

AN AVAIL INTELLIGENCE WHITEPAPER

Behavioral Category Management

A next-generation retail strategy





Introduction



In late 2008, as the financial crisis was hitting consumers' spending, online retailers started launching pre-Christmas sales and price promotions to bolster sales on the backdrop of the weak economy.

The measures may have bolstered volumes short-term, but across-the-board discounts would have been devastating to long-term profitability. Online retail needed a better way to grow traffic without sacrificing margins.

To help retailers better counter the harsh situation, Avail Intelligence invented the strategic concept of ***behavioral category management***, based on so-called “category management” strategies of the best-in-class international grocery chains.

Behavioral category management is applicable in virtually every retail sector and under many different circumstances – from coping with a lack of demand to countering and outperforming competitors. Online retailers who excel at Behavioral Category Management can beat competition when it comes to customer acquisition, without sacrificing profit.

This white paper explains:

- What Behavioral Category Management is
- How to use it to maximize traffic acquisition without impacting margins
- What you need to implement it



Traditional Category Management

The origins of category management

Category management began in the 1990s with the insight that each product category in a retail store should be treated as its own “business unit”. It should have a clear strategy and goals, and be managed accordingly in purchasing, advertising and merchandising.

The next step in the evolution of category management was leveraging the interplay between product categories – how some products have low margins but drive traffic, while others have high margins. Best-in-class retailers realized the strategic importance of category management, and developed advanced frameworks to systematically optimize across categories to drive overall customer acquisition, conversion rates and average order values.

Traffic drivers, profit drivers and loyalty builders

A simple but effective framework for category management defines 3 roles for product categories:

- 1. Traffic drivers:** High-interest products that a majority of a store's target audience know they really need and which they perceive as generally expensive, taking up a large share of their budgets.
- 2. Profit drivers:** Low-interest products, that are still important to the target audience, while being perceived as relatively insignificant purchases compared to traffic drivers.
- 3. Loyalty builders:** Feel-good or luxury products that give consumers a feeling of well-being.

After establishing which products fulfill each of these roles to the target customer segment, the retailer should then focus promotions and discounting on the traffic drivers to maximize customer acquisition, at the expense of a lower margin on these products. In exchange, they should then be able to maintain prices of the loyalty builders and even charge a premium for the profit drivers, recovering some or all of the discounts given on traffic drivers.

An example of category management

To understand how this framework could be applied in practice, consider a retailer targeting young families. Typical traffic drivers for families could be nappies, profit drivers could be shampoo or toothpaste, and loyalty builders could be freshly baked bread or other delicatessen. By promoting a competitive discount on the nappies, the retailer can attract more young family shoppers to the store. Once they are there, the retailer will make sure to display shampoo and toothpaste close to, or along the paths towards, the nappies. And on the way out, shoppers will be exposed to the aroma of freshly baked bread, creating a positive experience and thus urging the customer to revisit that particular store again in the future.



Behavioral Category Management

Applying category management online

Category management strategies work for online retail too – in fact, they can be even more effective.

Just as traditional category management, behavioral category management works by

1. Identifying the roles of various product categories in the assortment
2. Promoting the traffic drivers via various online advertising channels
3. Up-selling and cross-selling the inbound store traffic

For example, an online fashion retailer might find that in the autumn, children's winter jackets are in high demand as families consider them a significant expense. With this in mind, the retailer would put heavy price promotions on winter jackets and advertise them – giving them the role of traffic driver. Profit drivers in this instance could be items such as shoes, scarves, and gloves.

However, there is one key difference in online retail. For the traditional bricks-and-mortar store it is only possible to merchandise a selection of profit drivers at a time, since shelf space is limited. But in fact, there may be hundreds or even thousands of possible profit drivers, depending on the size and breadth of your catalogue. The best profit driver may even differ from shopper to shopper!

Online retailers have the unique opportunity to use **behavioral merchandising** technology to make sure each shopper is exposed to the profit drivers *most relevant to them* while they are shopping.

The benefits of behavioral merchandising

Behavioral merchandising means to observe and understand the behavior of each individual shopper as they click through the online store, compare it with similar data on all other shoppers, and draw conclusions to deliver relevant, personalized product recommendations. Relevant examples in category management include recommendations based on the current product (e.g. "*People who bought this product also bought:*") or cart contents ("*People who ordered these items also included:*"). By adding business rules based on gross profit ("*Only recommend items with a gross margin exceeding 50%*"), or price ("*Only recommend items priced at 10 dollars or less*"), the retailer can ensure that only profit drivers are shown as recommendations.

This way, the objective of traffic generation can be achieved by putting traffic drivers on sale, while the retailer boosts the sales of profit drivers to maximize profit contribution, more than compensating for the discounts on the traffic drivers. Simply put, by excelling at behavioral merchandising, online retailers will also excel at category management – allowing them to beat the competition when it comes to customer acquisition, without sacrificing profit.