



Placing the right bets

How to create winning category strategies



OC&C
Strategy consultants

uncommon sense



Optimising range

Delisting a typical product results in 60% of its volume being substituted by others - removing unprofitable and cannibalistic products can be a route to greater profit.

Do you know the real profit upside of reducing your range?

Price architecture

Retailers in highly competitive sectors often focus on matching competitors as a key price mechanic.

In reality, this often fails to account for how customers perceive value, and results in illogical price architectures which confuse customers.

Real

promotion impact

Most businesses deem a promotion successful based only on the sales uplift of that product, without considering how a promoted product cannibalises other sales.

Have you looked at the full category impact of your promotions?

Space

allocation

On average, over 70% of a retailer's categories need to change their micro space to maximise profitability.

How well tailored are your store layouts to your customers' needs?

Why is category strategy important?

Retailers have a wide variety of levers at their disposal to drive commercial performance - from price and promotions to range and space. Pulling these levers effectively requires a category strategy that is unlocked by an analytical understanding of their impact on performance.

At OC&C, we work with retailers around the world to deliver a better way of making these category decisions. What role do your categories play? Who are the target customers for each? What is the most powerful lever to drive each category's performance? Answering these questions is just part of defining category strategy.

Our experience has shown us that retailers get the most improvement by tackling category levers together. Trying to tackle one lever at a time can result in an inconsistent customer proposition. Our approach consistently generates material returns by unpicking these interlinked levers using a combination of commercial insight and analytics.

A model answer

WHAT MAKES US DIFFERENT?

At OC&C, we recognise that every retailer is different and that how you manage categories is integral to your DNA.

We think that best-in-class category strategy balances top-down strategy and bottom-up commercial optimisation. This helps category teams retain ownership of their category objectives while ensuring they deliver commercial benefits.

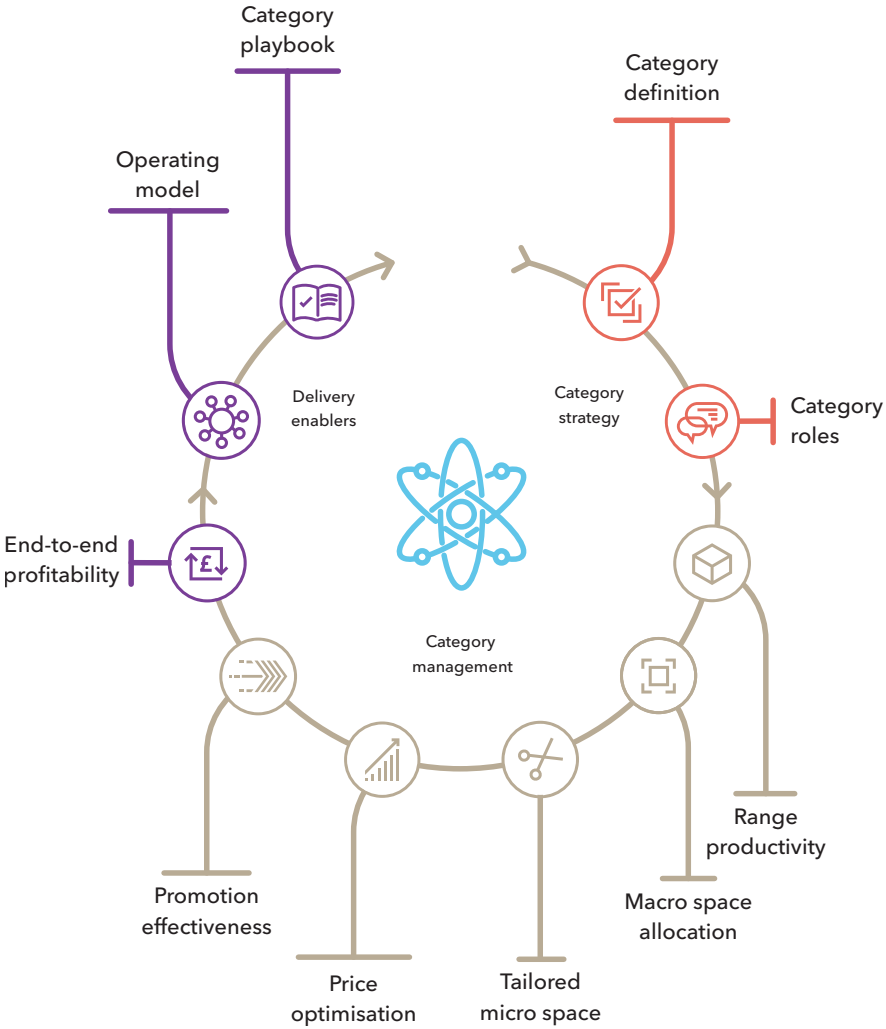
While the focus of our work with individual retailers varies, the key steps are:

1. **Category strategy** - prioritising *between* categories, defining the right way to think about your categories, their roles and their potential
2. **Category management** - recommendations *within* a category; identifying the opportunities to improve category profitability
3. **Delivery enablers** - supporting activity to make category management improvements more powerful and sustainable

Using a mix of proprietary tools and bespoke, human-led analyses, we work collaboratively and transparently with our clients. We work with massive amounts of data and balance our technical prowess with commercial sensibility to translate insights into pragmatic recommendations.

We also help our clients to build in-house analytics capability to continuously improve the data and insights that are used to make category decisions.

OUR APPROACH



Size of the prize

Category management goes to the heart of a retail business; making changes can be challenging, but the benefits are often sizeable.

MARGIN IMPROVEMENT POTENTIAL FROM DATA-DRIVEN CATEGORY MANAGEMENT



Category definition

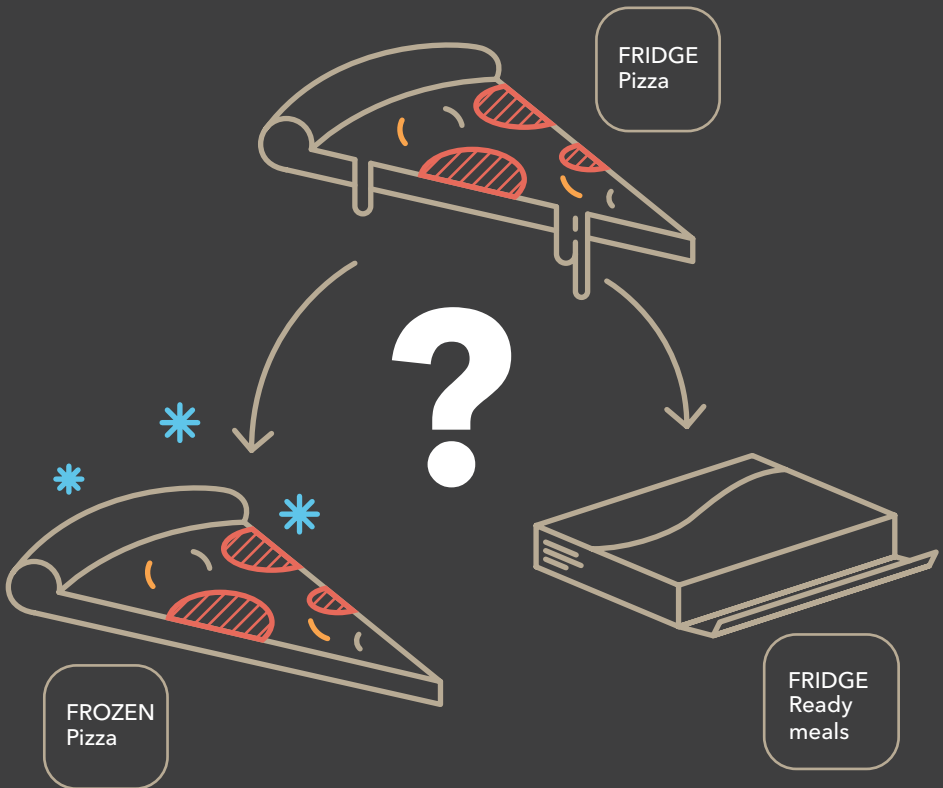
There are many ways to categorise products, such as by customer mission or product characteristics. In reality, many retailers' categories are driven by historical anomalies, such as the supplier relationships or seniority of the buyer.

These kind of inconsistencies result in the same product being bought by multiple buyers at different prices, or orphan products that are not complementary to other products in their categories.

We use web and basket analytics to understand how customers purchase products and overall baskets so we can challenge the category hierarchy and realign the category team around the customer offer.

What is a category?

