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New Modalities of Category Management

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Abstract

Category management is defined as a process that involves managing a range of product categories as business units and customizing them on a store by store basis to satisfy customer needs (Bogetic 2007). As a dynamic business concept Category management continuously improves through new modalities, which broaden its practice and usage. The most significant modalities are Loyalty Marketing, Shopper Marketing, Department Management, Coopetition Theory and RFID Technology.

Loyalty marketing helps improve the focus on growing and retaining existing customers. This naturally has a significant effect on the efficiency of Category Management and is therefore adopted by a lot of big retailers.

Shopper Marketing implies an understanding of consumer behavior of target groups and the use of that knowledge in obtaining benefits for consumers, buyers, brands, retailers and manufacturers.

The basic idea of Department Management is to offer consumers a whole range of complementary products in the same store department.

Coopetition Theory stimulates relationship and cooperation with competition in some fields of business while at the same time remaining competitors in other fields.

Strong development of RFID technology that supports Supply Chain Management, based on product identification through radio waves, is supposed to replace EAN codes. The expected outcome should be a significant cost decrease in the entire supply chain, which has already proven to be true where implemented.

Each of these new modalities of category management have their own advantages and disadvantages. Adopting the strongest features of each of them with Category Management practice can produce significant improvements for all stakeholders.

Keywords: Category Management, Loyalty Marketing, Shopper Marketing, Department Management, Coopetition Theory, RFID Technology

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Introduction

All participants in the ever growing and highly competitive fast moving consumer goods industry are facing a big challenge: to be more efficient and to satisfy consumer needs more effectively. It is fair to say that in the long run this is crucial not only for competitiveness but also for the survival of the participants on the market. Due to all movements and developments that have taken place in last decades of the 20th century, a new form of product management has emerged – the concept of Category Management (Karolefski& Heller, 2005).

Category Management could be defined as an efficient and effective manner of achieving goals, through planning, organizing and control. When talking about product category (class) we are thinking of a similar group of products in a product family which essentially have functional coherence (Gasovic, 2011).

Expert assessments, as well as advanced practice on developed modern markets indicate that Category Management will be upgraded through several possible directions, which will both support and provide it with some additional strength and added use. Some of those directions are within the “scope” of Relationship Management, others within Marketing or within the Supply Chain Management but that should not be an obstacle to have them all improve Category Management as a concept which strives to accomplish basic principles of modern business.

Considering the more dynamic environment of modern business i.e. new technologies enabling the customers to easily compare all offers, less free time available for shopping, increased intensity of fighting for every customer among retailers etc.., it is those Category Management modalities that provide a new impulse to retailers which can be used as a competitive advantage.

Those modalities first and foremost involve Loyalty marketing, Shopper marketing, Department Management, Coo petition Theory and RFID Technology (Gasovic, 2011).

All of these directions should add quality in the approach to the final customer as well as to accomplishing the goals set. Their basic role should be reflected in the improvement of efficiency and effectiveness of marketing efforts directed at upgrading category performances.

Creating the optimal combination of modalities is the task of Category Managers, who should ensure optimal results for each of the categories they are responsible for. As there are different goals among different categories the aforementioned modality combinations within each category also differ. (Bogetic, 2007).

Loyalty Marketing

The connection of Loyalty marketing and Category Management is seen as a huge potential for improvement of retail competitiveness. Both theoreticians and practitioners agree on that.

The ultimate goal of both concepts is the same: Profit increase and Return on Investment rates. The difference between the concepts is in the way of making it happen. Category Management is a concept of managing product categories as independent business units. The main goal of Category Management is to maximize profit through optimization of category, assortment, appearance, prices, promotion etc.

Loyalty Marketing, on the other hand, is variation of Customer Relationship Management which strives to make the most of the current as well as the possible future consumer potential. In doing so it employs a combination of promotional activities and non-monetary incentives for sale increase. The main goal of Loyalty Marketing is profit increase while focusing on potential of the existing customers and striving to attract new customers (Woolf, 2002).

