

The Retailers' Merchandise Mix Planning and the Process of Category Management

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Abstract

Retail merchandising is the process used in order to conduct retail sales. As part of the process, the merchandiser pays close attention to the types of products offered for sale, how to best present those products to consumers, and determining what is a reasonable retail price for each unit sold. The product assortment is the core of the retailing service. A retailer's total product offering is called a merchandise mix or product range. At a strategic level, merchandise management includes the process of selecting the right items for a store and, at an operational level, ensuring that they are available when customers want to purchase them. Items in the assortment are organised into groups, the so called categories. Merchandise planning encompasses selecting the right categories and the items within them. The selection of the appropriate items for a store refers to the breadth and depth of the assortment, quality levels and the brand portfolio.

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Introduction

The lowest level of detail identifying a product in the retailer's assortment is the stock keeping unit (SKU), which identifies a particular item. For example, a pair of pants of a certain brand, in a particular style, colour, and size, is one SKU. The number of SKUs at various retailers varies tremendously. While hard discounters often carry less than 1,000 SKUs, a typical hypermarket assortment accumulates to around 100,000 SKUs. Items in the assortment can be grouped in terms of many different criteria. The product life cycle is one important classification criterion:

- Staple merchandise consists of those products that are carried permanently by the retailer and that have relatively stable sales over time. A hammer or a paint brush at a DIY retailer or jeans and white T shirts at a department store would be examples of staple goods.
- Fashion merchandise refers to products that have cyclical sales due to changing tastes and lifestyles. Colours and cuts of clothing change and merchandise offered this year is usually out of date next year.
- Seasonal merchandise consists of products that do not sell equally well over consecutive time periods. Barbecue grills, skiing equipment, short pants and similar products have very high sales during one season of the year, but are not sold at all in other seasons.
- Fad merchandise generates very high sales for a short time period. Often, toys and games, certain clothing accessories, or certain music CDs are fads. Tamagochis and Pokémons, for instance, were classic fads. Movie merchandise (e.g. Batman accessories) also constitutes typical fads. Price sensitivity is often very low and ensuring supply, while demand is high, is crucial for success. The product life cycle of merchandise is also important, because it emphasises that all products in the assortment need to be replaced after a (varying) period of time.

Another merchandise categorization is the quality level, which is closely related to the price positioning. Should the retailer focus on premium products and target high income customers, offer standard products or focus on lower quality, less expensive items to target mainly (but not

only) low income customers? Another strategic option is to cover different quality segments and thereby approach a broader target group. For example, while discount apparel stores (e.g. KIK in Germany or the Dutch Zeeman) focus on the low quality segment, clothing boutiques focus on the high quality segment and department stores usually cover different quality levels.

For the assortment decision, demand interrelationships have to be considered in merchandise planning. The consumer usually buys a shopping basket. The demand for certain items is interrelated. This can be the case simply because it is more convenient to do all the food shopping for the week in one

store. However, complementary effects within the assortment can also arise, because products are consumed together and it has advantages to purchase them together because they can be matched.

One major challenge for retailers is that many stores have to accommodate the preferences of different consumer segments. Since the stores usually have only a limited geographic catchment area and the population in this catchment area is usually heterogeneous, many retailers cannot afford not to appeal to certain customer groups. This is especially the case for food retailers. General merchandise retailers, where consumers often travel further to the store of their choice (due to less frequent shopping trips) and stores in large city centers where customer frequency is generally high, can focus more easily on certain specific customer groups.

An increasing number of retailers use a combination of specialist and generalist approaches within their product offer. They are specialist in one or a few categories, but add other categories, in which they only offer a shallow assortment. Temporarily or permanently, retailers diversify by adding new products to their assortment, which do not belong to their traditional merchandise. Supermarkets sell non food products, DIY stores offer furniture, sports stores offer travel packages and food, to list just a few examples. This development results in a blurring of retail sector boundaries. There are a number of reasons for this trend. The average store size has increased continuously over the last decades, giving retailers more space to enter new categories. Many product categories have stagnated, making a move into new fields attractive. And some retailers wish to exploit their high customer frequency by selling new product ranges.

The brand extension strategy is sometimes called product scrambling, because it bears the risk of diluting the retailer's image. The concept of category migration can be compared to brand extension by a branded goods manufacturer. New categories that are related to existing ones therefore offer more potential with less image risk. Accordingly, successful category migration usually follows one of two diversification routes:

- Either new categories and services are offered that are closely related to the core assortment. Examples would be furniture stores that offer accessories, DIY stores offering garden furniture as well as sport stores offering skiing trips or sports nutrition.

