Merchandise and Category Management

<div style="text-align: right">**12**</div>

Abstract

This chapter will explain the different attributes of a retailer's merchandise mix and the factors to consider when merchandise planning. The chapter discusses the merchandise mix, the development and importance of store brands and the integration of merchandise planning into the broader process of category management.

12.1 Merchandise Mix

Product assortment is at the core of the retailing offer. A retailer's total product offering is called its **merchandise mix** or **product range** (Varley 2014, p. 82). At a strategic level, merchandise management includes the process of selecting the right items for a store and, at an operational level, ensuring they are available when customers want to purchase them. The latter function is discussed in more detail in Chap. 18 and 19.

Items in the assortment are organised into groups called **categories**. **Merchandise planning** involves selecting the right categories and the items within them. Selecting the appropriate items for a store or an online shop requires choosing the breadth and depth of the assortment, quality levels and the brand portfolio.

The lowest level of detail identifying a product in a retailer's assortment is the **stock-keeping unit** (SKU), which identifies a particular item. For example, a pair of trousers of a certain brand in a particular style, colour and size is one SKU, or a bottle of a specific ketchup brand in a specific size and variant. The number of SKUs at various retailers varies tremendously. While hard discounters often carry around 1000 SKUs, a supermarket has 10,000–15,000 SKUs. A typical hypermarket assortment reaches around 80,000 SKUs. A

DIY store can have around 50,000 SKUs, and a home accessories and furniture store like *IKEA* will have as many as 12,000 SKUs in a store.

Items in the assortment can be grouped using many different criteria. The length of the product lifecycle is one important classification criterion (Berman and Evans 2013, pp. 386–387):

- **Staple merchandise** defines products which the retailer carries permanently and which have relatively stable sales. A hammer or a paintbrush at a DIY retailer or jeans and white T-shirts at a department store are examples of staple goods.
- **Fashion merchandise** refers to products that have cyclical sales because of changing tastes and lifestyles. Colours and cuts of clothing change, and fashion products offered one year are usually out of date the next.
- **Seasonal merchandise** refers to products that only sell well during particular periods. Barbecues, skiing equipment, shorts and similar products have very high sales during one season, but are hardly sold at all during other seasons.
- **Fad merchandise** generates very high sales for a short period. Toys and games, certain clothing accessories or certain music CDs are often fads. *Tamagochis* and *Pokémon* are examples of classic fads. Movie merchandise (e. g., *Jurassic World* toys) is also usually faddish. Price sensitivity is often very low, and ensuring supply while demand is high is crucial for success.

The product lifecycle of merchandise is particularly relevant. All products in the assortment need to be replaced after a particular period of time, but the time span for achieving sales also varies. It also has a substantial influence on the ability to forecast demand.

Another frequently used product taxonomy is **food**, **near-food** and **non-food** items. Non-food products are non-perishable general merchandise items such as clothing, electronics, toys and so on. Near-food products are products such as detergents, toothpaste and shampoo, which are not food, but which are bought in a similar way to fast-moving consumer goods.

Merchandise can also be considered by **quality level**, which is closely related to **price positioning** (see Chap. 13). Should the retailer focus on premium products and target high income customers? Should it 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; department stores often cover different quality levels (see Chap. 3).

The breadth and depth of the assortment are the most commonly used criteria for structuring the merchandise mix:

- The number of product lines (or categories) the retailer offers is referred to as **the breadth (width) of the assortment**. Breadth is generally depicted on a scale from

narrow to wide. A wide assortment usually has the advantage of appealing to **broad target groups** and facilitating **one-stop shopping**, i. e., customers can find most of the merchandise they want "under one roof". One drawback is that very wide assortments often result in a diffuse, non-specific store image.

• The number of SKUs in a particular category (e. g., brands, colours, tastes, sizes) is called the **depth of the assortment**. Depth is mostly measured on a scale ranging from **shallow to deep**. Deep assortments have the advantage of providing consumers a good choice within categories, which appeals to customers with high product involvement. Shallow assortments may lead to a weak merchandise image, but a shallow assortment lets retailers focus on the fast-selling items within a category. Deep assortments often lead to many items with low inventory turnover. When a category assortment is deep, it usually covers different quality and price levels.

Specialty stores are typical examples of retailers that have rather narrow but very deep assortments. Conversely, convenience stores have rather wide but shallow assortments. Traditional full-line department stores have both a very wide and rather deep assortment. Online shops are often characterised by very deep assortments because they do not have the same space restrictions as store-based retailers. This is true for specialist online shops like *Zalando* but also for Amazon, the largest online retailer in the world (see Chap. 2, 3 and 4).

Retailers are not limited to four different strategies, as the combination of these two dimensions (depth/breadth) might imply at first sight. As the examples in Fig. 12.1 show, a women's fashion boutique might carry a deep selection of a few fashion categories (such as evening dresses, blouses and trousers), but also a small selection of shoes, handbags and accessories. Food discounters usually have a rather wide assortment (they cover all relevant

Fig. 12.1 The merchandise mix: breadth and depth of assortment

food categories, some near-food categories and even a few non-food categories), but they have a very shallow assortment in most of these categories. *Amazon* still has a much deeper assortment of books than of most other product categories.

When deciding on an assortment, **demand interrelationships** must be considered. Consumers usually buy a shopping basket. The demand for certain items is interrelated. This is sometimes as simple as it being more convenient to do the whole week's food shopping in a single store. However, complementary effects within the assortment can also arise because products are used together, and thus there are advantages to purchasing them together. Shirts and ties or paintbrushes and paint are typical examples of **complementary goods**.

As a practical consequence, retailers usually try to cross-sell to customers by placing such products next to each other, making it more likely that latent demand complementarities manifest in a joint purchase.

Category Migration as a Trend

An increasing number of retailers use a combination of specialist and general approaches within their product offers. They specialise in one or a few categories, but also add other categories in which they only offer shallow assortments. Retailers temporarily or permanently diversify by adding new products to their assortments that do not belong to their traditional merchandise (Zentes and Morschett 2004b). Supermarkets sell non-food products, DIY stores offer furniture, sports stores offer travel packages and energy drinks, and food discounters like *Aldi* and *Lidl* have promotions on all types of products, e. g., electronics. This blurs retail sector boundaries.

