Category Management and its Applicability to Business Markets: Issues and Outlook

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ISBM Report 17-1995

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This publication is available in alternative media on request.

U.Ed. BUS 96-028

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Abstract: ***This paper outlines the potential use of category management as a means to optimize manufacturer returns in the marketplace. A brief history and overview of category management and it's use in consumer packaged goods is discussed. It is suggested that category management has already begun to take hold in business and industrial markets and that firms which are proactive in developing category management strategies will be able to enhance the returns of both themselves and their distributive partners. Several useful methods of operationalizing category management are discussed.***

History of Category Management

With the introduction of the "Camay" brand of soap in 1935, Procter and Gamble (P&G) ushered in the era of brand management. Wary of a potential conflict of interest, management was reluctant to entrust the new Camay product to the established Ivory group. Thus, an independent team of managers were assigned to the fledgling brand. The success of Camay led to a brand/product management philosophy which has persisted in large part to this day.

Management has generally argued that employing dedicated "product based" specialists is likely to lead to more efficient and effective development of an individual product in the marketplace. Conventional wisdom has suggested that limiting a management team to one product or brand will in effect enhance their motivational incentive to develop that product.

Emergence of Category Management

"Category management" has recently emerged as an important trend in marketing, particularly in the consumer packaged goods industry. Currently, there is neither a standard definition of category management nor universally accepted guidelines for its implementation. Popularly understood, the concept of category management is generally acknowledged to be a marketing control system under which the objective is to maximize performance of a large collection of competing brands or products (i.e., the ***category)*** rather than individual brands. This approach contrasts sharply with the ***product management*** strategy wherein dedicated managers are charged with the responsibility of maximizing returns from individual products"

The present movement toward category management is due to a number of shortcomings inherent in product strategies. Though a brand management system offers some advantages, it can cause several inefficiencies such as effort wasted on internal competition. For example, a promotional campaign for product A may be successful from the perspective of A's product manager, but if the success is largely at the expense of sister product B, it offers minimal justification to the firm. In contrast, category management systems are designed to evaluate marketing programs from the joint perspective of both brands.

A second benefit of category management has to do with the assortment of products or services with which an individual product is sold. The assortment of brands or products available can favorably effect product sales in one of two ways, either it can enhance the number of units sold or it can help positively influence the price of products sold. For example, the sales of milk chocolate may rise in a grocery store when fresh strawberries are available. That is, by offering strawberries the retail location may see a rise in chocolate sales as the two products have a synergy between them. Similarly , many manufacturers would suggest that the ability to purchase a complete line of chemicals for a process often raises the value they place on each individual chemical.

A third, and related reason, for the growth of category management has to do with the purchasing group's valuation of time. While Suppliers often analyze their ability to achieve economies of scale in their distribution arm, buyers are scrutinizing supplier relationships in an effort to minimize on transactions and handling costs. For instance, a motorsports dealer recently relayed the following: "I love to do business with them [Company X] but they have six different salespeople calling on me. They are all competent at what they sell, but so am I, and lets face it I have a lot of other things to do around here other than baby-sit all of their salesmen! ”

The “right-sizing” of the past decade has been felt by purchasing firms. Today, buyers are being pressed to perform more functions than ever before, causing them to emphasize economy of transactions.

Category management has been adopted at a variety of levels in marketing channels. Suppliers have begun to adopt category management in explicit recognition of the competition within their product lines. At P&G, brand managers were once given ***carte** blanche* in marketing decisions affecting their brands. However, it was recognized that the uncoordinated marketing activities of these independent managers often resulted in wasteful duplications of effort as well as inter-product “cannibalization”. Over time P&G has consolidated the responsibilities for related brands under the aegis of category managers who coordinate sales and marketing efforts over multiple brand lines.

While suppliers have moved tentatively toward category management, the distributive trade has begun to adopt the category approach with a vengeance. This is not surprising since distributors and retailers often carry competing product lines from multiple suppliers, a market phenomenon which causes naturally formed categories. Indeed, much of the distributive trade is defined by the categories of products they carry. The coordinating of marketing programs across products within a category has been a major thrust of competition and source of profits for these firms. By managing the potency of the assortment of products they carry, retailers have been able to enhance sales per square foot, and marginal return on investments. Further driving the trend toward category management has been the increased sophistication and savvy of retailers. Retailers once relied on suppliers for pricing and promotional guidance. Today, retail firms in many industries are developing their own strategies and objectives for the marketing of products, and dictating the manner in which business will be conducted.

The future of category management

It is unlikely that the trend toward category management systems will remain confined to consumer industries for several reasons. Category management offers industrial marketers many of the same benefits currently realized by consumer goods firms.

The shifting structure of business markets is beginning to dictate category management. Two particular dimensions deserve note. First, the lines between business and consumer markets are becoming blurred. For instance, a number of electrical suppliers have indicated that an increasing share of their sales to electrical contractors are coming from outlets such as Home Depot and Builders Square. While these so called “retail” channels did not exist a decade earlier, they represent the bulk of sales to small businesses and electrical contractors in many markets. Secondly, manufacturers have found that they do not have the efficiencies and effectiveness to compete with their distributive partners for many accounts. By carrying large assortments of products and multiple lines within each category, distributive partners are able to develop economies of scale and scope which are not readily available to manufacturers. Furthermore, by carrying broad and deep product lines distributive partners are in a position to develop the synergy’s, both within and between categories, that we spoke of earlier.

Possibly the most the most compelling reason for category management has to do with the consolidation of information. Buyers have been looking backward at their suppliers for the past decade as a means to reduce their costs. In doing so, they have become very familiar with many of their suppliers’ cost structures and have used this information to bargain away rents from competing individual suppliers. When products are sold on an individual basis the information received by buyers will inevitably be greater than that of the manufacturer By pitting supplier against supplier, and when possible brand against brand, downstream channel members have been able to exert tremendous pressure on manufacturers. Industrial suppliers, whose products generally have less recognizable brand franchises than their consumer counterparts, will be unable to escape this trend.