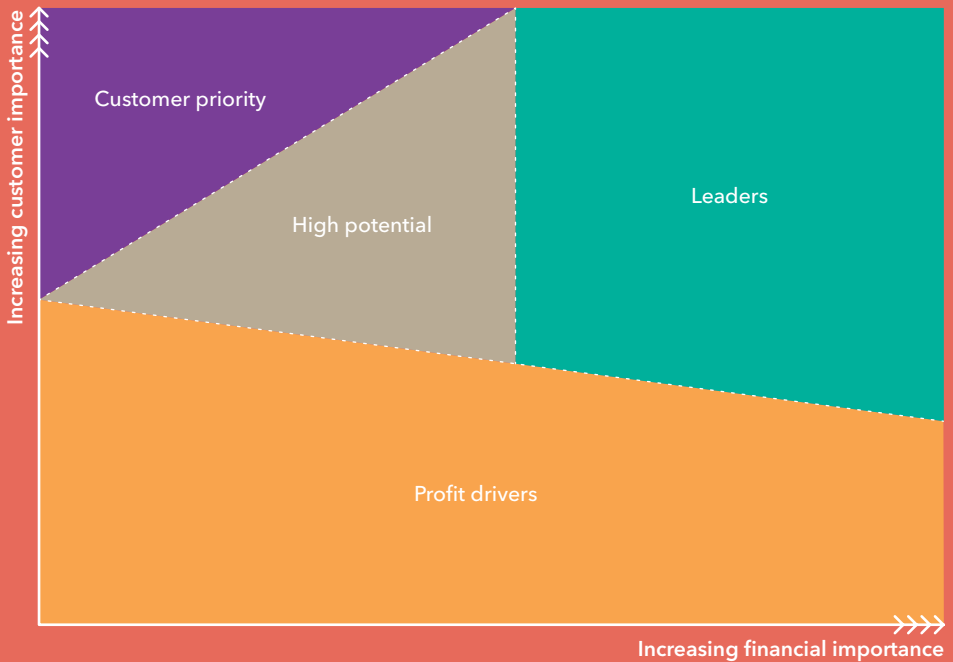
This sounds like a simple question, but it can be deceptively tricky to answer. To take an example, which category should refrigerated pizzas be part of? Is it most like a frozen pizza or a refrigerated ready meal?



Category roles

A category strategy can only work when everyone understands the role each category plays in the shopper experience and for the business as a whole.

ILLUSTRATIVE CATEGORY ROLE FRAMEWORK



The traditional approach is to assign high level category roles and set rules for categories in those roles. While this is useful for making strategic investment decisions, it is a relatively blunt tool to guide product level decisions.

Our approach is to:

Build a category framework using customer, market and financial metrics that reflect and recognise how you are differentiated and help you to prioritise.

Create differentiated guidelines for each (sub-)category using advanced analytics. This helps category teams fulfil their part in delivering the strategy for your customers.

Quantify the size of prize through product and store level analyses.

By being clear on your focus areas, your categories are more able to fulfil your strategy, present a strong customer proposition and deliver a balance across growth and efficiency.

Range productivity

Categories always want to add in new products because they appear to generate additional sales. We can help you to tell the difference between products that are *building* your category and products that are *cannibalising* more profitable alternatives.

A common approach cuts low volume SKUs resulting in a generic, undifferentiated range of basics. By understanding how products cross-substitute, we give you confidence to remove high-volume, low profit products and improve your overall category profitability.

This approach relies on a data-driven understanding of:

1. The incremental benefits of each product
2. The customer decision hierarchy

Incremental benefits

Adding a product is rarely done successfully in isolation - disaggregating sales arising from cannibalisation vs. true incremental growth is critical.