As mentioned before, both concepts have the same goal – profit increase. The difference is that Category Management focuses on product category, while Loyalty Marketing focuses on customers. Category Management also targets customers but with one important difference when compared to Loyalty Marketing: the first concept targets the database of all consumers on a certain territory, while Loyalty Marketing operates with a database of existing customers of a certain retailer.

One may often hear the thesis that Loyalty Marketing is in fact focused on customer retention, which is its long term perspective. According to that particular thesis, Category Management is focused on designing a great value proposition for ultimate consumers which can be achieved through promotion but it is actually a short term perspective. If we look at it from a practical point of view in terms of its limited investment budget it is very hard to imagine reaching a compromise between the short term and long term perspective. Basically a promotion of a larger products pack to existing customers builds their loyalty but the actual sales increase effect is moderate. On the other hand when organizing promotions which are beneficial to ultimate consumers (significant gratis or significant discounts), sale rates do go up can but that does not stimulate customer loyalty. Those that get the biggest benefits from such promotions are customers who search for the best offer (cherry-picking customers) and their loyalty to any retailer is not significant.

If we are aware of budget limitations and often opposing goals of certain promotional activities, then another question emerges: who makes the actual decisions on investments from limited funds? In most cases those are Category Managers in cooperation with suppliers. In fact, it is very common that suppliers allocate their budgets for investments in cooperation with Category Managers. In this way Category Managers have a significant influence on budget allocation (Muller & Singh, 2006).

If we look through the lens of suppliers' interest, it is obvious that they are not very much interested in investments focusing on retailer loyalty. Basic goal of a supplier is brand loyalty, not retailer loyalty. However, if we do study the available customer database in a certain area thus dividing the customers on those who are loyal and those who are not, among those deemed as loyal customers a group can be found that is both loyal to a specific brand and a specific retailer. That particular group should be the focus of joint efforts of suppliers and each retailer in order to strengthen loyalty to both the brand and the retailer. Increase in the size of that group of customers would be highly valuable to both suppliers and retailers.

The only way to identify the aforementioned joint consumer groups is through high quality information systems developed for Loyalty Program needs. Any retailer genuinely interested in Loyalty Programs has to consider the use of information technology that will enable it.

Apart from that, Loyalty Marketing should have a part in category assortment. In fact, loyalty to a certain brand or product within a category, is a significant factor to consider when deciding whether to include a product in an assortment or not. If it appears that a certain group of consumers loyal to a retailer chain, buys a certain product in disproportionally large amounts with regards to its designated product group (Top shopper index – TSI)[1], than the product in question should not be excluded from the assortment regardless of the facts that its sale is low in the absolute sums. If that product is excluded the above mentioned group of loyal consumers will abandon the retailer and its main loses shall be felt in other categories that don't contain the product in question.

It is thus possible to conclude that there is a significant potential in integration of Loyalty Marketing and Category Management. The reasons are the following (Muller & Singh, 2006):

- Loyalty to any retailer chain is still very low. 30% of biggest customers make 65% of sales, which means that 70% of all customers make less than 1/3 of total purchases.
- Promotions offering major benefits to consumers are, in general, not profitable for suppliers and very often the same goes for retailers.

