Working Paper on Category Management

Introduction and Summary

1. This paper evaluates the practice of category management undertaken by various retailers and suppliers in three sectors of the grocery market. A working definition of category management is developed and earlier work by the CC on this topic is noted.

2. Category management is any exchange of information between a retailer and supplier with the overall objective of improving sales or performance across a category of products sold by the retailer. The practice of category management is common within the grocery industry.

3. An earlier working paper[1] identified three possible anticompetitive outcomes from the practice of category management. These can be summarised as follows: better market information or trading advantages being available to a particular supplier; collusion opportunities for retailers; and collusion opportunities for suppliers.

4. This paper provides a cross-section of industry practice in two grocery sectors and one case study of the practice of a large conglomerate company. The Fruit industry is a good example of a sector dominated by intermediaries, the Yogurt sector is dominated by large conglomerates and the Frozen Food study focuses on the practice of a single company when managing its retailer relationships. Consequently, this paper is not an exhaustive review of category management within the UK grocery sector.

5. In the case studies considered, category management does seem to facilitate regular meetings and interactions between suppliers that would not otherwise occur.

[1] Supply chain practices working paper, January 2007, paragraphs 35-47.

However, no particular anti-competitive effects were observed as resulting from such conduct, in the material that we were able to review.

6. In theory, there is potential for a supplier to manipulate its position at the expense of other suppliers, and ultimately consumers, if it were given control of the retail sale of its own (and other suppliers') goods. In practice, retailers validate and cross-check sales recommendations made by their suppliers because it is in their best interests to do so. All of the retailers that were evaluated have sufficient resources to measure category performance over time, and against other retailers, and could therefore, we consider, quickly identify when recommendations for a category are not optimal.

Background

7. The 2000 CC investigation of supermarkets,[2] which led to the Supermarkets Code of Practice, inquired into concerns that category management was leading to increased cooperation between suppliers, distributors and retailers, and thereby acting as a barrier to others wishing to enter the market. No adverse findings were made in relation to category management. However, the CC did make two recommendations. Firstly, where category management is practised by a retailer, that retailer should not discriminate between suppliers when providing access to information. Secondly, responsibility for the allocation of shelf space should remain with the retailer and not the category manager. The Supermarkets Code of Practice, created as a result of the 2000 Investigation, does not include any provisions in relation to category management.

[2] CC, *Supermarkets: a report on the supply of groceries from multiple stores in the United Kingdom*, TSO, Cm 4842, October 2000.

8. In Emerging Thinking[3], the CC considered whether a number of practices arising from the relationship between grocery retailers and their suppliers might have an adverse effect on competition. The accompanying working paper on supply chain practices (January 2007) considered this issue further.

9. Category management was also raised in the results of a survey of suppliers conducted by GfK for the CC, and published in January 2007 (the GfK report)[4]. In that survey, 32 per cent of the sampled suppliers said that they undertook some form of category management role.[5] A separate questionnaire was sent to a selected group of branded goods suppliers, and most respondents said that they were involved in some form of collaboration on marketing and/or category management with at least one major retailer.

10. Most grocery retailers have also told us that they collaborate to some extent with suppliers on marketing and merchandising activities. Some suppliers assist retailers in determining appropriate range and space allocation and promotional mechanics for categories of products, and many retailers share information on category performance with their suppliers. Within the case studies, these arrangements do not seem to be more frequent or relevant for particular product categories; rather, they can apply to any product category.

11. Although suppliers might provide market and trend information and give strategic and marketing advice for the development of a category, retailers told us that they did not delegate stocking responsibilities to suppliers. The final decisions on range, marketing and merchandising rest with the retailer.

[3] At paragraph 100.
[4] The GfK report is available on our website at www.competition-commission.org.uk/inquiries/ref2006/grocery/index.htm.
[5] GfK Report, Chart 41.