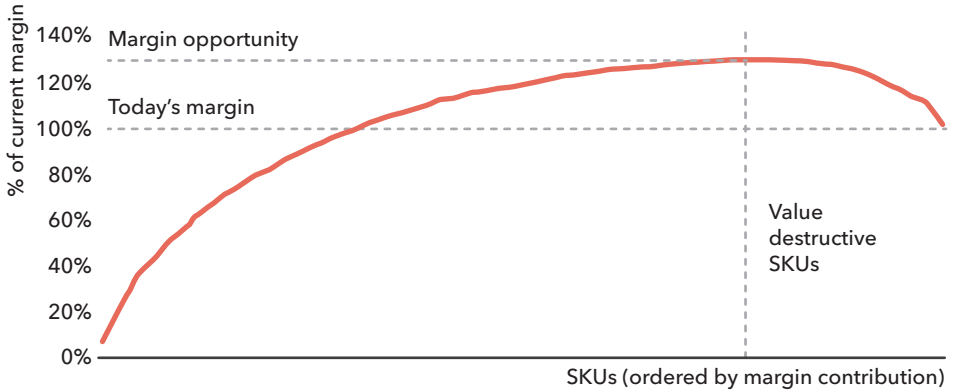
We use a variety of statistical techniques to calculate the category cannibalisation. This allows us to calculate the true incremental contribution of a product and delist those that are value destructive - products that cannibalise higher margin alternatives.

Decision hierarchy

We use basket analysis to understand how customers substitute products to identify what matters to them most. For example, do they always go to the same brand but don't mind having a different packet size - or the other way around?

We use these approaches to articulate a strategic business case and to make specific recommendations to category teams. We know that you can never capture all of the data points that will matter in a ranging decision, such as supplier relationships or logistical implications, so we recommend using a balanced scorecard to arm your category teams with a holistic view of their products.

CUMULATIVE INCREMENTAL MARGIN



Typically we see that 10-20% of products are value neutral or destructive, i.e. are rationalisation opportunities

Macro space allocation

The amount of space a category is allocated is hugely influential on sales, but often that space could be used more productively by another category. To understand the potential prize, we calculate the rate of diminishing returns from adding new space and optimise across many category combinations.

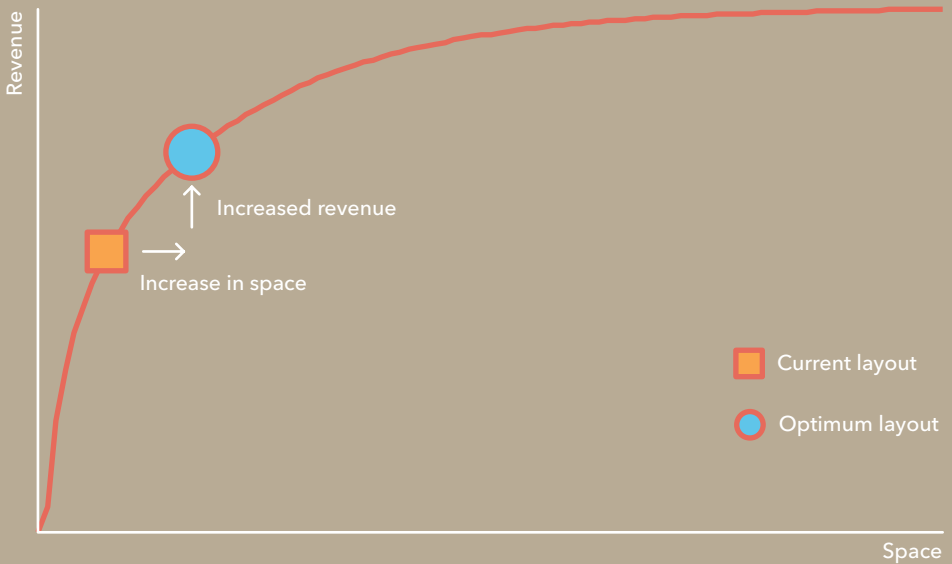
Furthermore, many retailers rarely redesign and lay out their stores from first principles and so inefficiencies grow over time and are never checked.

To answer these questions we use store and category level sales data, and combine it with future growth expectations to calculate the expandability of a category and the rate of diminishing returns.

We rebalance the category-space allocation to more productive uses of space. We apply commercial overlays and sense checks to avoid allocating unfeasibly large space to categories which are very productive in a small space (e.g. batteries) or to prevent minor moves that would cost more to implement than the benefit they unlock.

The result is optimised store layouts and a compelling financial case for updating your macro space layout.

DIMINISHING RETURNS FROM ADDING SPACE



Typically, half your categories have too much space and half have too little. The re-balancing opportunity can be hugely additive to profit. Have you placed your bets?