There are a number of reasons for this trend:

- The main reason for limited time promotions with non-food products at *Aldi* and *Lidl* is to attract new customers into the store and to generate short-term profits with high quantities of a few promotion products.
- The permanent addition of new products has other motives. Average store size has increased continuously in recent decades, giving retailers more space to enter new categories. Many product categories have stagnated, making a move into new fields attractive. And some retailers want to exploit their high customer frequency rates by selling new product ranges. Furthermore, from the perspectives of food retailers, non-food items often provide higher profit margins; thus, exploiting the customer frequency created by their food offer to sell more profitable products is a reasonable way to improve margins.

This strategy is sometimes referred to as **product scrambling**, because it risks diluting the retailer's image (Varley 2014, p. 12). The concept of category migration can be compared with **brand extension** by a branded goods manufacturer. New categories that are related to existing ones offer more potential with less image risk. Accordingly, successful category migration usually follows one of two diversification routes (Zentes and Morschett 2004b, p. 163):

- New categories and services are offered that are closely related to the **core assortment**. Examples include furniture stores offering accessories, DIY stores offering garden furniture and sports stores offering skiing trips or sports nutrition. This can even enhance the retailer's competence in the eyes of the consumer and strengthen its image as a specialist.
- Other retailers diversify their assortment into new categories that appeal to their **core target group**. A good example is clothing retailers for young fashion that add cosmetics or music CDs to their assortments.

Reduction in Variety as an Emerging Trend

Adding or eliminating items from a retailer's assortment is a fundamental and ongoing process. Studies into consumer habits have repeatedly found that the variety of an assortment is an important determinant of attitudes towards a store and store choice, ranking only behind location and price. Shoppers are often looking for specific items. A greater variety and larger assortment increases the probability they will find what they want. Consumers may also like variety because of a simple desire to purchase alternatives rather than the same thing each time. This has led many retailers to continuously increase their product assortments.

However, selling space is one of a retailer's most valuable assets, which imposes a severe resource limitation. Thus, retailers must make trade-offs. In addition, too much variety in an assortment has some severe disadvantages (Hoch et al. 1999, p. 528):

- An increasing number of SKUs usually increases retailing costs. Assortment complexity raises various costs, including those of sales, shelf space, planning, advertising, inventory and logistics. Discounters, for example, are very successful despite a strictly limited assortment.
- A large number of alternatives within a category can lead to **choice overload** for consumers and make the shopping process more complicated. Consumers often prefer "mental convenience". However, research has not proven that choice overload actually occurs (Scheibehenne et al. 2010).

There are studies that show that even radical reductions to an assortment do not necessarily reduce customer visits to a store, and sales may remain stable (see the overview by Boatwright and Nunes 2001). It is not the actual number of different products in a category that matters for store choice behaviour, but the consumer's perception of variety.

Eliminating different but similar versions of the same product from an assortment is rarely noticed or evaluated negatively by consumers. Therefore, many retailers are currently analysing their assortments and streamlining each category by eliminating underperforming items and brands (Zentes and Morschett 2004a, p. 2739). For example, in 2015, *Tesco* announced that it would reduce its assortment of 90,000 SKUs (across its different retail formats) by as much as 30 % to increase profitability.

12.2   Manufacturer Brands and Store Brands

12.2.1 Brand Ownership and Brand Management

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

12.2.2 Functions of Manufacturer Brands in the Assortment

For many retailers, manufacturer brands make up most of their merchandise. Examples include *Danone* in food retailing, *Bosch* and *Black & Decker* in DIY retailing, *Adidas* in shoe retailing and *Sony* in consumer electronics. Retailers include manufacturer brands in their assortments for several reasons, but the two most important are the **pull effect** and **image transfer** (Zentes and Morschett 2004a, pp. 2725–2731):

- **Pull effect**: 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 their favourite brands. Manufacturer brands are often heavily advertised in the media, so consumers have clear images of them. Retailers can benefit from the brand equity built up in this way. Strong manufacturer brands pull customers into stores, allowing retailers to reduce other selling efforts.
- **Image transfer**: Having manufacturer brands in their assortment can influence a retailer's image. A retailer's store image can improve when it is associated with manufacturer brands that are evaluated positively. The number of manufacturer brands and strong anchor brands in an assortment can affect a retail brand positively (Mulhern 1997, p. 110). Positive effects can 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, *Mammut* and *Timberland* will be associated with different characteristics than a store carrying mainly *Prada* and *Gucci*.

In addition, manufacturer brands are often **innovation** leaders. Manufacturers invest heavily in R&D and introduce new products onto the market. The examples of *Apple*, *Nike* or even low-tech products such as nappies from *Pampers* show that new product introductions with innovative technologies or features regularly stem from manufacturer brands. However, 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 rather **low profit margins** for the retailer (Ogden and Ogden 2005, p. 265).

12.2.3 Functions of Store Brands in the Assortment

One of the major developments in retail merchandising strategy is the increased share of store brands in many product categories (Bruhn 2012; González-Benito et al. 2015, p. 74). Once seen as low quality by consumers, in most countries store brands are now widely accepted substitutes for manufacturer brands (Varley 2014, p. 104; Kumar and Steenkamp 2007). The store brand market share (by value) has reached 45 % in Switzerland, more than 40 % in the United Kingdom and Spain and more than 30 % in Germany, with an increasing trend in every country (see Fig. 12.2).

The major argument for retailers introducing store brands is profit margins. For example, in 2009, *Metro* announced that one of the most important instruments for increasing profit margins in its hypermarket chain *Real* would be to increase the sales share of its standard store brand *Real Quality* from 7 to 14 %.