Category Management Defined

12. Previously the CC has described category management as broadly entailing "a leading supplier being responsible for analysing data on consumer preferences; identifying the best means of meeting these; determining the most effective ways in which suppliers provide the relevant products, in terms of range and allocation of space; and advising the multiple accordingly."[6]

13. There are different ways for retailers to manage the allocation of shelf space to products. One approach is to break down the management of a retail operation into categories of like products. Decisions about product selection, placement, promotion and pricing are made on a category-by-category basis to maximise the profit of the category as a whole. By assessing consumer demand at the category level, store shelves can be stocked to reflect that demand. Before the use of category management, supermarket chains divided management duties by task (eg shelf allocation, promotions, replenishment) or by brand.

14. For the purposes of this market investigation, we have regarded category management as any exchange of information between a retailer and supplier with the overall objective of improving sales or performance across a category of products sold by the retailer. The exchange might relate to sales volumes and trends, consumer demographics, profiles and preferences. The retailer may take advice on the range of products displayed, placement and size of the product displays, pricing, promotion, supply chain improvements, stock management, or customer experience improvements.

[6] Supermarkets: a report on the supply of groceries from multiple stores in the United Kingdom, TSO, Cm 4842, October 2000 at paragraph 2.307.

15. As noted in the earlier working paper on supply chain practices, the superior knowledge of suppliers regarding consumer demand may mean that category management introduces efficiencies. For example, a supplier is likely to be in a better informed position, from its intensive consumer research, to provide advice on which products in a category are likely to appeal to particular types of consumers. This technique of managing categories may directly benefit consumers, and result in increased total sales for the category from the retailer's perspective.

Category Management contrasted with Category Captaincy

16. Category captaincy is a particular form of category management in which a supplier (usually a large supplier) is designated by the retailer to have full responsibility for the way in which products within a category are presented and sold to consumers. The exact function performed by category captains can vary widely across firms and product categories. At one end of the spectrum, some retailers do not use category captains at all, even though they do undertake category management processes. Other retailers rely on a single supplier for advice about the management of the category and check this advice against the recommendations of other suppliers and their own data. At the other end of the spectrum, some retailers might delegate all category management responsibilities to the captain for one or more categories.[7]

17. The terms "category management" and "category captain" are sometimes used interchangeably, but it is important to note the distinction between the terms when discussing common market practice. Certain competitive concerns have been raised over category management from time to time, particularly in the US, where it appears to be more common for retailers to delegate significant responsibility for the management of a category to an individual supplier. In contrast, it appears that the

[7] Report on the Federal Trade Commission Workshop on Slotting Allowances and Other Marketing Practices in the Grocery Industry, A Report by Federal Trade Commission Staff, February 2001, http://www.ftc.gov/os/2001/02/index.shtm at p48.

majority of the retailers in the UK receive a variety of information from a number of suppliers and make decisions based on their own evaluation of that information.

18. Notwithstanding the form of category management employed by retailers, competition issues might be raised by the frequent exchange of detailed, and recent sales and performance information on categories of product between a retailer and suppliers.

Case studies

19. We undertook a selective analysis of three grocery sectors, from three different perspectives, to obtain a better understanding of how the process of category management is undertaken in the UK market. The fruit sector was evaluated with information from both wholesalers and retailers, the frozen food category was considered from the perspective of a single large supplier, and the yogurt sector was analysed with information from a collection of six suppliers. The range of categories and perspectives has helped the CC to identify some common themes prevalent in category management and to evaluate the likelihood of systemic competition issues with this particular business strategy.

Review of the issues raised in the supply chain practices working paper

20. Three possible ways in which category management might adversely affect competition were identified in the earlier working paper:

    i. where a supplier receives better or more detailed information from a retailer, as a result of any category management role, it may obtain an advantage over other suppliers. In addition, a supplier might use its category management role to increase its own market power or to exclude other suppliers (particularly in the case of category captains);

ii. the process of category management may provide the opportunity for collusion among retailers; and

iii. the process of category management may provide the opportunity for collusion among suppliers.