- Another strategy is to diversify the assortment into new categories that appeal to the core target group of the retailer. Clothing retailers for young fashion that add cosmetics or music CDs to their assortment are good examples.

Adding new items to the assortment or eliminating items from the assortment is a fundamental and ongoing process for retailers. Studies of retail patronage have found repeatedly that the variety of assortment is an important determinant of attitude towards the store and store choice, ranking only behind location and price. Shoppers are often looking for very specific items. A greater variety and larger assortment increases the probability of finding what they really want. Consumers may also like variety, because of a simple desire to purchase different alternatives rather than the same thing each time.

Manufacturer Brands and Store Brands

In defining their merchandise mix, retailers also have to decide on the mix of manufacturer brands (e.g. Ariel, Nestlé, Philips, Ferrero) and their own brands, the so called store brands. While manufacturer brands are owned, produced, managed and marketed by manufacturers, store brands (also called private labels or own brands) encompass all product brands that are owned, managed and marketed by retailers. The property rights for the brand in this case, are held by the retailer.

For many retailers, *manufacturer brands* comprise the main part of their merchandise. Danone in food retailing, Bosch and Black & Decker in DIY retailing, Adidas in shoes retailing and Sony in consumer electronics are just a few examples. Retailers include manufacturer brands in their assortment for several reasons. The two most important ones are the pull effects and image effects exerted by the manufacturer brands. Strong manufacturer brands often enhance customer frequency in stores, because strong brands have loyal customers and their store choice is influenced by the availability of brands. Manufacturer brands are often heavily advertised in the media, so that consumers have clear images of these brands. Brand equity has been built up from which retailers can benefit. Strong manufacturer brands are said to pull customers into the store, so that other selling efforts by the retailer can be reduced.

The image of manufacturer brands in the assortment influences the retailer's image. A retailer's store image can be improved when it is associated with manufacturer brands that are evaluated positively.

The number of available manufacturer brands as well as a strong anchor brand in the assortment can affect the retail brand positively. Positive effects can be expected to raise the perceived quality level and enhance certain intangible brand features such as brand character. A store carrying a good range of Camel Active clothing, Levi's and Timberland will be associated with other characteristics than a store carrying mainly Prada and Gucci. However, the suppliers of strong brands are well aware of these benefits and their heavy advertising investment has to pay off. They have a strong negotiation position with retailers, which often results in unfavourable procurement prices for the latter. Therefore, manufacturer brands usually yield low profit margins for the retailer.

The proliferation of *store brands* in many product categories is one of the major developments in retail merchandising strategy. Once viewed with skepticism by consumers in terms of quality, in most countries store brands are now widely accepted substitutes for manufacturer brands and regarded as being of comparable quality. Store brands, on the other side, provide an opportunity for differentiation. They are available at one retailer only, and can, therefore, be used to distinguish the retailer from its competitors. The brand image of a store brand must be established by the retailer himself and communication expenses paid by the retailer, but the brand can match the retail brand image of the retail company perfectly.

Customer loyalty can more easily be built on store brands than on manufacturer brands. If a customer is satisfied with a store brand and intends to repurchase it, he needs to revisit the retailer. Conversely, if he is satisfied with a manufacturer brand, he can still switch stores and buy the product elsewhere. At the same time, store brands are not easily comparable across retailers. Therefore, price competition may be less severe. This factor, combined with lower procurement or production and marketing costs, often results in better profit margins for store brands.

The first store brands were generics, that is, very low cost commodity products, with no brand like labeling, but plain white packages that contained only the name of the product ("sugar" or "milk"). Currently, there are store brands in all price and quality segments. Store brands also cover different segments with different attributes, for example, organic food or healthy eating.

For budget store brands and standard store brands, price still plays a dominant role. The standard store brands are usually positioned as being of as good a quality as the manufacturer brand, but for a lesser price, and are targeted at the price conscious customer segment. Premium store brands, on the other hand, are often positioned even above the manufacturer brand. Currently, many retailers are establishing a premium store brand segment. While all store brands have an impact on the retail brand, the premium store brands in particular, are introduced to improve the profile of the retailer and shape the retail brand image.