Beyond the lower profit margins of manufacturer brands, one of the most significant disadvantages of manufacturer brands for retailers is **ubiquity**, meaning that many other retailers also offer these brands. Store brands, by contrast, provide an opportunity for **differentiation**. They are only available at one retailer, and can therefore be used to distinguish
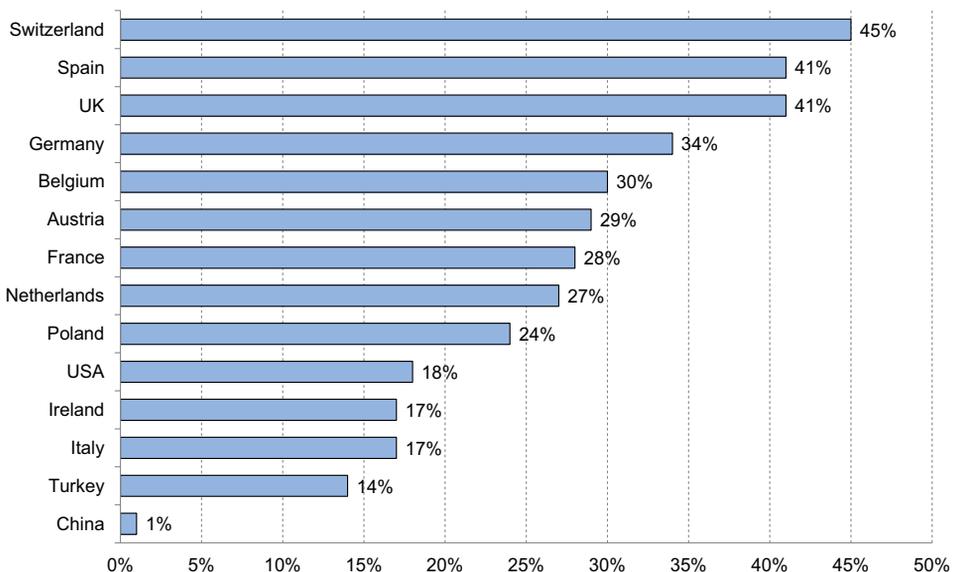

Fig. 12.2 Market share of store brands in selected countries in 2013 (by value; consumer packaged goods). (Nielsen 2014, p. 6)

that retailer from its competitors. A similar effect can be achieved via **exclusive brand** products that are owned by brand manufacturers but only sold at a specific retail chain.

Retailers must establish the brand image of their store brands themselves, but the brand can perfectly match the retailer's brand image. The positive effects of store brands on retail image and retail profits have been proven in many studies (see, for example, Dhar and Hoch 1997, Corstjens and Lal 2000).

Customer loyalty is easier to build via store brands than manufacturer brands. Customers satisfied with a store brand and intending to repurchase it must revisit the retailer. Conversely, customers satisfied with a manufacturer brand can still switch stores and buy the product elsewhere. At the same time, store brands are not easily comparable across retailers. Therefore, price competition can be less severe. This factor, combined with lower procurement or production and marketing costs, often results in higher profit margins for store brands (Corstjens and Lal 2000, p. 281).

Retailers carrying both manufacturer brands and store brands are generally reducing brand selection to avoid consumer confusion and increase efficiency. Only the best manufacturer brands are kept in the assortment, while others are systematically eliminated or replaced by store brands.

12.2.4 Positioning and Labelling of Store Brands

The first store brands were **generics**, i. e., very low-cost commodity products, with no brand-like labelling, simply plain white packages bearing only the name of the product ("sugar" or "milk"). Value store brands such as *Tesco Value* or *M-Budget* still have this appeal today and clearly signal their no-frills positioning.

However, modern store brands exist across all price and quality segments (see Table 12.1 for examples). Store brands also cover different segments with different attributes, for example, organic food or healthy eating. For value and standard store brands, price still plays a dominant role. Standard store brands are usually positioned as being of equivalent quality to the manufacturer brand but at a lesser price, and targeted at the price-conscious customer segment (González-Benito et al. 2015; Dhar and Hoch 1997, p. 211).

Premium store brands, by contrast, are often positioned above manufacturer brands. In the last five years, many retailers have established a premium store brand segment. While all store brands have an impact on the retail brand, premium store brands are specifically introduced to improve a retailer's profile and shape retail brand image.

Creating Store Brand Portfolios
A recent trend in this field is the increasing segmentation of store brands to address even small target groups by offering several sub-brands that appeal to a wide spectrum of consumer needs. These store brand portfolios then help fulfil the heterogeneous objectives of store brands via a portfolio of different brands. For example, many food retailers now offer store brands for vegetarians (e. g., *Coop Delicorn*), for people with

Table 12.1 Examples of differently positioned store brands in four retailers' portfolios

Positioning	Tesco (Food)	Coop (Food)	Castorama (Home Improvement)	Group Casino (Food)
Premium	Tesco Finest	Coop Fine Food		Casino Délices
Value Added	Tesco Free From, Tesco Organic	Coop Naturaplan, Coop Naturafarm, Coop FreeFrom		Casino Bio, Terre et Saveur, Casino Avenir, Casino Fairtrade Max Havelaar
Standard Segmented	Tesco Healthy Living, Tesco Goodness	Coop Delicorn, Coop Weight Watchers, Coop Jamadu, Coop Betty Bossi	Colours, Form, MacAllister	Les Doodingues de Casino (Kids range)
Standard	Tesco	Coop Qualité & Prix	Casto	Casino
Value/Budget	Tesco Everyday Value	Coop Prix Garantie	1er Prix	Tous les Jours

allergies (e. g., *Tesco Free From*) or for children (e. g., *Les Doodinges de Casino* or *Coop Jamadu*). Some retailers have introduced store brands that emphasise sustainability (*Casino Avenir*).

Thus, the portfolio contains store brands designed to improve the retailer's margins (often the standard store brand), others designed to improve the retailer's image (often the premium brands, organic products and fair trade products) and others mainly designed to signal the retailer's price competitiveness (often the value store brands). Still others are designed to attract specific target groups and build their loyalty (e. g., gluten-free products). Table 12.1 shows the store brand portfolios of four selected retailers.

A few years ago, *Castorama* strategically restructured its store brand portfolio, announcing its intention to develop a clear three-layered portfolio: *1er Prix* as its budget brand, *Casto* as its standard store brand (*Casto* across many categories) and other store brands at a standard and sometimes upscale (but not premium) level, segmented by product-category such as *MacAllister* (power tools), *Colours* (paint and decorative products) or *Form* (storage solutions).

As with every portfolio, it is important for such a portfolio to be balanced and inter-relationships to be considered. If a portfolio is over-fragmented, then cannibalisation may be strong and the critical mass within each different product brand segment may be too low. If the portfolio is too small, there may be substantial niches which are not addressed.

