

**Regensburger  
DISKUSSIONSBEITRÄGE  
zur Wirtschaftswissenschaft**

University of Regensburg Working Papers in Business,  
Economics and Management Information Systems

**Linking Multi-Category Purchases to Latent Activities of  
Shoppers: Analysing Market Baskets by Topic Models**

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September 5, 2014

Nr. 482

*JEL Classification:* M32, L81, C35, C11

*Key Words:* multi-category buying behavior; market basket analysis; topic models

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# Linking Multi-Category Purchases to Latent Activities of Shoppers: Analysing Market Baskets by Topic Models

## **Abstract**

We investigate the application of two topic models, latent Dirichlet allocation (LDA) and the correlated topic model (CTM), to market basket analysis. Topic models measure the association between observed purchases and underlying latent activities of shoppers by conceiving each basket as random mixture of latent activities. We explain the structure of the two topic models used. We discuss estimation of LDA models by blocked Gibbs sampling. In addition we show how to evaluate the performance of topic models on estimation and holdout data. In the empirical study we analyse a total of 18,000 purchases made at a medium-sized supermarket which refer to 60 product categories. The LDA model performs better than the CTM in terms of log likelihood values. Latent activities inferred by this models are intuitive and interpretable, e.g., related to shopping of beverages or personal care, to baking or to an inclination towards luxury food. To illustrate the managerial relevance of estimated topic models we sketch the core of a recommender system which ranks purchase probabilities of other product categories conditional on the basket of a shopper.

Keywords: multi-category buying behavior; market basket analysis; topic models

## **Executive Summary - Deutsch**

Im Mittelpunkt dieses Beitrags steht der Zusammenhang zwischen beobachteten Käufen in mehreren Produktkategorien (Warenkörben) und den dahinter liegenden latenten Aktivitäten von Konsumenten. Aktivitäten wie Beschaffung oder Verwendung von Produkten stellen ein zentrales Element in Definitionen des Konsumentenverhaltens dar. Im Kontext des Lebensmitteleinzelhandels können latente Aktivitäten alternativ anzeigen, welche Produktkategorien wichtig sind, falls ein Käufer das Frühstück vorbereiten, einen Kuchen backen oder die wöchentliche Beschaffung von Getränken oder Pflegeprodukten erledigen möchte, usw.

Um latente Aktivitäten aus beobachteten Käufen abzuleiten, benutzen wir Topic Modelle, deren Anwendung im Text Mining weit verbreitet ist. Dazu benötigen wir nur Daten, über

die viele Unternehmen verfügen und zusätzliche Kosten für Primärforschung, etwa von Befragungen, können entfallen. Topic Modelle bilden latente Aktivitäten in solcher Weise, dass Produktkategorien mit höheren (bedingten) Wahrscheinlichkeiten für eine Aktivität häufig gemeinsam in Warenkörben auftreten. Alle Warenkörbe partizipieren an denselben Aktivitäten, aber die Aktivitätsanteile sind warenkorbspezifisch und werden zufällig aus einer geeigneten Wahrscheinlichkeitsverteilung gezogen.

Die Daten der empirischen Untersuchung umfassen 18 000 Warenkörbe von Einkäufen in einem Supermarkt mittlerer Größe. Diese Einkäufe beziehen sich auf insgesamt 60 Produktkategorien. 50 Prozent der Warenkörbe enthalten mindestens vier, 25 Prozent mindesten acht Produktkategorien.

Die Schätzung der Topic Modelle ergibt wohldefinierte und differierende latente Aktivitäten. Außerdem erweisen sich diese latente Aktivitäten als intuitiv nachvollziehbar und interpretierbar. Wir erhalten latente Aktivitäten, die in starken Beziehungen zu folgenden Kategorien stehen:

- Getränke, Zeitschriften und Zigaretten
- Milch und Teigwaren
- Backen (Backmittel, Fette und öle, Zucker, Mehl, Butter, Trockenobst)
- Brot und Milchprodukte
- Pflegeprodukte
- Zigaretten, Zeitschriften, Brot, Schaumwein
- Genußmittel (Süßigkeiten, Schokolade, Pralinen, Zigaretten)

Ausgehend von einem geschätzten Topic Modell zeigen wir, wie man Empfehlungen für einen Käufer in Abhängigkeit von den bereits im Warenkorb enthaltenen Kategorien ableiten kann. Diese Empfehlungen umfassen jene anderen Produktkategorien, die höhere (bedingte) Kaufwahrscheinlichkeiten aufweisen. Eine derartige Vorgangweise ist von offensichtlichem Interesse für Cross-Selling Programme von Onlinehändlern, könnte aber auch von stationären Händlern verwendet werden, sofern sie Daten von Warenkörben einzelner Käufer über elektronische Kassen online erhalten. In dieser Situation können die Empfehlungen ausgedruckt und an die Kassenquittung angehängt werden.