Shopper Marketing

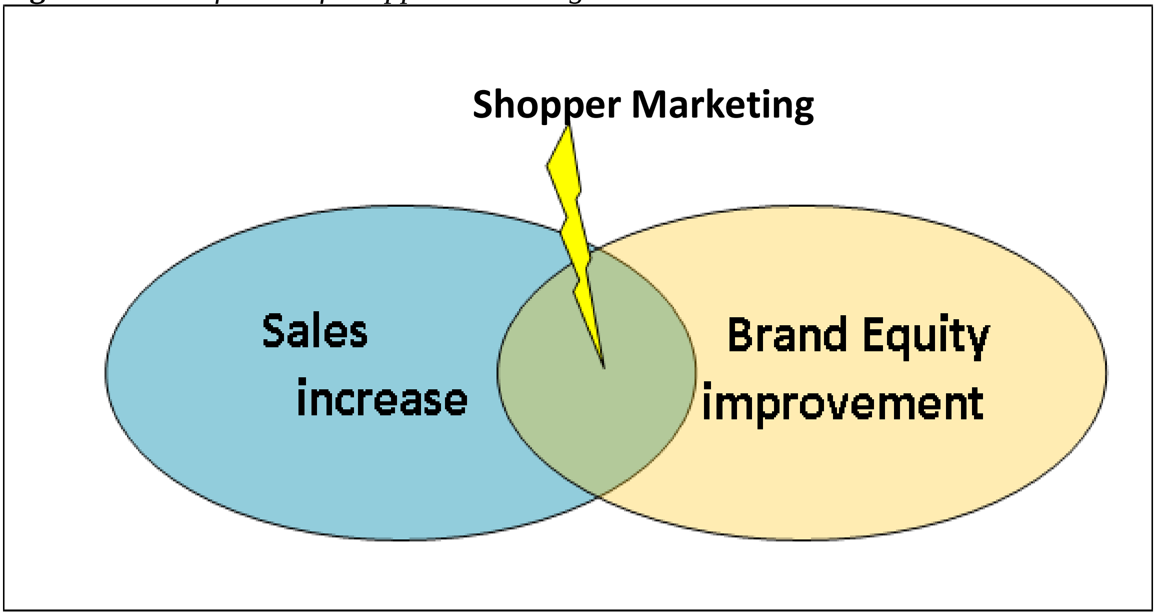
Most of the promotional activities on the market can, in general, be divided into those that develop Brand Equity and those that increase sales. Brand Equity development is a long term activity that does not show immediate results in sales, but uses significant financial resources. Sale increase, on the other hand, directly reflects on the goals of the business plans,

[1]Presented at the Category Management Conference, October 14, Belgrade, Serbia

but can often cause Brand Equity decline which is not good in the long run. All these reasons have created a need for activities which will have a positive impact on both components. Shopper Marketing has emerged as a result of such needs. Shopper marketing consists of activities which have a positive impact on both sales and Brand Equity (Figure 1).

Shopper Marketing is an understanding of how one's targeted consumers behave as shoppers, in different channels and formats, and leveraging this intelligence to the benefit of all stakeholders i.e. brands, consumers, retailers and shoppers.

Figure1. *Field of work of Shopper Marketing*[1]



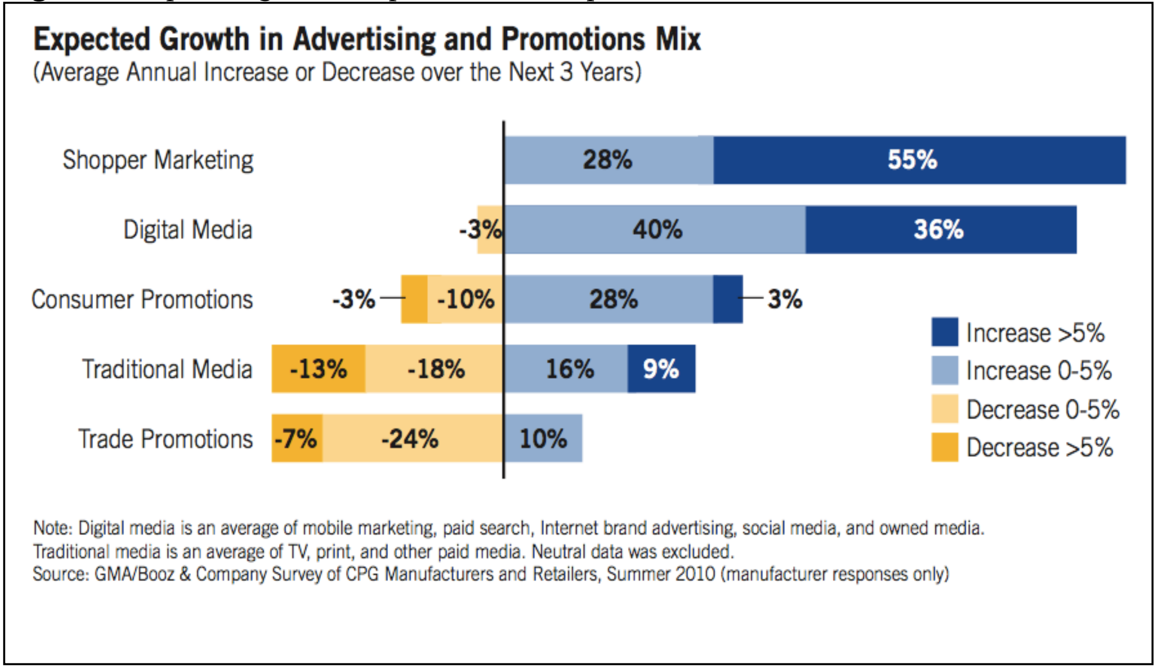
Hence, within the area of Shopper Marketing there are activities that impact the sales growth and at the same time develop Brand Equity. This is the main reason for evolving investments in this field and increased importance of Shopper Marketing in the management field.