Choosing a Brand Name for Store Brands

As part of the branding strategy, a retailer must also decide 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 Everyday Value,* among others, as store brands), while in other cases the store brand is not directly connected to the retail brand. Examples include *Anna's Best*, the store brand for pasta at the Swiss retailer *Migros*, *McAllister*, the power tool store brand of *Castorama* and *B&Q*, or *Kenmore*, a store brand *Sears* uses for its home appliances. *Aldi's* store brands are all of this type.

For labelling, there is a clear trend in grocery retailing towards using the retail brand as an umbrella brand for the store brands as well. For example, in 2008 *REWE* converted its former store brands *Erlenhof*, *Salto* and *Today* into *REWE* products and its ecological line was renamed from *Füllhorn* to *REWE Bio*. *Carrefour* renamed its value brand line from *Numéro 1* to *Carrefour Discount*. *Migros*, in 2010, followed this trend and announced a new *Migros* store brand *M-Classic* that would comprise many established products previously offered under different store brand names.

The reasons for this trend are clear: No retailer has the advertising budget to compete with manufacturer brands in terms of strength. Fragmentation renders this almost impossible. But by uniting the store brand products under an umbrella brand, the store brand can be strengthened and managed like a strong manufacturer brand. Furthermore, linking the store brand to the retail brand leads to a cross-fertilisation of both brands. Launching new products under the established brand name is easier and, simultaneously, a successful store brand is much better for the image transfer to the retail brand.

The downside of this strategy is that the image transfer is strong and – as with umbrella brand strategies in general – there is a risk that a single low-quality product will harm the image of the entire store brand portfolio. Furthermore, using the retail brand as an umbrella brand for differently positioned store brands may lead to stronger cannibalisation.

Particularly for value brands, the optimal strategy is not yet clear. Some retailers link these store brands to their retail brand (such as *Tesco Everyday Value*, *Carrefour Discount*, *Coop Prix Garantie*), but others avoid this (such as *REWE*, who just label these products *Ja!*).

Category-specific vs. Cross-category Store Brands

Retailers generally have the choice between establishing store brands specifically for each product category or across their total product range. The category brand strategy has the advantage that the brand message can be focused on specific product features and that a clear positioning compared with other product brands in this category is easier, while the second strategy has the advantage – as described above – that advertising spending can be bundled across many different categories.

In food retailing, the trend towards shared store brands for different categories has already been described. In non-food retailing, store brands are often focused on specific categories, as the *Castorama* example above showed. *Walmart* and its subsidiary *ASDA*, as a further example, use the store brand *George* for their clothing assortment (here it is logical

to separate this brand from, for example, a store brand for yoghurt). *Sears* has a number of different store brands, among them *Kenmore*, which is used for home appliances and is the clear market leader in the USA, and *Craftsman*, which is used for tools and power tools and which is also one of the strongest brands in these categories.

The above mentioned trend towards linking the store brands clearly to the retail brand name is not as pronounced in non-food retailing. Here, some retailers have introduced some store brands with a link to their retail brand (e. g., *Casto* for *Castorama*, *OBI classic* for *OBI*), but the competition's brand names often focus on specific product categories, and the retail brands do not currently evoke the same image. Therefore, category-specific store brands that are not clearly associated with the retail brand are used instead. The brands listed in Table 12.1 for *Castorama* are examples. Similarly, the sporting goods retailer *Decathlon* has structured its store brands into categories; every store brand ("passion brand") represents a particular sport and the brands do not overlap within the assortment. Each store brand clearly focuses on customer needs in their specific category, as the descriptions of some of the brands illustrate (Decathlon 2015; see the case study in Chap. 3):

- *Quechua* is the store brand for outdoor sports. This brand, launched in 1997, contains products for hiking, mountaineering, camping, Nordic skiing, etc.
- *Btwin* covers bicycles and cycling equipment and accessories. The brand is the world leader in the cycling market, with more than 2.7 million bikes sold annually.
- *Kipsta* is *Decathlon's* store brand for team sports, e. g., football, volleyball, sports clothing and shoes for team sports, training equipment, etc.
- *Tribord* is the store brand for nautical and water sports, e. g., diving equipment, swimsuits, inflatable boats, etc.

12.3   Category Management

In the last two decades, the merchandising process has increasingly been integrated into a more holistic management approach to retailing, so-called *category management* (see, e. g., A.C. Nielsen 2006; ECR Europe 1997). ECR Europe (1997) defined category management as a retailer's or supplier's 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.

Category management has developed as a stepwise planning process for categories, and was first proposed by the consulting company *The Partnering Group*. Over the past two decades, it has developed into a standard industry process, promoted by national and international ECR initiatives. Nowadays, most grocery retailers, but also retailers from other sectors (e. g., drug stores, home improvement stores, perfumeries), use this standard process. Standard processes support easy knowledge transfer across different retailers and/ or suppliers. The basic process is shown in Fig. 12.3. This is still the most commonly applied process, although simpler processes have also been developed.
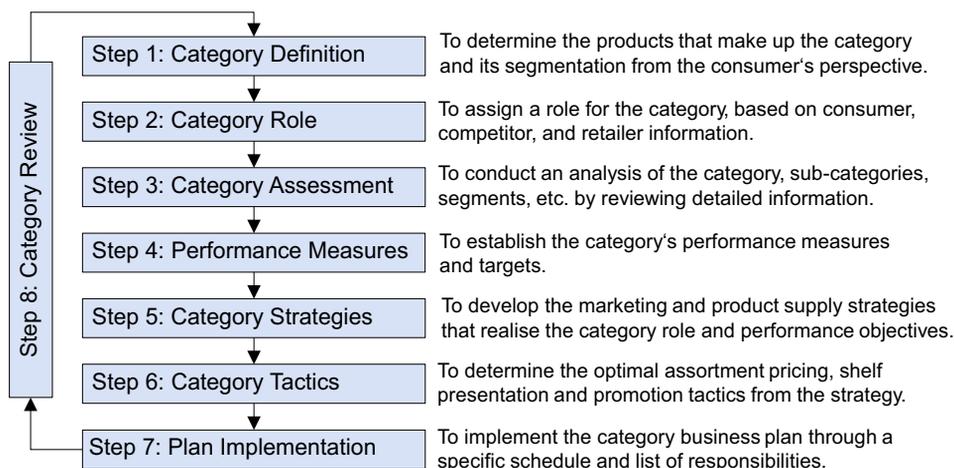
Step	Description
Step 1: Category Definition	To determine the products that make up the category and its segmentation from the consumer's perspective.
Step 2: Category Role	To assign a role for the category, based on consumer, competitor, and retailer information.
Step 3: Category Assessment	To conduct an analysis of the category, sub-categories, segments, etc. by reviewing detailed information.
Step 4: Performance Measures	To establish the category's performance measures and targets.
Step 5: Category Strategies	To develop the marketing and product supply strategies that realise the category role and performance objectives.
Step 6: Category Tactics	To determine the optimal assortment pricing, shelf presentation and promotion tactics from the strategy.
Step 7: Plan Implementation	To implement the category business plan through a specific schedule and list of responsibilities.