21. It was noted in the earlier working paper that some of the possible adverse effects that might arise from the process of category management could be mitigated. For example, the introduction of effective 'Chinese walls' between a supplier's category management staff and its planning and negotiations departments would, in principle, deal with the danger that access to competitors' strategic information might be used to gain an unfair advantage.[8] Equally, retailers are unlikely to organise their category management in such a way that it allows suppliers to collude and increase the price charged to the retailer. In a similar way, retailers are likely to act to prevent suppliers providing biased advice by validating the information they receive with that from other suppliers.

(i) **Information asymmetry and preferential treatment of suppliers**

22. The earlier paper suggested that there are two ways in which a supplier may benefit from being the category manager of a retailer. First, as part of its role in category management, the supplier might receive strategic information on its rivals' plans from the retailer. Secondly, recommendations made by a category manager might be biased to its own benefit.

23. Strategic information that would be useful to a supplier includes information on its competitors' pricing and sales, new product launches, promotions, re-branding and other strategic initiatives. This could provide the supplier with the opportunity to

[8] FTC 2001, p51, proposes managerial firewalls as a potential solution to this problem. In response to our questionnaire, a retailer stated that it expected category advisers to operate such Chinese walls.

devise a pre-emptive response and could, in turn, reduce the incentives for other firms to compete with the supplier. It seems likely that a category captain (with sole responsibility for a category) might have access to such strategic information. However, there were no examples, in the sectors reviewed by the CC for the case studies, of any individual suppliers receiving greater amounts or better information than its competitors because of a better or closer relationship with a retailer. The only minor distinction is that Asda provides its “category advisors” with volume data on the other suppliers in that category from its Retail Link database.[9] The volume of information that is passed between retailers and suppliers is large, although it generally seems to be provided on a non-exclusive basis.

24. Secondly, it was suggested in the earlier paper that a category manager might provide category advice to a retailer which is biased towards that supplier’s products (for example, advice on where to place products within planograms[10] and on the timing and form of promotions). A supplier that is a category manager might have the opportunity to induce a retailer to allocate detrimental shelf locations or a reduced size of placement to its rivals. The supplier may also have the opportunity to advise the retailer to conduct promotions in a way that does not benefit the supplier’s competitors, or attempts to exclude some competitors altogether.

25. There was no evidence in any of the case studies that a supplier held a position that could be described as “category captaincy” (ie the supplier’s advice was relied upon to the exclusion of advice from other suppliers). For example, in the fruit case study, the ‘lead’ intermediary was generally rotated depending on their ability to supply fresh produce. In the example of the yogurt industry, the suppliers were regularly

[9] [✂]
[10] Planograms are charts used by retailers to organize and implement the way in which products in a category are presented on the shelves.

reminded of their relative performance against other suppliers and retailer market share.

26. In the case studies, there was no indication of new suppliers being excluded from a category. However, it should be acknowledged that there is no objective measurement process that could show exclusion of new suppliers that have not yet listed a product. We note that we have not received any evidence to suggest that new suppliers have been excluded from supplying a retailer on the basis of category management advice. At a product level, there was evidence to suggest that supplier recommendations balanced product inclusion, and exclusion, on the basis of performance rather than brand. In all the examples, retailers received recommendations from a variety of suppliers (whether the supplier was a category manager or not) and in no instance did a supplier appear to be in a position to dictate management of a category. In addition, the retailers regularly evaluated the performance of suppliers and their own relative performance against other retailers over time. That regular analysis by retailers acts as a cross-check on supplier management advice for a category. Given that retailers validate and cross-check the information that they receive from their suppliers, it is difficult to devise a scenario (in the absence of collusion – discussed below) whereby a supplier might be in a position to provide biased or self-promoting recommendations that could not quickly be identified as such by the retailer.