Efficient implementation of Shopper Marketing requires stepping away from a store-oriented way of thinking and adopting consumer-oriented strategic thinking. Knowledge of consumer behavior has to be the core of such thinking as well as the manner of how that knowledge can be used to increase the benefits for all.

Shopper Marketing is getting more and more attention from managers and is granted bigger budgets. Results presented on Figure 2 are from a research conducted in the summer of 2010 indicating the biggest increase in investments into Shopper Marketing.

[1]Johnson&Johnson internal documents

Figure 2. *Expected growth in promotion and promotional mix*[1]



When preparing a Brief concerning costs and benefits evaluation of Shopper Marketing it is necessary to consider to following proposition[2]:

E > R (C + I)

Effectiveness > Risk (Complexity + Investment)

This formula shows that effectiveness of promotion in Shopper marketing depends on risk attached to it as well as the complexity of implementation and necessary investments for the promotion. It is crucial to point out that complexity should, in this particular formula, be shown as monetary value. Therefore the costs of people engaged in this promotion should be calculated as well as agency costs, though not directly variable and all other costs that will emerge but are not shown in investments. Thus calculated complexity, shown in monetary value, should be added to investments multiplied with the risk. The risk should be shown in a way that absolute security is indicated as equal to 1, which understands that the risk factor will not increase the E i.e. the amount required to mark the activity as effective. As the risk grows the factor increases, and as it is to be multiplied with the amounts of complexity and investment, that automatically increases the amount which should be achieved in promotion in order to have it characterized as effective.

Shopper Marketing planning consists of 3 steps:

First step consists of a good consumer/shopper insight. The insight should be correct as to achieve the planned results when used in promotion. The second step relates to transformation of insight into ABC proposition for customers. It understands that the idea should be attractive for

[1]GMA/Booz & Company Survey of CPG Manuafacturers and Retailers
[2]Johnson&Johnson internal documents

consumer/shopper who should participate and is expected to positively react to a promo offer; it should also build Brand Equity and be easy to communicate (***Attractive***, *builds* ***Brand*** *Equity, easy to* ***Communicate***). Third step understands the implementation of the idea. In this step it is necessary to make a good operational plan of implementation. Following the preparation of the plan the idea should be implemented. Once the promotion is completed, the success rate should be measured. This brings us back to the formula from the beginning but with actual values (value of the risk is 1). This is the way to verify all our estimates from the beginning and to evaluate the success and effectiveness of the promotion.

Department management

The idea of Department Management understands management of related product categories aiming to ensure better value to consumers and a cost effective business thus improving efficiency and effectiveness (Muller & Singh, 2006).

Wall-Mart's Neighborhood prototype store in Bentonville, USA is a practical example in the USA market. The example for the Balkans are retailers Delhaize and Mercator with the opening of "Baby Corners".