(Step 8: Category Review spans the process.)

Fig. 12.3 The category management process. (ECR Europe 1997)

The first steps in the **category management process** are the most innovative because they include formulating a clear strategic objective for each category. These first steps distinguish the new process of category management from the traditional, more operational method of merchandising, because they position the retailer by providing a clear profile in its merchandise mix.

Category definition involves determining the specific SKUs that make up the category, based on which products consumers perceive to be interrelated and/or substitutable. The primary aim is to develop a category definition based more on a consumer perspective than the retailer's procurement perspective. For example, customers with babies usually want to buy different baby products (e. g., diapers, lotions, baby food, baby toys), and placing them close together and managing these products together can be very beneficial. For example, a price promotion on specific baby products may draw people into the store who are then very likely to buy other products. This kind of cross-selling can be strongly promoted via category management.

Product categories are also segmented into sub-categories. This segmentation should be based on the consumers' **decision tree** when purchasing in the category, i. e., the sequential consumer choice process. For example, the category "wine" could be segmented at the first level by price (premium, standard or budget wines), countries (French, Italian or German wines), colours (red, white or rosé) or brands. The category "beer" may be segmented into "impulse" (e. g., a single can or a six-pack), "stocking up" (e. g., crates) or by different beer types (e. g., Pilsner, wheat beer or stout) or brands.

In the next step, each category is assigned a **category role**, whereby the retailer determines the purpose of this category. Thus the retailer decides how the category fits into wider company strategy. This facilitates managing categories according to their importance and allocating resources (such as marketing budgets, shelf space and management capacity) optimally. The four roles in the category management approach are shown in Table 12.2. Before assigning a role to a category, the category's importance to the consumer, retailer and competition should be analysed (A.C. Nielsen 2006, pp. 79–93).

Table 12.2 Category roles. (ECR Europe 1997)

Role	Share of Categories [%]	Role Description
Destination	About 5	To be the primary category provider and help define the retailer as the store of choice by delivering consistent, superior consumer value
Routine	55–60	To be one of the preferred category providers and help develop the retailer as the store of choice by delivering consistent, competitive consumer value
Convenience	15–20	To be one of the category providers and help reinforce the retailer as the full-service store of choice by delivering good consumer value (i. e., to support the customer's wish for one-stop-shopping)
Occasional/ Seasonal	15–20	To be a major category provider, help reinforce the retailer as the store of choice by delivering frequent, competitive value

After a more thorough analysis of the category and sub-categories (**category assessment**), the retailer sets category targets and selects relevant performance indicators (**category performance measures**), because different roles lead to different target indicators. The so-called **fair share** is an important indicator. This is a retailer's market share in a category compared with its overall market share and is an indicator of retailer performance in this category relative to overall performance (see Table 12.2).

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; e. g., by offering price promotions for frequently purchased products.
- **Transaction building**: increasing the average size of the shopping basket; e. g., by exploiting demand interrelationships in 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 sold uniquely at the retailer or offering an outstanding choice in the category.

At the level of **category tactics**, operational decisions on the assortment, pricing (see Chap. 13), space allocation (see Chap. 15) and other retail marketing instruments are derived from the overall 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 adapting the plan if needed.

The high relevance of category management is also due to the fact that the category strategies and category tactics are embedded in a strategic process and thereby follow strategic considerations instead of purely operational optimisations.

Category Management of Online Shops

While the eight-step category management process was developed from the perspective of store-based retailers, it can be applied to online shops as well. However, for certain steps, differences to the traditional approach may emerge. For example, in an online shop, the same product can be placed in several categories (e. g., a *Barbie* doll can be put in the "dolls" category and also in the "*Barbie*" category). Associations between products are not limited to placing them "next" to each other; they can also be created by recommendations, for example "consumers who bought these diapers also bought this baby lotion". In addition, the shop can be customised to match individual customer behaviour. Still, the basic principles of category management (i. e., defining categories, assigning roles to categories, deciding on performance measures, etc.) can also be used in online shopping as well.

Cooperation between Retailers and Suppliers in Category Management

In a category management approach, it has always been vital to work together with the suppliers of a category. One reason is that manufacturers usually have a deeper knowledge of the specifics of their categories, because they often offer only products in one or a few categories and can invest time, effort and money into gaining extensive consumer insight. Conversely, the retailer has knowledge of its customers' behaviour across all categories. Thus, the two can merge their knowledge in the pursuit of mutual goals.

When category management was initially conceived, one far-reaching idea was that retailers could literally "outsource" category management to specific suppliers, so-called **category captains**. These would be leading suppliers in a category who would then manage the category (including their own and competitors' products) on behalf of the retailer to the benefit of both partners. This concept is rarely used in practice, though, because of the obvious risk that the supplier will strongly prefer to optimise their own product sales, even at the expense of their retail partner. However, retailers still have preferred suppliers for a category who provide information and make recommendations. These **category consultants** have a significant influence, but the final decisions are still taken by the retailer. It is still essential for retailers to maintain (and enhance) their competence in assortment management. Retailers and manufacturers may have shared objectives in certain situations, but they are still two independent companies with potentially diverging objectives.

12.4   Conclusion and Outlook

As with many other facets of retail management, merchandising is becoming more strategic and more fact-based, because retail information systems can provide the data needed to analyse the effects of merchandise changes. Some trends have emerged in the past 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 assortments.
- These store brand portfolios cover all segments, including the premium segment.
- In many cases, merchandise planning is integrated into a category management process, which supports strategic retail positioning by assigning defined roles to a category and systematically deriving subsequent marketing decisions from the role.

