improved assortment mixes are tricky to define – it is possible to do so (Needel, 2006) but there is no guarantee that altering the assortment leads to growth. For example, if a store adds a number of lower priced items, it is possible to increase category turns but reduce category sales (Needel and Bean, 2002).

This inelasticity shows up quite a bit in our research into category management initiatives. Using the 4P Shopper virtual reality research system, we have conducted 183 studies of shelf sets and shelf assortments. What we have found is somewhat discouraging for category management. With the goal of a win-win situation, only 13% of the studies we’ve conducted achieve this objective (see table 2).

Not all of these failures are due to category inelasticity. As we’ve discussed elsewhere, and will revisit below, weak research can also lead to weak category management solutions (Needel and Bean, 2002, Needel, 2007).

The idea that manufacturers and retailers will play nicely together in order to grow categories and brands has its own built-in roadblock. Both sides have to believe that cooperation produces better results than an adversarial process. We believe that this was (again, with the benefit of hindsight), a naïve conception. What we have seen is often a distortion of the relationship originally intended by category management. In the early formulations of category management practice, manufacturers, as the more knowledgeable partner, would bring consumer information to the party. This information would illuminate category problems and opportunities, which the retailer would correct and exploit; both sides should win. The reality falls far short of this ideal and is what gives rise to our questioning the value of category management.

In order to organize the influx of data and information, retailers created category captains, a manufacturer

### TABLE 2

**RESEARCH SUMMARY**

<table>
<thead>
<tr>
<th>% OF STUDIES</th>
<th>CATEGORY</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>BRAND POSITIVE</td>
</tr>
<tr>
<td>POSITIVE</td>
<td>13%</td>
</tr>
<tr>
<td>NEUTRAL</td>
<td>5%</td>
</tr>
<tr>
<td>NEGATIVE</td>
<td>1%</td>
</tr>
<tr>
<td></td>
<td>19%</td>
</tr>
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</table>
with primary responsibility for “running” the category. A category captain’s job is to make recommendations on assortment, layout, pricing, and new product introductions to the category manager, who acts as a “validator” for those recommendations. In some organizations, this validator role is passed on to other manufacturers, which presents its own set of problems. In return for taking on category responsibility, the manufacturer would receive some unspecified level of preferential treatment. This has often turned into creation of a mini-organization for the manufacturer, one for each retailer. These manufacturer organizations have teams of people who provide very simple data analysis (of sales data the retailer already has) and who are often given planogramming responsibility, churning out hundreds of store-level shelf sets.

What category captaincy has not turned out to be is an unbiased representation of the best thinking regarding consumer preferences and how to deliver to those preferences. We have only two examples, out of the 8 studies we’ve conducted, where the category improved at the expense of the manufacturer’s branded product; neither were recommended to the retailer, even though they were the best of the tested alternatives.

With category captaincy, smaller category players find their voices hard to be heard, even when they have a legitimate insight to share. Retailers often make one of two assumptions – if you are a small player in a category, you can’t know much, or you’d be bigger, and their time is better spent letting the category captain handle the category. We often ask our clients who are the weaker manufacturers in a business whether retailers will look at the results of our study – we want to avoid non-actionable research. A recent discussion of category captaincy at the Retailwire website made two interesting points (Retailwire, 2006a):

- It is rare that a manufacturer will make a recommendation that goes against self-interest. Quoting Chris Hoyt in this discussion, he notes that, “Among the approximately 1,100 suppliers to the U. S. supermarket business, we estimate maybe five to 10 are large enough and broad-based enough to make category recommendations that might adversely affect their brands.”
- It is unclear that the process works the way it was intended.

We want to identify a final roadblock to the proper functioning of category management. Category management research is, relatively speaking, a new and expensive form of investigation. Whether the research involves generating market structures to understand how consumers think about the category or whether it is testing actual recommendations, category management research does not come cheap. Even with the advent of virtual reality technologies for in-store simulations, the price tag is substantially higher than most other types of research (surveys, focus groups, etc.). What often happens is that researchers accept much weaker standards of research quality with category management research. We have seen a number of studies conducted with one or two stores per test cell, with non-representative samples, and inadequate experimental and/or statistical controls. While we don’t wish to embarrass by citing these recently published studies, we’d be happy to send anyone who asks the references. Category management research deserves the same level of methodological rigor we’ve come to apply to copy testing, product testing, new product forecasting, and so forth.

OVERCOMING OBSTACLES?

We’ve identified a number of obstacles to successful category management experiences.