Tailored micro space

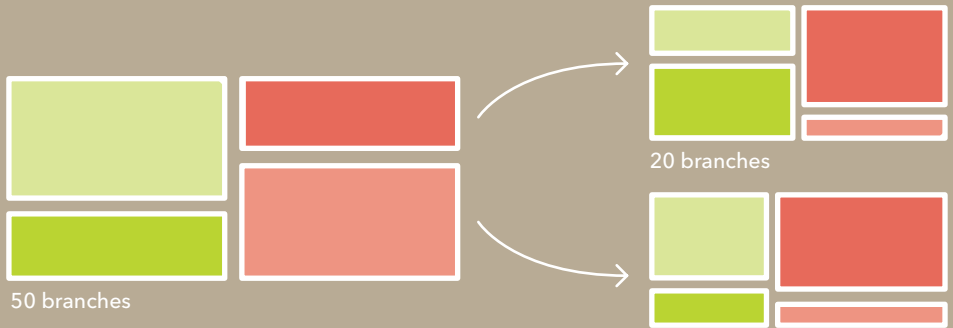
In allocating micro space, retailers need to strike a balance between the high operational cost of creating individual plans for every store and a one-size-fits-all plan that isn't right for customers.

To do this we:

1. Identify the categories where a differentiated approach has a significant effect on sales
2. Understand the drivers of sub-category performance for each store (e.g. store demographics, missions, store sales density)
3. Cluster stores with a similar profile of sub-category space productivity
4. Identify opportunities to change space plans (e.g. changing sub-category space allocation, range premiumisation and pack size mix)

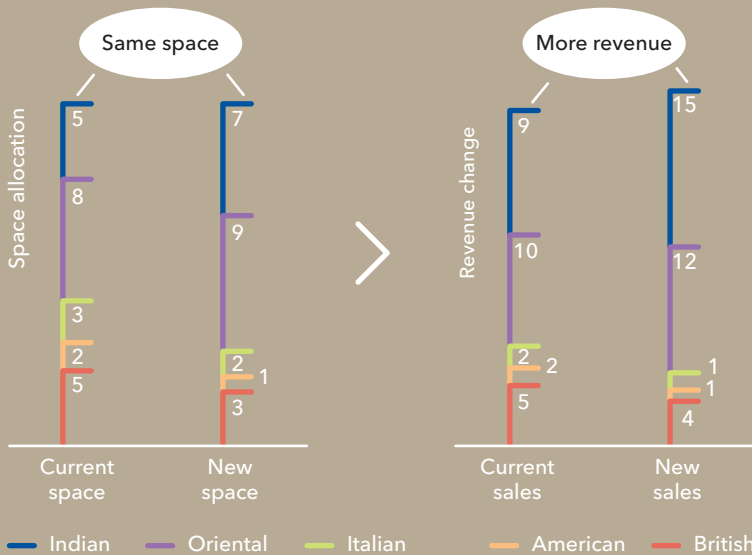
We evaluate the financial value of each change, so that we can ensure we are not recommending changes that would cost more to implement than they would reap in benefits. The result is a new set of branch-specific layouts, alongside a compelling financial business case.

CREATING NEW BRANCH LAYOUTS USING STORE CLUSTERING



Changing a store layout that covers 50 branches to two more appropriate layouts covering 30 and 20 branches

RE-ALLOCATING SPACE TO MORE PRODUCTIVE SUB-CATEGORIES



Price optimisation



Price is a highly effective lever on performance that goes directly to the bottom line - but price is so tied to customer experience and brand identity that changing price can be a high risk approach.

We give you the confidence to take these decisions by combining analyses of:

Price elasticity

We use econometric analysis to cut through the traditionally challenging task of isolating the impact of price changes on volumes and revenue; and combine a broad range of internal and external data sources to decompose the multitude of factors which impact a product's sales.