The merchandising process is determined by the retailer's most valuable and limited resource: shelf space. Online shops, however, do not have this constraint. 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 provides consumers an alternative way to find the right product. More than one consumer decision tree can be modelled.

Online shops increasingly customise their product offers to specific customers (e. g., *Amazon*). Even though online shopping has still not achieved a very high market share in most retailing sectors, these merchandising processes could also have an impact on store retailing. Multichannel retailers can use their Internet merchandising to gather knowledge about consumer behaviour (e. g., demand interrelationships) and subsequently use that knowledge to improve merchandise management in their stores.

> **Further Reading**
> - ECR Europe (Ed.) (1997): *Category Management Best Practice Report*. Brussels.
> - Kumar and Steenkamp (2007): *Private label strategy: How to meet the store brand challenge*. Boston: Harvard Business Review Press.
> - Varley, R. (2014): *Retail product management – buying and merchandising* (3rd edn.) London: Routledge.

12.5   Case Study: Whole Foods Market

12.5.1 Profile, History and Status Quo

The origins of the American retailer *Whole Foods Market*[1] date back to 1978, when the two founders John Mackey and Renee Lawson borrowed 45,000 USD from family and friends to open a small natural foods store called *SaferWay* in Austin, Texas, where the company

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[1] As well as the explicitly cited sources, this case study uses the websites http://www.wholefoods-market.com, http://media.wholefoodsmarket.com/ and various reports and presentations.

is still headquartered. Two years later, they merged with another small retail company, *Clarksville Natural Grocery*, which led to the opening of the first *Whole Foods Market* in 1980. In 1984, *Whole Foods* started its expansion into Houston and Dallas. Four years later, expansion continued with the acquisition of the New Orleans-based *Whole Food Company*, followed by the opening of a new store in Palo Alto, California, in 1989. While continuing this organic growth by opening new stores, *Whole Foods* decided to accelerate its expansion by acquiring other natural food chains in the 1990s, e. g., *Wellspring Grocery* in North Carolina, *Bread & Circus* in Massachusetts and Rhode Island, *Mrs. Gooch's Natural Foods Markets* in Los Angeles and *Nature's Heartland* in Boston. In 2002, *Whole Foods* began its international expansion with market entry into Canada, followed by entering the UK in 2004 with the acquisition of seven *Fresh & Wild* stores.

Whole Foods' growth strategy (see Chap. 7) is clearly based on three pillars: Strong growth of sales in existing stores (comparable store sales, see Fig. 12.4), expansion by opening new stores and – to a small degree – acquiring smaller chains to gain access to new geographic areas (Whole Foods Market 2014, pp. 4–5). In particular, comparable store sales indicate that *Whole Foods'* marketing mix appeals to a growing number of customers in their catchment area.

Nowadays, *Whole Foods*, which operates as a publicly listed company in the natural and organic food segment, is the **largest organic food retailer in the United States**. For 17 years, the retailer has been listed in *FORTUNE* magazine's *"100 best companies to work for in America"*. In 2014, the American private label industry journal *Private Label Buyer* elected *Whole Foods* retailer of the year (Peckenpaugh 2014). In addition, it is also the first national *"Certified Organic"* grocer, positioning itself as *"America's Healthiest Grocery Store"*. As of 2014, *Whole Foods* operates 399 stores, generating 7.7 million customer visits per week on average. *Whole Foods* stores are supported by a network consisting of the Austin headquarters, regional offices, distribution centres, bakehouse facilities, commissary kitchens (which produce, e. g., deli food, take-out food, etc.), seafood-processing
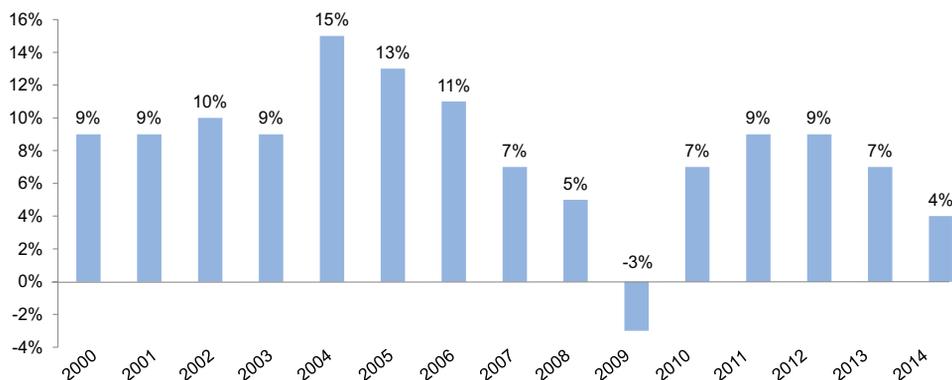

Fig. 12.4 Comparable store sales growth for Whole Foods Market. (Whole Foods Market 2014, p. 5)

facilities, meat and produce procurement centres and a specialty coffee and tea procurement and roasting operation.

The planning process is an interesting feature of opening new stores which is not directly linked to the company's merchandise policy, but to operational and financial performance monitoring (see Chap. 20). When a new target site has been selected, *Whole Foods'* development group conducts an in-depth site study, projects sales and estimates construction and operating costs. **Economic Value Added** (EVA) is used to estimate a store's profitability. Based on expected net operating profits and cost of invested capital necessary to generate those profits (currently calculated with an internal weighted average cost of capital of 8 %), a store is expected to generate cumulative positive EVA in five years or less (Whole Foods Market 2014, p. 6).

In 2014, *Whole Foods* achieved sales of 14.2 billion USD, an increase of 9.8 % compared to the previous year. The EBITDA margin was 9.2 %. Although *Whole Foods* operates internationally, its primary market is still the United States, which accounts for 96.7 % of sales. This strong growth is also observable in job figures: In 2014, the retailer created more than 8800 new jobs and employed 87,200 staff members, including 58,100 full-time, 26,100 part-time and 3000 seasonal employees.