- Shifting from a buying perspective to a category management perspective;
- Having a retail strategy that is both accessible to the consumer and one that is “correct”;
- Finding category management solutions that are consistent with the retail strategy;
- Unrealistic expectations about category growth potential;
- Misuse of manufacturer resources;
- Manufacturers acting against self-interest;
- Weak research technologies providing weak category management solutions.
With all these obstacles in the way, we might question whether they are serious enough for us to consider abandoning category management. Individually, these impediments are not insurmountable, but the solutions for overcoming the obstacles are not simple. For example:

- Educating retailers is too easy a solution to put out there – this is not going to solve a lot of problems quickly. We suggest that manufacturers need to do a better job of taking what they know and translating it into a language useful for the retailer. In the end, the retailer wants to know whether a category management initiative is going to: a) increase sales, b) increase customer satisfaction, or c) both (with emphasis on increasing sales). Keep it short, keep it simple, keep it focused, and try to educate a bit along the way. This may also require some hard research. In 2002, Bill Bean and I (Needel and Bean, 2002) showed that face-validity and reality often clash in category management. Persuading category managers that their assumptions may be incorrect is not easy.
- Retailers need to have a positioning, need to have that positioning permeate their stores, and need to have consumers understand that positioning. Category management needs to operate within that positioning framework. For a chain that emphasizes product variety, assortment reduction is not going to be as useful an exercise (Needel, 2006). Showing a discounter like Walmart or Aldi how to raise prices may be less interesting to them, given their low-price positioning. Manufacturers need to tailor their research to fit a retailer’s positioning and not assume there is a global category management solution. They need to recognize that how people shop may vary by the retailer proposition.
- Retailers need to be more relaxed in applying a category growth action standard to research results. We may not expect category growth in certain categories or when making certain types of category management-driven changes (for example, shifting the shelf set from a branded layout to a flavor or form layout). Sloot, Fok, and Verhoef (2006) do a nice job of discussing the issue of long term versus short term category growth. Some changes we make may not have immediate impact, but may have long-term impact. We believe there are initiatives that are overlooked because of the “grow the category” mantra that may be beneficial to the retailer in ways not obviously measured. For example, reducing shelf space for a category without changing category revenue should be a positive outcome for the retailer, who can now use the space for other purposes. When we do see sales improvements, we need to better understand whether it is real growth or only revenue growth. That is, are we selling more stuff or are we selling more expensive stuff.
- Finally, the process of category management, the way retailers and manufacturers interact, is in need of a severe overhaul. Manufacturers have become the data crunchers and planogram production departments for many retailers. This diverts resources (both money and people time) away from research that could be used to help those same retailers. It also diminishes the manufacturer’s role in the retailer-supplier partnership. Manufacturers should, we believe, be bringing research results (whether primary or secondary research) to bear on retailer issues in a way that helps each of them do a better job of marketing.

We asked at the beginning, only somewhat rhetorically, “Is category management dead?” Certainly we believe it is in the context of the original conception. Those guiding principles have gotten lost along the way and what passes for category management today looks more like free labor for the retailer and exclusionary practices for the manufacturer rather than a sharing of responsibility for running a category.

It is unclear that category management pays out – whether it is actually a good business practice. It is certainly paying out for the retailer, who gets free labor and consulting services. For the manufacturer, the question of value is less well-defined. We recently asked a number of senior category management personnel working for U.S. based FMCG companies whether being a category captain had value and had the company work to define the value. The responses were remarkably similar – yes, we think it has value and no, we have no idea whether it is profitable to be engaged in that effort.
Should category management die? We don’t think so, but we say that with some trepidation. On the one hand, we believe that FMCG retail outlets can be improved, both from the retailer’s perspective, the manufacturer’s perspective, and the shopper’s perspective. Why – because we’ve seen win-win outcomes in our own research. We believe that manufacturers have the research skills and marketing/merchandising knowledge to make improvements for both retailers and their customers. On the other hand, the process of category management has morphed into something barely resembling its original intentions.

We, as an industry, have very little research to suggest that category management is a better process than what went on before. There are any number of poignant questions to which we do not know the answers:

• Are retailers being more efficient and better able to meet the needs of their shoppers with category management?
• Is the retailer more efficient after adopting category management principles, and does that efficiency lead to greater profitability?
• Are manufacturers actually making money at the category management process, after we consider all the costs they incur to be a part of the retailers’ “team”?
• Are consumers any happier with their set of stores when the stores are subject to category management initiatives? Are they spending more?

All of these questions suggest that category management may not be the panacea we once thought. The future, then, suggests a re-tooling of the process, particularly in the way that retailers may take advantage of manufacturers. In its place a more partnership-like approach may be what’s needed to make category management work for all parties. We can get there by:

• Understanding what it is we want to achieve with category management.
• Understanding what resources make sense to allocate to category management (personnel, research funds, etc.).
• Agreeing what is each partner’s responsibilities (and the limits on those responsibilities).

• Doing the research necessary to improve brand and category performance, where possible, with an eye toward a solution that is compatible with the retailer’s strategy.
• Being unafraid to say that there is no basis for improving a category.
• Using research tools that pass reliability tests and represent sound methodological practices.

Bibliography


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