

CHAPTER 2

LITERATURE REVIEW AND THEORETICAL BACKGROUND

2.1. Literature Review

According to Consoli *et al.* (2013), category management will help the retailer to convert each item into a category and managing them as a strategic business unit that focusing on delivering consumer value. Category management also will establish a positive relationship between retailer and manufacturer and/or supplier. This relationship will be in the form of market share. The existence of category management in retailer will result in the increase of sales and positive growth of market share.

Category management will influence the buying power of customer (Hong *et al.* 2016). Based on their research, the customer will tend to buy more items from various category. This statement also supported by Utami (2008). Category management will maximize sales and profit from category. However, each category will gain a different response from the customer. Category management also will help the retailer with merchandise management (Ham, 2007).

Many retails have unplanned purchases. Bell *et al.* (2011) found this as out-of-store drivers or constant buying. Constant buying in this research means purchases that are unplanned and continuously repeated.

OTB can be defined as the amount of money a retailer can afford in order to purchase the goods as long as it does not exceed the planned amount of stock (Ray, 2010). OTB similarly is a tool to keep both inventory investment and sales harmony so that financial objectives of retailers are achieved (Goodwin, 2018). On his research, a certain company in Australia is selected. The problem occurred in this company was related to maximizing profit. OTB was selected to solve the problem. Some recommendations in inventories, mark-down budget, and closing stock were made in order to maximize profit. However, OTB needs the sales forecast accuracy as the input. All the sales, purchases, and also reductions will be included in this OTB calculation.

Another research corresponds to OTB was conducted by Bandinelli *et al.* (2015). They grouped replenishment into two steps namely pre-season and in-season planning. Pre-season planning typically done in six months before

the selling season, in this case, it is merchandise budgeting. On the other hand, in-season planning will assure current sales with the projected pre-season performance. In-season planning will maintain whether the stocks could supply for the demand or not.

Bandinelli *et al.* (2015) gave the questionnaire to the seven related fashion retailing to find out how they handle the replenishment process of the new item in selling season, products in pre-season, and some products in pre-selling season. Findings from this research are retailers not yet applied the appropriate replenishment step-by-step. Most all of retailers only applied the replenishment step in pre-selling planning. Due to this misstep, problems occurred are both over and lacking products. This article already proves that OTB is critical in retailing.

2.2. Theoretical Background

2.2.1. Category Management

Category management is a merchandising process of grouping product into categories as strategic business units. It focuses on a product category rather than in each individual brand (Berman *et al.*, 2018). Each category will be managed as a business unit that has turnover, growth and profitability targets, this will ensure that both retailer and supplier achieve the enhanced business performance (Ray, 2010). Category defined will focus on delivering customer value as higher as possible regarding customer's buying behavior and providing wide choices of selection in the desired price range. In practice, according to Ray (2010), category management is a manageable group of products or services which customer implies as interrelated and or substitutable in meeting their needs.

In line with Ray (2010), there are five steps process in defining a category. Those steps are listed as follows:

1. Defining the category based on customer needs;
2. Finding options which meet with the customer needs;
3. Finding options perceived to be interrelated and substitutable;
4. Finding options from the retailer point of view as interrelated and manageable; and
5. Grouping selected options into each category.

There are four category roles which will enhance retailer performance. Those are destination category, preferred category, occasional category, and convenience category (Ray, 2010). Destination category is customer's most preferred choice and has superior value. This category will always be the number one customer's target and the customer will be fine if spending time traveling the store to meet this category. Basically, there will be 5% up to 7% of a retailer having a similar category like this. The preferred category has competitive value and about half of the retailers have a similar category. This category can be defined that the retailer wants to be the preferred needs provider for the customer and it will help the retailer with a reasonable profit. The occasional category contains seasonal products such as Christmas decoration and Lunar basket cake. This category provides competitive value and good profit. Typically, 15% to 20% of retailers manage this role. The last is the convenience category. This category can be called as a target for one-stop shopping because the customer feels no need to travel the store for this category. Products inside this category are socks in a shoe retailer or lingerie for the apparel retailer.

Based on the category management, a code can be made as a representation of it. The code will be the combination of each element in the category management. For example, there are four elements in the category management; category, sub-category, segment, and sub-segment. Each element will have its own code. The making process is subjectively or based on the category management maker. Category element can use numeric code for all of the existing category, if there are only 8 categories, the biggest number of codes in the category will be 8. For sub-category, if there are 10 sub-categories, the biggest number of codes will be 10. This is done also for other elements in the category management.

The code from the category management result is different with the origin code in the product. The code from the product is UPC or Universal Product Code. UPC will help the manufacturer in managing their inventory control. This code contains 12 digits of number. The first six number is manufacturer identification number, the next five number is item identification such as size and color, and the last number is for check digit. The UPC code will not link with the retailer category management, so some retailers make code in order for them to easily find the category management.