12.5.2 Uniqueness of the Whole Foods Assortment

Whole Foods has achieved its impressive growth through very sharp positioning, with **clear differentiation** from its competitors via its merchandise mix, which is upscale, organic, healthy, ethical and top quality and displays a huge variety and a focus on perishable goods, including prepared meals. The company's motto signals its socially responsible vision: "Whole Foods, Whole People, Whole Planet".

The product range of a *Whole Foods* market covers produce and flowers, grocery, meat, seafood, baked goods, prepared foods, coffee, tea, beer, wine, cheese, nutritional supplements, vitamins, body care and lifestyle products including books, pet products and household products. It focuses on natural and organic food and customer well-being, along with very high quality. The CEO, John Mackey, often claims: "We're selling **the highest quality foods in the world**." The drawback of this strategy is **high prices**. This has strongly influenced *Whole Foods'* image, which is sometimes derided by customers as "Whole Paycheck".

Another factor is the **huge variety** of the assortment, which is much larger than that of equivalently sized supermarkets. The average *Whole Foods* store carries more than **32,000 SKUs**, while some larger stores carry up to 49,000 SKUs. The impression this creates is evident from this journalist's enthusiastic description when the first UK *Whole Foods* store opened: "Aside from Whole Foods' frequently expressed ethical and environmental concerns, the store is infamous for the sheer variety. In the London store there are more than 100 different olive oils, 40 types of sausage and 50 fresh juices. […] The

directory above just one of the dozen aisles in the London store reads: 'Marinades, Tinned fish, Mediterranean, Middle Eastern, Macrobiotic, Thai'" (Freeman 2007). This ambition is also clear in the company's quality standards, strongly communicated to customers on *Whole Foods'* website:

"Our Quality Standards:

- We carefully evaluate each and every product we sell.
- We feature foods that are free of artificial preservatives, colors, flavors, sweeteners, and hydrogenated fats.
- We are passionate about great tasting food and the pleasure of sharing it with others.
- We are committed to foods that are fresh, wholesome and safe to eat.
- We seek out and promote organically grown foods.
- We provide food and nutritional products that support health and well-being.
- The aim of *Whole Foods* is to offer a broad selection of high-quality natural and organic products, with a strong emphasis on perishable foods."

Whole Foods' focus on freshness as a strength and differentiation criterion from other competitors is clear from the proportion of perishables in its assortment: 66.8 % of the assortment is perishables, with 19.2 % prepared foods and baked goods and 47.6 % other perishables.

With this strategy, *Whole Foods* profits greatly from the increased demand for organic products in the United States and rising awareness about the importance of organic food, which is one of the most important food trends in the United States (Nie and Zepeda 2011). From 2000 to 2013, organic food sales in the United States rose from 6.1 billion USD to 35 billion USD, corresponding to a growth of 473 % within this period (Statista 2015). Thanks to its very clear positioning in this segment, *Whole Foods* profited greatly from this development. However, despite this strong growth in recent years, the market for organic food is still niche (Haas et al. 2013).

The idea of exclusivity and freshness is also clear from *Whole Foods'* store design; the retailer strives to transform traditional food shopping from a chore into a dynamic experience (see Fig. 12.5). The store design provides a lively, inspirational atmosphere, emphasising freshness and healthy eating with an **experience-oriented product presentation** and produce areas like open kitchens, scratch bakeries, expansive prepared food stations like juicing and hand-crafted coffee stations, greens, beans and grain cooking bars, brick pizza ovens and burrito and ethnic foods stations. Some stores even offer sit-down wine bars and taprooms featuring local craft beer to create areas for customers to gather. The product presentation is characterised by bulk departments and hand-stacked produce, evoking an atmosphere of a weekly market. In addition, *Whole Foods* tailors store size, store design, product selection and pricing to the particular community. When the first store opened in the UK, British newspaper *The Guardian* called it "The Disney World of Food" (Freeman 2007).

Fig. 12.5 *Whole Foods'* store design and merchandise presentation

12.5.3 Whole Foods Store Brand Portfolio

Whole Foods' assortment has two pillars: freshness and exclusivity. Freshness appeals mainly to natural and organic food-oriented shoppers, while the exclusivity attracts gourmet shoppers, based on the fact that the popularity of organic and local foods reflects more than meeting just basic needs; it is an expression of identity and worldview (Senauer 2001). Unlike conventional food, organic food often generates a price premium of 30 % or more (Haas et al. 2010); thus, *Whole Foods* offers a range of exclusive store brands to capitalise on this fact. With approximately 4400 SKUs in different categories, the company's exclusive store brands generated 1.8 billion USD in sales in 2014. At 13 % of total retail sales and 18 % of non-perishable sales, store brands are a key component of *Whole Foods'* value concept and essential for the company's product innovation and differentiation.

As mentioned before, *Whole Foods* offers a **broad variety of store brands** to its customers. Unlike other companies, *Whole Foods* uses a mixed strategy and offers store brands with and without connection to the company name. Most brands are umbrella brands and cover a range of different categories. *Whole Foods* describes its store brands as exclusive brands. The following four private labels are *Whole Foods'* main store brands (see Fig. 12.6):

- "*365 Everyday Value*" combines a high product quality approach with a value price approach. The store brand focuses mainly on price conscious consumers and combines simple packaging design with basic, but still natural and high quality, ingredients and quality standards. *365 Everyday Value* has both conventional and organic varieties. In addition to food products, *365 Everyday Value* also contains simple, straightforward and affordable supplements and body care products. The *365 Everyday Value* store brand accounts for approximately half of *Whole Foods* store brands.
- The *"Whole Foods Market"* store brand focuses on exceptional flavour, authenticity and a remarkable quality. With natural and organic choices, the brand contains a huge variety of products.
- *"Engine 2 Plant-Strong"* contains health-oriented vegan food products for everyday use, especially for people who are short on time. *Engine 2 Plant-Strong* products are based on a diet developed in the USA by Rip Esselstyn, a former firefighter turned health activist and food author. *Engine 2 Plant-Strong* products focus on defined health guidelines, like no use of animal components, 100 % whole grains, no use of added oils, minimal or no sugar and fewer than 25 % total calories from fat.
- "*Whole Trade*" is the brand for fruits and vegetables in *Whole Foods* assortment which are traded under the so-called *"Whole Trade Guarantee"* label. The idea is to highlight *Whole Foods"* commitment to ethical trade and the environment and selling high-quality products sourced from developing nations. Purchasing *Whole Trade* products helps fund projects like building community centres and schools and providing better wages and working conditions for farmers in developing countries like Ecuador and Haiti. In addition, 1 % of sales are donated to the *Whole Planet Foundation* to support environmental responsibility and offer microfinance for local projects.