As part of the branding strategy, it also has to be decided how closely the store brand should be associated with the retail brand. Sometimes, the retail brand is used as an umbrella brand for the store brand products (for example, Tesco uses Tesco Finest, Tesco Organic, Tesco Value, among others, as store brands), while in other cases, the store brand is not directly connected to the retail brand. Anna's Best, the store brand for pasta at the Swiss retailer Migros, or Mibell, the store brand for German Edeka's dairy products are examples. For those retailers which carry manufacturer brands and store brands, a general trend can be observed towards reducing the brand selection in order to avoid consumer confusion and enhance efficiency. Only the best manufacturer brands are kept in the assortment, while the others are systematically eliminated or replaced by store brands.

In recent years, the merchandising process is often integrated into a more holistic management approach to retailing, so called *category management*. ECR Europe (1997) defines category management as a retailer/supplier process of managing categories as strategic business units, producing enhanced business results by focusing on delivering consumer value. Each category follows a specific strategy, which is embedded in the retailer's overall strategy. The importance of working together with the suppliers of a category is emphasized. One reason is that manufacturers usually have a deeper knowledge of the peculiarities of their category, because they frequently offer only products in one category. By contrast, the retailer has knowledge of his customers' behaviour across categories, so that the two can merge their knowledge in the pursuit of mutual goals.

Category management has developed as a stepwise planning process for categories, and was first proposed by the consulting company The Partnering Group in the mid 1990s. Over the last decade, it has developed into a standard industry process, which has been promoted by national and international ECR initiatives. Standard processes support an easy knowledge transfer across different retailers and/or suppliers. Category definition involves determining the specific SKUs that constitute the category, based on which products consumers perceive to be interrelated and/or substitutable. The primary aim is to develop a category definition that is based less on the procurement perspective of the retailer and more on

the consumer perspective. Within the category definition, the category is also segmented into subcategories. This segmentation should be based on the consumers' decision tree, when purchasing in the category, that is, the sequential consumer choice process. For example, the category "wine" could

be segmented at the first level by price categories (premium wines, standard wines, budget wines), countries (French wines, Italian wines, German wines), colours (red wine, white wine, rosé) or brands.

In the next step, a role is assigned to each category, that is, the purpose of this category for the retailer is identified. Then it is analyzed how the category fits in the retailer's company strategy. This facilitates managing categories according to their importance and allocating resources (such as marketing

budgets, shelf space and management capacity) optimally. Before assigning a role to a category, the category's importance to the consumer, retailer, and competition should be analyzed. After a

more thorough analysis of the category and subcategories (category assessment), the category targets are set and relevant performance indicators selected (category performance measures), because different roles lead to different target indicators. The so called fair share is an important indicator. This is the market share of a retailer in the category, compared to his overall market share. It is an indicator of retailer performance in this category relative to overall performance.

The next step is to decide on a marketing strategy for the category. Many different strategies are possible, including: Traffic building, attracting many consumers into the store, for example, by offering price promotions for frequently purchased products. Transaction building, enhancing the average size of the shopping basket, for example, by exploiting demand interrelationships in the space allocation in stores or encouraging impulse purchases. Profit generating, enhancing the profitability of customers' shopping baskets, by offering products with high margins and/or higher inventory turns. Image creating, improving the retailer's image, e.g. by offering products that are sold uniquely at the retailer or offering an outstanding choice in the category. At the level of the category tactics, operational decisions on the assortment, pricing, space allocation, and other retail marketing instruments are derived from the strategy and the other steps in the process. The final steps of the process are implementing the plan and a regular review of the category's performance, including plan adaptation.

Conclusion

As with many other facets of retail management, merchandising is becoming more strategic and more fact based, because retail information systems provide the necessary data for analyzing the effects of merchandise changes. Some trends have emerged in the last few years:

- Retailers are increasingly adding new categories to their merchandise (category migration).
- Retailers are reducing the depth of their assortments in each category, focusing on leading brands, and eliminating underperforming manufacturer brands.
- Retailers are increasingly adding store brands to their assortment and the store brand portfolios cover all segments, including the premium segment.

In many cases, merchandising planning is integrated into a category management process, which supports the strategic retail positioning by assigning defined roles to a category and systematically deriving the subsequent marketing decisions from the role. The merchandising process is determined by the retailer's most valuable and limited resource: shelf space. For Internet shops, however, this constraint does not apply. Therefore, merchandise planning for e-commerce is different. Assortments can be larger and structured differently: products can be placed in more than one category, because this does not use shelf space, and constitutes an alternative way of finding the right product. More than one consumer decision tree can be modelled.

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