Stretch / optimise price ladder

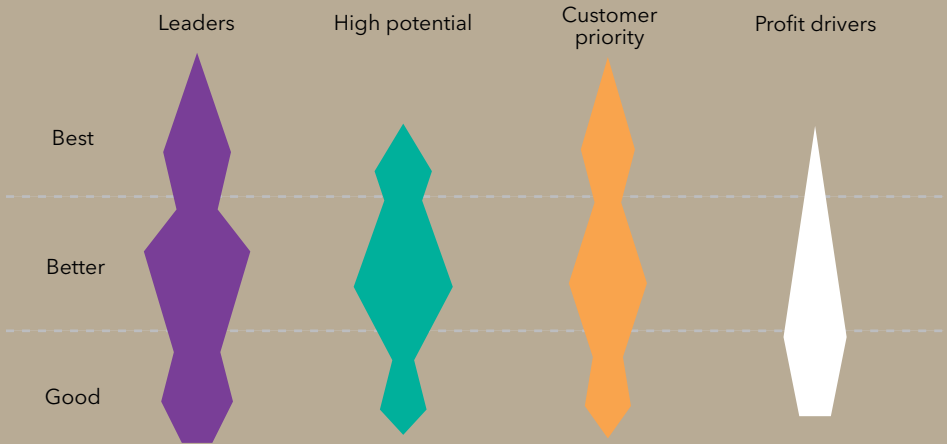
We use commercial logic, combined with cognitive pricing principles, to create price ladders which make it easier for customers to shop.

Price indexing and mix

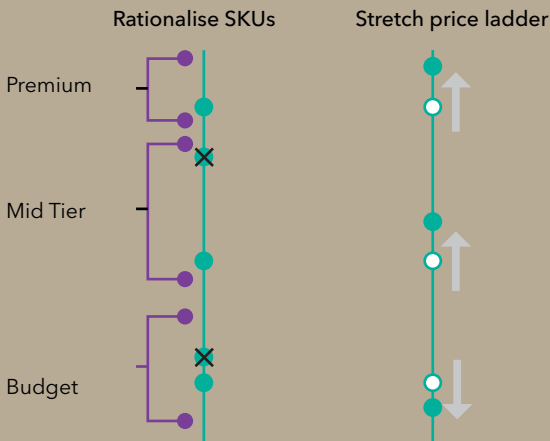
We establish the price index for each category by combining competitor benchmarking with product price elasticities. To complement this we then allocate a desired range shape to your tiers.

Together this allows us to recommend simpler, clearer ranges for your customers that are more productive and efficient.

EXAMPLE PRICE TIER DISTRIBUTIONS



PRICE LADDER



Promotional effectiveness



Investment in promotion is often wasted. Up to 30% of promotions do not generate positive profitability after including wider promotional effects.

Many retailers continue to measure product sales uplift as the only measure of promotion analysis. Instead, true promotional analyses must look beyond the direct product impact to the entire category as a measure of effectiveness.

To properly evaluate a promotion you also need to consider several other promotional effects:

- **Cannibalisation:** decreased sales of other products in the category during the promotion as customers make substitutions
- **Pull forward:** reduced sales after the promotion as a result of stocking up
- **Halo:** increase in sales of complementary non-promoted SKUs (e.g. biscuits with cheese)
- **Carryover:** increased sales sold immediately after promotion due to publicity

As with range optimisation, it is important to isolate these effects within groups of products that are substitutable.

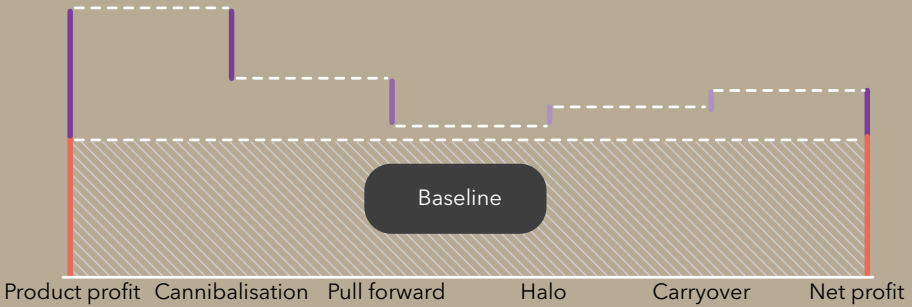
We can help you make better promotional decisions by adding all of these effects together to get a measure of true promotion value. With advanced statistical modelling we can isolate the various effects, create optimal promotion constructs and category playbooks for your portfolio.

This allows you to have more informed conversations with your supplier base to make your promotions work for you.