Fig. 12.6 Selected *Whole Foods'* store brands. (Whole Foods)

It must be noted that the terms "standard" and "budget" do not refer to market comparison, but are relative to *Whole Foods'* other prices, which are higher than supermarket prices. Even the value range is quite expensive compared to competitors' merchandise mixes.

In addition to these four main store brands, further store brands, like *Whole Catch*, *Whole Fields*, *Whole Pantry*, *Whole Living*, *Allegro Coffee*, *Wellshire Farms* and *Nature's Rancher*, have been established. However, these are not the main focus of advertising.

In addition to expanding existing store brands by launching new products, *Whole Foods* decided to diversify its brands in 2013, expanding into the relatively new segment of premium pet supplies with a new store brand line, "*Whole Paws*". In the year of the launch, spending on pet products in the United States hit over 55.7 billion USD; in 2015, the *American Pet Products Association* (2015) expected spending of 60.5 billion USD. *Whole Paws* replaced products which were already available in the *365 Everyday Value* line and which encompassed multiple types of premium pet foods and treats, like gluten-free and weight management products (Peckenpaugh 2014). Pets are an emotional topic, and *Whole Foods* has targeted new customers and created sales potential in a fast-growing segment. In 2015, the retailer strengthened its engagement in pet food and launched a second store brand called "*Tender & True*". *Tender & True* is the first and only pet food line to offer fully USDA Organic certified dry dog and cat food choices, made with animal proteins from farms that have been certified under the *5-Step Animal Welfare Rating System* and with *Marine Stewardship Council (MSC)* certified sustainable seafood. In addition, all *Tender & True* products are made in the United States.

12.5.4 Establishing a New Retail Format Based on a More Focused Merchandise Mix

In reaction to fast-growing demand in the natural and organic food market in the United States, more and more retailers from the classic grocery sector, like *Walmart*, *Kroger Co.* or *Trader Joe's*, have intruded into *Whole Foods'* market segment, and this increased

competition has begun to erode organic food prices. As a result, *Whole Foods* has struggled with customer perception that its groceries are **too expensive** and can be easily found elsewhere (Bloomberg 2015). *Whole Foods'* price perception is particularly poor among younger consumers. *Whole Foods*, which has been operating for 37 years, has traditionally mainly addressed upscale clientele. However, it is younger consumers who have been most enthusiastic about organic and natural food products in recent years. Unfortunately, most of these eager consumers do not fall in the upscale category (Consumer Affairs 2015).

To revitalise its brand and defend its market position in the natural and organic segment, *Whole Foods* announced the launch of a new and smaller **store chain concept** in May 2015, which was branded "*365 by Whole Foods Market*". Around 10 stores will be opened in the USA starting in 2016. The aim of this new concept is to address a broader and younger audience, with a clear focus on fun and convenience and also on penetration into new locations where it was previously not possible to operate the established *Whole Foods* store concept. In addition, the *365 by Whole Foods Market* stores will target price-conscious consumers by providing a clear quality meets value shopping experience (Sustainable Brands 2015). This strategic realignment via a new, smaller store concept, which is a kind of budget *Whole Foods* chain, may be a direct assault on its competitor *Trader Joe's* (see the case study in Chap. 9), which has smaller stores, a very high percentage of store brands (much higher than *Whole Foods*) and substantially lower price positioning (Consumer Affairs 2015). Where *Whole Foods* developed as an upscale grocery chain, *Trader Joe's* has received a lot of attention in recent years thanks to a focus on organic and innovative products at the lower end of the market that appeals to younger customers. *365 by Whole Foods Market* is thus a defensive strategy.

Another reaction by *Whole Foods* to increased competition in the natural and organic segment is the shift from a purely natural and organic brand positioning to a stronger combination based on value, responsibility and especially sustainability. In autumn 2015, the retailer launched its first national TV and print advertising campaign, *"values matter"*, along with a new ratings system for its produce, called *"responsibly grown"*, which measures sustainable farming practices such as farmworker welfare, soil quality, water-conservation practices and pesticide use on a "good", "better" and "best" scale. This is a response to an increased consumer interest in going beyond *Whole Foods'* umbrella promise of selling sustainable produce, becoming more granular about the products they buy (Sustainable Brands 2015). However, sustainability and ethical sourcing are still criteria for differentiating *Whole Foods* from many of its competitors, who mainly focus on price.

12.5.5 Summary and Outlook

As the pioneer for the organic and natural food sector in the United States, *Whole Foods* has managed to grow from a small store in Austin, Texas, to become the biggest organic supermarket chain in the country over the past 37 years. Thanks to this clear positioning,

the company profited hugely from the emerging trend for buying healthy and organic food. Because there were no big manufacturers or well-known brands for natural and organic food, *Whole Foods* decided to establish its own store brands. *Whole Foods* uses a mixed strategy and offers a variety of store brands with and without connections to the company name. Most brands are umbrella brands and cover a range of different categories. The different brands target different customer needs and price levels.

Besides natural and organic products, *Whole Foods'* most important differentiation criterion from competitors and classic supermarkets is freshness. This is also reflected in the high share of perishable goods in *Whole Foods'* assortment, accounting for approximately 67 % of sales and more than half of the assortment. This is simultaneously a strength and a great challenge, because it is more complicated to deal with changes in demand and speed of rotation within the assortment.

Nevertheless, *Whole Foods* has managed to transform the challenges of a natural and organic assortment with a high proportion of perishables into a competitive advantage. Thanks to continuous adjustment to meet changing customer needs, it is likely that *Whole Foods* will continue its success story.

Questions

1. Do you think that store brands in the natural and organic sector are a profitable and future-safe strategy?

2. *Whole Foods* differentiates itself from its competitors via a high share of perishable goods. What are the risks of this strategy?

3. *Whole Foods* has had tremendous success with a clear focus on organic food and a very upscale market segment. However, this has come under pressure recently from new competitors. Discuss the strengths, weaknesses, opportunities and threats (SWOT) for *Whole Foods*.

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