Preparing for category management

The emergence of category management has a number of implications for suppliers in industrial markets Category management will make it imperative that suppliers:

1. Understand the Structure of the Market. As suppliers and distributors move from product based management to category management, it will be critical to understand the role of each product within the category. This requires knowledge of the substitutability (and the complementarity) of products within the category. It may therefore be necessary for suppliers to conduct a formal audit of market structure by benchmarking substitution rates or cross-price elasticities.

2. *Understand and Match Goals with Distributive Partners.* In the era of category management, it will be critical for suppliers to recognize the category goals of their distributive partners. Some distributors may, for example, have overall category profit as a goal; others may focus on category growth. Marketing efforts and product offerings of suppliers must be consistent with the goals and objectives of distributors. To expect distributors to have market share considerations for individual products or brands may not be realistic While manufacturers are concerned with winning*interbrand* wars, the distributive trade generally wants to win *intrabrand* wars. A reseller of copy machines in Buffalo NY. may not care whether they are selling more of brand A or brand B, what they are most concerned with is selling every unit of brand A bought in Buffalo and every unit of brand B bought in Buffalo. That is relative marketshare's of each brand are inconsequential to the reseller, they are only a means to dominating their local level of competition. This focus forces the retailer to think in terms of categories of goods rather than brands.

3. Rethink Brand Performance Measures. Financial performance of individual products as measured by profitability and growth is becoming inadequate. Increasingly, suppliers and distributors will need to know the incremental contribution of the product to category profit. As the distributive trade continues to consolidate and grow in sophistication, suppliers must demonstrate that marketing efforts focused on their brands have a demonstrable positive impact on the category as a whole, in terms of measures such as growth, profitability, or overall category return. It is no longer enough to point to the individual brand sales as a justification for their existence. A retailer recently relayed the following: " we dropped our number three brand in the frozen orange juice category. We were afraid to do that because it was seen as something of a low cost leader. It was a big seller but we had some other low cost brands that had higher margins to us. Dropping it didn't cause a change in unit sales but our category margins increased as consumers shifted to other brands."

4. Create Variety, not Duplication. In the packaged good industry, retailers have identified brand proliferation as a major logistics problem. A typical grocery store can have more than 25,000 stock keeping units (SKUs). Many of these items are "me too" products that add little to overall category performance. Even those items that individually have high sales and profitability may have very close substitutes, increasing the likelihood that they can be deleted from the store with little effect on the category as a whole. In such situations, the reseller will likely favor items with the lowest supply cost. The increasing popularity of "private label" brands provides a cautionary lesson to suppliers of poorly differentiated products whose distributors are adopting category management.

Internally, the decision for suppliers is similar. They must look at the contribution of individual products or brands to overall category sales. This is especially so for vertically integrated suppliers, particularly those that face firms specializing in distribution

Implementing Category Management

Successful implementation of category management by suppliers may necessitate a fundamental change in the culture and structure of management. It demands an evolution from the compartmentalized, parochial interest in individual brands or products to a system-wide orientation. We have noted that powerful members of the distributive trade will increasingly seek suppliers who understand and design strategies consistent with their own category objectives. For the supplier, it is therefore less a question of *whether*, but *how* to implement category management.

Coordinating marketing efforts may help to enhance the customers' satisfaction and overall assessment of value. Below, is a brief overview of several ways to implement category management.

The most obvious method for initiating category management would be to supplant current product managers with a new centralized category management function. The success of this unit would depend on the requisite centralization of decision-making authority.

A second, and less obvious means of implementing category management might be achieved through intense *decentralization.* Field salespeople may be ideal candidates for surrogate category managers, since they typically are responsible for entire product lines. Implementing category management through decentralization might involve further empowering salespeople by giving them responsibility for a wider array of marketing decisions. Often the brand managers make individual product based decisions that may or may not make the job of the sales force easier. Allowing the salesforce greater latitude in their marketing decisions may lead to better adaptation of the firm's products to the local market.

Third, category management might be implemented by altering the incentive structure of existing product managers. Enhancing compensation and bonus schemes for category performance might achieve category management goals while leaving the current product management infrastructure largely intact. Such compensation programs may stimulate greater "cross talk" between the product managers. Such information exchange could lead to integrative solutions, and enhanced consumer satisfaction.

Category management is occurring in nearly every industry, either for reasons internal to the suppliers or simply because the buying side is dictating it. Beyond the internal adoption of category management practices, suppliers must be poised to accommodate those distributive partners who adopt category management. To better serve these distributors, suppliers must be willing to share sensitive information relative to inventories, costs etc.. Suppliers in the consumer goods industry are actually providing category management as a service for key accounts. For example, Frito Lay has funded and implemented category management for the salty snack category at Safeway-Portland. If successful, the partnering supplier is in a strong position to make recommendations for the category. Additionally, these suppliers are better poised to fully understand competitive dynamics of their marketplace. By furthering their understanding of each entrants competitive position in the category these firms are able to make more worthwhile recommendations to their distributive partners and enhance the effectiveness of their own strategic decision. Implementing such a strategy obviously requires a great deal of trust.

An individual brand approach to the marketplace has been an important and viable strategy for many years. However, as the distributive trade continues to consolidate and the remaining firms enhance the scope of products and functions they provide, the ability to efficiently and effectively distribute single products or brands is questionable. In those instances where brand management is still a profitable means to reach the customer, serious questions must be asked regarding whether or not this is an efficient use of resources, and whether distributive partners or customers are willing to tolerate this system.