Basic intention of Department Management is to have all related and complementary products on hand for the consumers. Therefore if you observe baby corners the intention is to offer everything that young parents might need for their baby (baby food, cosmetics, diapers, toys, buggy, baby hens…) on a small visually separated space inside a shop. This new way of product management offers not just an opportunity for a better approach to the final consumer but for savings for retailers and their suppliers.

There are opinions that Department Management was initiated by the suppliers as a response to retailers' pressure through Category Management. However, even if this is truth, retailers obtain significant benefits as the whole process of new management practice takes place in their shops.

Product Management through Department Management reduces possible negative impacts of improper product categorization. Product categories are defined through planning as one phase of Category Management and those may differ from consumers' understanding of the categories in question. Thus created negative impact can be reduced through Department Management (Muller & Singh, 2006).

Department Management also brings more synergy to promotional activities of different categories. The companies that practice Category Management often have two Category Managers responsible for categories which could normally be classified into one department hence the merger of these categories would enable one manager to manage both categories. In such situations the total investment in promotion is evaluated for the department as a whole and the goal is to also achieve better synergy.

The requirement for implementation of Department Management is *Activity Based Costing* method, as a new method of cost calculation.

When forming departments, apart from consumers' view it is necessary to consider effectiveness and efficiency and in particular the following:

- Sales volume of a particular department
- Traffic created by particular department
- Contribution to profit, after cost exclusion
- Demands for space (in m3) in minimizing out of stock situations
- Productivity and margin contribution curve

Therefore, Department Management is something that will make a significant impact on the Fast Moving Consumer Goods industry. The future will show if it will be accepted and successful in practice. This new management method will certainly live on and stay in use, if retailers acquire bigger benefits. If Department Management does get accepted in practice, an upgrade and improvement of existing practice in Category Management will have to follow. Those that will be best prepared for accepting new methods of doing business are companies with vast experience in Category Management.

Coopetition Theory

Coopetition (occurs when companies interact with partial congruence of interests. They cooperate with each other to reach a higher value creation if compared to the value created without interaction, and struggle to achieve competitive advantage (Nalebuff & Brandenburger, 1998). An example of such cooperation is the Peugeot and Toyota project on development of a city car for European market in 2005. The companies made savings in cooperating area, but remained intensive competitors in other areas.

The above-mentioned indicates that this new method of competition tests the Porter's model of competition. Namely, it is suggested that competitors can cooperate in one segment while still remaining competitors in others. It understands that both competition and cooperation may exist between two companies at the same time.

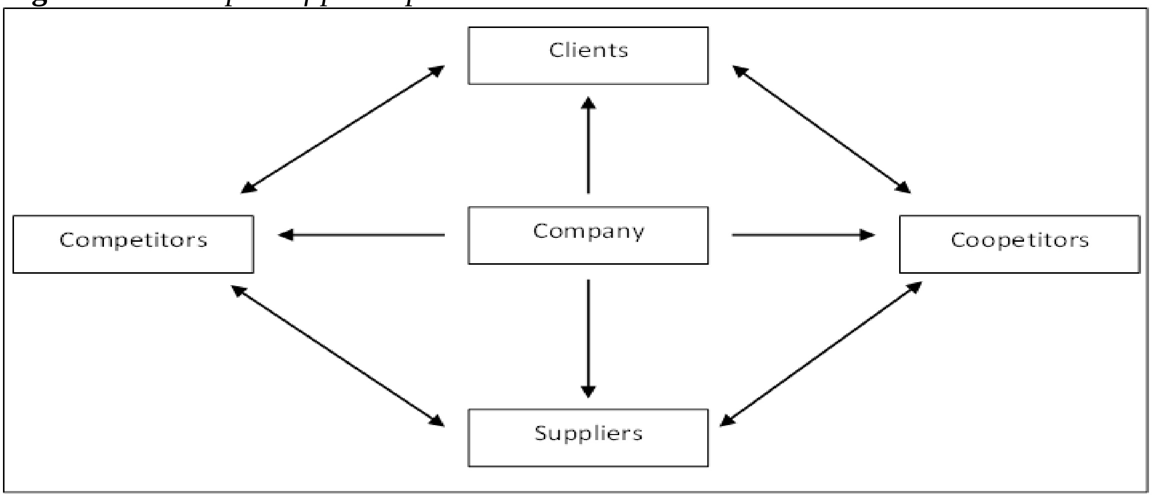
Nalebuff and Brandenburger were the first authors to promote this method in their book "Co-opetition". These authors promote the idea that the period of thinking about competitor as arch enemies which should be destroyed is in the past. They believe that it is now necessary to work together in fields of common interest (coopete) while remaining competitors in other fields. A good example is again within the vehicle industry and cooperation between Peugeot, Citroen and Fiat, in development of delivery vans for European market. In this project the aforementioned companies were coopeting in the process of development where they shared the costs which were significant even for such giants in the car industry. After completing the vehicle development, these companies become competitors in sales of the same vehicle on their common market where they fought for the same customers.