TRUE PROMOTIONAL UPLIFT

Simple product uplift 90%

True promo uplift 30%



IDENTIFYING OPTIMAL DISCOUNT LEVELS

Promotion margin impact

0 - 20%

20-30%

30 - 50%

50% +

Discount level

Higher discounts lead to higher volume uplifts for the promotion, but that volume is probably cannibalising full price sales. The key to promotion effectiveness is understanding the sweet spot of promotion depth that maximises category margin uplift - not product volume uplift

End-to-end profitability



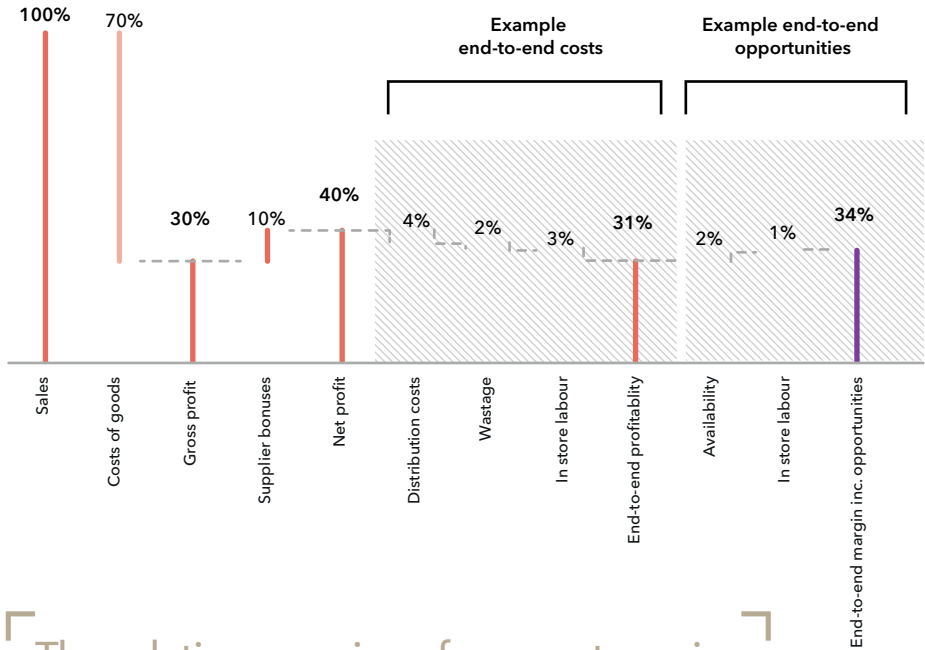
Many categories have a distorted view of true profitability because commercial KPIs do not recognise the full costs of the product's journey to a customer.

For example, it is not uncommon for retailers to emphasise an excellent buying margin without factoring in the costs of non-standard labelling or packaging, or high replenishment frequency.

We aggregate data from many sources, including labour cost, wastage, markdowns, distribution cost, head office and others and allocate them to categories to get their full end-to-end profitability.

We use end-to-end profitability throughout our other analyses to reach a truer understanding of the impact of decisions. This is a powerful component of understanding category roles, and helps set better hurdle rates for commercial actions (e.g., promotions or product listings).

ELEMENTS OF END-TO-END PROFITABILITY



「 The relative margins of your categories may actually be very different to what you think they are. Have you allowed for labour, wastage, etc.? 」

Operating model

To deliver the benefits from optimising category performance, you need to align your organisation around the strategy.

Buying, merchandising and product development are the trio of key players for every category. These voices are often unbalanced in strategic debates, and the dominance of one detracts from the ability to maximise the strength of the category proposition, and ultimately its profitability.

We support retailers to build a more robust operating model by:

1. Assessing different operating models which fit with your needs and culture
2. Streamlining your processes and governance around critical path(s) to enable you to bring products to market efficiently and at speed
3. Empowering contributions from key voices at the right time
4. Evaluating the relevant KPIs, data points and capabilities to deliver on the category strategy and broader corporate strategy
5. Build your Analytics capability to support category strategy analyses, eg: Pricing, Promo, Marketing Effectiveness and others

The result is a refreshed, customer-centric organisation structure with a clear mandate to deliver the strongest customer proposition while maintaining your organisation's distinctive character.





Category playbook

Each category will have different levers that are important to them, whether this be sales mix between branded and own label, marketing and visual merchandising allocation, or level of product innovation or quality.

In each case we work with you to decide which are the relevant factors for customers shopping in each category and prioritise where categories focus.

We then understand the performance drivers behind each lever and make clear the practical options to improve them.

For example these could include:

- Cost savings and price increases from re-tiering products,
- Competitor quality benchmarks, or
- Driving sales from improved product innovation.

Building an analytics capability

Sometimes we catch a fish for you. Other times, we support our clients to build their fishing capabilities.