27. In the Frozen Food and Yogurt case studies, there was evidence that resale pricing recommendations are made by suppliers in the course of category management. There was no evidence from the case studies to indicate how those recommendations were treated by retailers. Resale price maintenance is a separate issue which is not considered in this paper.

28. It is clear that category management is a common business strategy in the UK grocery market. However, it seems that the resources and information available to the majority of retailers are sufficient for them to identify their relative performance in any particular category against their competitors. The amount of detailed information available provides an effective balance against the power suppliers might wield in a more fragmented market with relatively smaller retailers. Should a particular supplier provide biased information or make recommendations for its own benefit, it appears that UK grocery retailers generally have sufficient information and choice of supply to identify and counteract this advice.

(ii) **Retailer Collusion**

29. Where a supplier provides category information to a number of retailers, that information may facilitate collusion between those retailers. For example, where a supplier provides the same category management advice or information to a number of competing retailers, this may have the effect of dampening competition between them. Alternatively, if the category management function facilitated the indirect exchange of information between competing retailers, this might facilitate collusion.

30. However, the case studies did not provide evidence that category management activities were being used to facilitate, or had the effect of facilitating, collusion between grocery retailers.

(iii) **Supplier Collusion**

31. Finally, our earlier working paper suggested that the process of category management may adversely affect competition by leading to collusion between suppliers. This could happen through increased opportunities to exchange information between suppliers, whether directly or indirectly via retailers.

Alternatively, if retailers consult with a number of suppliers together, those suppliers may be able to coordinate marketing strategies.

32. Category management processes do seem to lead to certain levels of supplier interaction and this might be of concern in the following instances. Firstly, a group of suppliers might collude where retailers do not have the resources to cross-reference supplier advice or measure a supplier's relative performance. Secondly, a supplier as category captain, or together with a group of other suppliers, might exclude or marginalise a new supplier through biased recommendations to retailers.

33. All of the case studies showed varying levels of supplier interaction as a result of category management relationships. In all the sectors that we considered, the retailers at least approved the coordination of supplier interactions and advice and, in certain instances, actually encouraged and assisted supplier meetings. The most explicit examples were evident in the yogurt category. We reviewed emails, provided by a supplier, where [✂] had organised a meeting for all its dairy food advisors, and urged some suppliers to conduct a monthly discussion on category recommendations. The emails that we reviewed also showed that similar meetings are encouraged by [✂] in that sector. There were no instances of the frozen food manufacturer that we studied being involved in meetings with other suppliers, although there was one example of a joint presentation to a retailer.[11] The fruit category displayed a high level of coordinated activities between suppliers, although it seems likely that these activities are a function of the intermediaries endeavouring to secure consistent levels of supply.

[11] It is believed that this 'joint' presentation was a result of Tesco purchasing the One-Stop chain and was therefore an exception to the usual business practice of [✂]. The presentation content was no different to other presentations made by [✂].

34. In the fruit category, BIFGA expressed concerns about the level of supplier interaction and stated that it affected the profit of independent growers. However, after evaluating examples of the category management relationships in that sector, it appears that the intermediaries provide an important security of supply service to the retailers. A degree of interaction between intermediaries seems justified in order to ensure that a retailer is not relying on alternative supply options that duplicate the same ultimate grower. It would appear that a degree of consolidation is occurring in the fruit supply industry, as most retailers wish to use intermediaries that are able to provide a majority of fruit supply for large portions of a year. This working paper does not consider the benefits or otherwise of greater consolidation amongst marketing intermediaries in the fruit supply sector. It is noted that no other submissions were received from suppliers considering themselves to be marginalised by category management processes.

35. The degree of interaction amongst suppliers is a cause for concern. Given the level of interaction amongst suppliers, and the large amount of information that is passed between retailers and suppliers, an opportunity for harm exists. However, on the evidence evaluated, it seems that retailers have the ability and incentive to prevent the potential for an anti-competitive effect to arise from the category management process.

[✂]