There is a common belief that competitors primarily focus their energy into winning bigger market or category shares, while coopetitiors work together on market and category increase. Once the market is increased every coopeting competitor will feel the benefits. An example in IT industry is the cooperation between Microsoft and Intel, where they used joint components to create a superior product, which ensured more trust on consumer's side and a bigger market share.

The above mentioned example explains how coopetitors should be understood. Those are market players whose shares in particular product increases the value of that product. The Competitor, on the other hand, is a market player whose product decreases the value of the same product in customer/consumer's eyes.

Nalebuff states: 'there are no more cycles of war; peace, war…war and peace coexist now'. The author provides a scheme of a new view on market participants (Figure 3).

Figure 3. *New aspect of participants in market*



Coopetitors are introduced among traditional participants in this figure. Characteristic of the new relationships is that all participants are mutually related to a company and that today's competitors may become tomorrow's coopetitors.

Reflected on the field of Category Management this means that in the near future there will be more than one key supplier as a partner of a retailer in category development. The current situation is such that in most categories, at least two important suppliers are present. According to the presented concept of coopetition, these suppliers could be coopetitiors in category development and partners with retailers in the implementation of Category Management. Good examples of such cooperation are already present with production of Private Labels where the producer who has its own brands produces the label to be sold on the shelves of a retailer. The two are at the same time partners in production of a Private Label and competitors on private label retail.

RFID Technology

RFID technology is a factor that will have a significant impact on modern Fast Moving Consumer Goods industry. It is a technology based on identification through radio signals (*Radio Frequency Identification*) that should replace barcodes on products and provide many other advantages. One of the advantages is that the use of this technology can assist in avoiding frequent changes in design of etiquettes as a part of the package. Etiquettes appear as stickers and/or graphic parts of a package. Role of the etiquette, as a sticker, is to provide necessary information. Any change of information, regarding product or package, must be visible on the etiquette. In case of any change the producer as well as the storage company must use the latest versions of a product under new codes and with a new barcode. This can cause significant expenses throughout the whole value chain (producer, its central warehouse, distributer, retailer's central warehouse, retail unit warehouse, retail shelves). The implementation of RFID technology could make this a thing of the past. The etiquette could keep its graphic function only and other functions could be taken over out by RFID technology (Muller & Singh, 2006).

RFID technology consists of the following components: tag/chip that is glued on a package, antenna for data transmission and data transmission controllers. It is also necessary to possess the required computer equipment that will transform the data into user friendly information.

The procedure is as following: the chip containing the necessary product information must be placed on it during the production and follow it through its life span. This is the way to ensure absolute information availability about a product in all places with installed equipment (antenna and controllers).