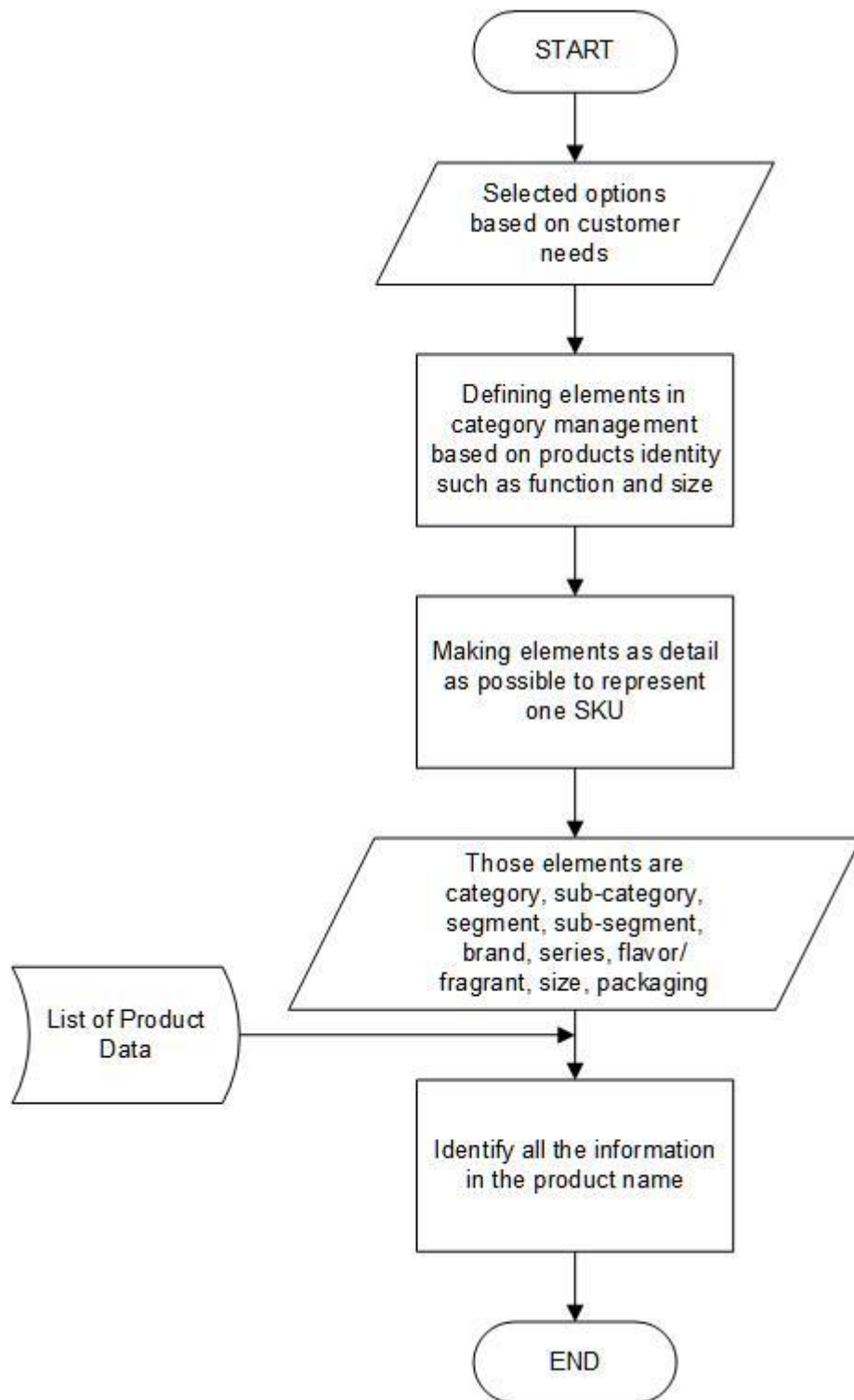


Figure 2.1. Flowchart of Defining Category Management

2.2.2. Open-to-Buy

Open-to-Buy (OTB) is a merchandise control system that will manage the stock availability at the retail store through the procurement of the goods. OTB also will match the planned sales and planned closing stock as close as possible so that it will not become overlap (Ray, 2010). In addition, according to Berman (2018), the difference resulted from planned purchased and the purchased which is already made between the buyer and supplier is called OTB. It is normally recorded in the currency unit or at cost.

Berman *et al.* (2018) added OTB has two main concepts that should be understood. The concepts are as follows:

1. OTB keeps inventory and planned sales in harmony thus no overbuying or underbuying occurred;
2. OTB gives permission to the retailers to adapt with the change in purchases so the changes in sales, markdowns, and so on can be considered.

In short, OTB can be mentioned as a tool that will define the number of goods to be purchased so that it will not exceed the planned amount of stock. There are seven inputs to the OTB according to Ray (2010), those are:

- a. Forecast sales, future sales estimation;
- b. Period cover, stocks retailer has to meet some number of periods;
- c. Opening stock, stocks at the beginning of the period;
- d. Intake requirement, amount get from the subtraction of opening stock and stock requirement;
- e. On order, an already ordered item and ready for delivery;
- f. Open to receive, amount get from the subtraction of order quantity and intake requirement;
- g. Closing stock.

There steps to define the amount of OTB are calculate the contribution percentage for each category, calculate the planned sales, planned reduction, planned the ending of month (EOM), and planned beginning of month (BOM) for each category, and the last is to calculate OTB for each item (Prasetyani, 2019).

In the end, OTB can be formulated as follows:

$$\text{Open to Buy} = \text{BOM} - \text{EOM} + \text{Projected Sales} \quad (2.1)$$

This OTB control gives an idea for a retailer to manage and plan their money for the purchased goods of each category.