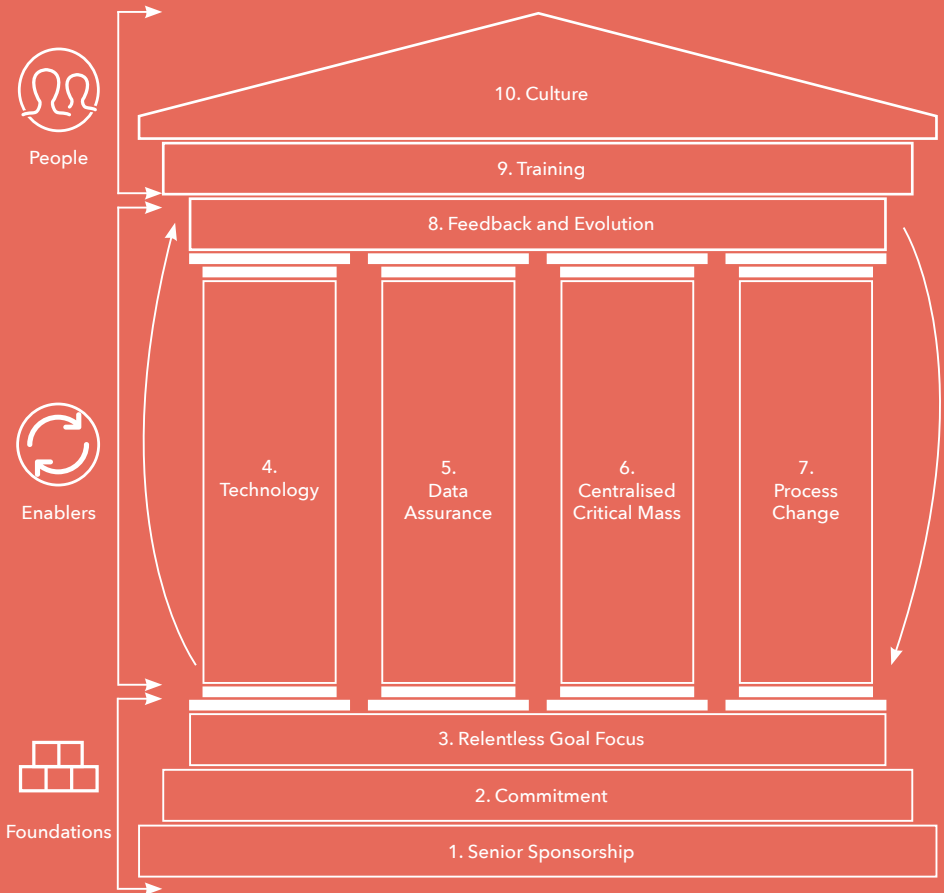
Our research and experience indicates that there are ten imperatives for successfully building an analytics capability that adds value to your business. The biggest challenge is in establishing the right governance processes and initiating the cultural change needed to support the new capabilities introduced into the organisation.

By working closely with your senior leadership, OC&C helps you build a successful analytics capability by:

- Assessing your organisation's current level of analytical maturity
- Identifying use-cases and developing proofs of concept
- Defining team structure and ways of working
- Defining the roadmap, enablers and success criteria
- Creating the vision to articulate and deploy it across the organisation

A successful analytics capability requires putting in place a long-term approach to a number of delivery imperatives

10 IMPERATIVES FOR BUILDING A SUCCESSFUL ANALYTICS CAPABILITY



Conclusion

Our analytics-driven approach to category strategy has generated game-changing margin improvement of between 2 - 6% for a variety of clients, including leading supermarkets, department stores, convenience stores and gas stations.



CEOs and commercial leadership should challenge whether category management processes are delivering a proposition that is aligned with business strategy, and whether you have the insights they need to deliver on your goals.

Some key questions to consider:

- Do my categories reflect how my customer shops?
- Do my category teams know which missions and segments they should be targeting to deliver my business strategy?
- Have I considered how cannibalisation affects range and promotion design?
- How do returns diminish when I increase space?
- Is my store range tailored for different store demographics?
- What is the end-to-end profitability of each category?
- Is my decision making process effectively supported by both internal and external insights?

By tackling these questions there is a huge opportunity for better category performance – a clearer customer proposition, more aligned teams, higher profitability and lower costs.

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