By application of RFID technology the modern Fast Moving Consumer Goods industry may potentially achieve significant savings. Its biggest potential is in reducing the Out-of-stock issues, which are generally estimated to an 8% level. This is an important potential in terms of achieving savings and increasing efficiency and effectiveness. There are also significant possibilities for improvements in logistics and warehousing. Namely, the RFID technology would make it possible to know the exact location of any shipment, and expected arrival to its final destination. It would also be possible to determine the quantity available on the shelves at any time. Those who advocate for RFID implementation also talk about the Just-in-Time method of supplying the retail shelves.

Even though all major benefits from RFID are expected in Value Chain Management, some significant benefits should apply to Category Management as well:

- RFID technology should enable early out of stock warning and the need for an order, which reduces sales losses;
- More information about a product could be stored and made available to customers, through the use of scanners in retail shops, before they make decision to buy the product;
- Price changes on shelves could become automatic providing that mini price displays are available on shelves;
- Planogram implementation control could also become automatic in the second implementation stage, etc.

The considerable advantages available through use of RFID technology would also include the following:

- Significant reduce of Out-of-stock situations
- Logistics improvements, inside the value chain
- More possibilities for tracking the product through value chain
- Better evidence of stock available
- Reducing the total stock thus releasing financial capital
- Inventory count process would be made possible in just a few moments
- Reducing warehouse space because of reduced stock
- Reducing losses because of expiration and damage
- Efficient fight against counterfeit and fake products
- More efficient post-sale services
- Reducing time spent at cash desk
- Reduced number of employees

The main reason for RFID technology not being widely implemented is its relatively high price i.e. price of chips which should be placed on products (Muller & Singh, 2006). Its current price of 0, 20-0.30 USD still does not offer a good pay out, especially for producers. It is the producers who should fund the placements of chips on products and that part does not pay off at the moment. Antennas, controllers, hardware and software are not problematic from this point of view. The estimates show that once the price of chips is reduced (to 0, 15 USD) it will bring a huge expansion of RFID technology. Wal-Mart has started with implementation of RFID for pallets and transportation packs back in 2005. In fact Wal-Mart made a request to all the main suppliers to implement RFID. Wal-Mart asked all its suppliers in China to implement RFID on all commercial packs as of January 2009. It was also made known that all of those who do not implement this strategy will not serve as suppliers to this retail giant any more.

For any broader implementation of RFID it is important to adopt standards for the technology so that everyone working on its development has clear standards that are accepted by everyone. Its standardization was a main topic of a conference held in Prague in 2008.

Estimates indicate that the current RFID technology market is worth 5, 3 billion USD and is expected to rise to 9, 8 billion USD by 2013.

Conclusion

It is possible to say that Category Management is a process in which retailers and suppliers manage product categories as strategic business units, with the intent to achieve better results and offer more value to consumers. Focusing on consumers is crucial and the only correct practice within this concept. The efforts made to achieve optimal results through the above mentioned modalities of Category Management are being intensified and their scopes broadened.

Shopper marketing involves an understanding of targeted consumer behavior in different shopping conditions. This concept is now blooming because the financial resources used in it affect the sales increase as well as improvement of Brand Equity. All presented data indicates the rise of investments through Shopper Marketing activities.

Loyalty programs have enabled reestablishment of direct relations between consumers and retailers. Establishing and keeping close relations with consumers, as well as strengthening their loyalty, would not be possible without development and use of modern information technology.

Department Management, as a new form of Category Management, is its natural extension. Many companies have already started with the realization of this concept and have produced tangible results. Benefits achieved through Department Management will certainly stimulate companies which do not implement it, to do so.

Coopetition Theory has already found its place in the Fast Moving Consumer Goods industry. This is the case with production of Private Labels for retailer by the producers that make their own brands; shelves of the retailers thus making them partners in production of the Private Label but competitors in sales of brands and Private Labels.

RFID technology will definitely bring significant savings in the value chain. It will directly affect category profit increase. The world's biggest retailers have already implemented this technology with certain categories, or package types hence they can prove its efficiency.

To conclude, it is clear that the above-mentioned modalities have a positive impact on improvement of efficiency and effectiveness of Category Management, as a basic strategic direction in the modern era of Fast Moving Consumer Goods industry.

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