Ein solches auf einem geschätzten Topic Modell basierendes System ist weniger aufwendig als eine direkte Methode, bei der Kaufhäufigkeiten für z.B. alle Paare und Tripel der Produktkategorien ermittelt werden. Wir geben für zwölf ausgewählte Warenkörbe mit jeweils zwei Kategorien die fünf empfohlenen anderen Kategorien mit den höchsten bedingten Kaufwahrscheinlichkeiten an. Einem Käufer, dessen Warenkorb z.B. Schokolade und Haarpflegeprodukte umfasst, empfiehlt das System Körperpflegemittel, Obst, Süßigkeiten und Zahnpflegeprodukte. Falls z.B. Brot und Mehl gekauft wurden, stellen Backmittel, Trockenfrüchte, Fette und Öle, Zucker und Butter die fünf Empfehlungen dar.

Schließlich erwähnen wir Erweiterungen der von uns verwendeten Topic Modelle, die auch für das Management Relevanz aufweisen. Falls einzelne Käufer, z.B. durch Kundenkarten, identifizierbar sind, können Topic Modelle so erweitert werden, dass sie gleichzeitig Käufersegmente bilden. Die Berücksichtigung der Effekte von sozio-demografischen Käufermerkmalen und von Marketing-Instrumenten (z.B. Preis, Verkaufsförderung) stellt eine weitere Möglichkeit dar, falls entsprechende Daten zur Verfügung stehen.

### **Executive Summary - English**

In this contribution we focus on the association of observed multi-category purchases and underlying latent activities of shoppers. Activities like purchasing and using products constitute a major element in definitions of consumer behavior. In a grocery retailing context a latent activity may alternatively indicate which product categories are more important if a shopper wants to prepare a breakfast, intends to bake a cake or does the weekly purchase of beverages or personal care products, etc.

To infer latent activities from observed purchases we use topic models which are often applied in text mining. That is why we only need data which are available to many firms and additional costs of primary research by, e.g. surveys, may be avoided. Topic models form latent activities in such a way that categories with higher conditional probabilities for an activity frequently co-occur with each other in baskets. All baskets share the same latent activities, but their proportions are specific to each basket and randomly drawn from an appropriate distribution.

The data of the empirical study consist of 18,000 market baskets of purchases made at a medium-sized supermarket. These purchases refer to a total of 60 categories. 50 % of the

baskets contain at least four, 25 % at least eight product categories.

Estimation of the topic models provides latent activities which are well defined and different from each other. In addition the latent activities turn out to be intuitive and interpretable. We obtain latent activities strongly related to:

- beverages, periodicals and cigarettes
- milk and pasta
- baking (baking ingredients, fat & oil, sugar, flour, butter, dried fruits)
- bread and dairy products
- personal care
- cigarettes, periodicals, bread, sparkling wine
- luxury food (sweets, chocolate, confectionary, cigarettes)

Starting from an estimated topic model we explain how to make recommendations to a shopper conditional on the categories already purchased. These recommendations consist of those different product categories which attain higher (conditional) purchase probabilities. Such an approach is of obvious interest for cross-selling programs of online retailers, but could also be used by brick-and-mortar retailers if they get online information about market baskets of shoppers via electronic cash registers. In such a situation product recommendations may be added to the receipt printed out at the POS.

Such a system based on an estimated topic model is very parsimonious compared to a direct approach which has to determine purchase frequencies for, e.g., all pairs and triples of product categories. For twelve selected baskets with two categories each we present the five recommended other categories with the highest conditional purchase probabilities. For example, to a shopper with chocolate and hair care products in the basket the system recommends body care, fruits, sweets, periodicals, and dental care. If, e.g., bread and flour have been purchased baking ingredients, dried fruits, fat & oil, sugar, and butter are the five categories recommended.

Finally we mention extensions of the topic models we used which we think are also managerially relevant. If individual shoppers are identified by, e.g., customer cards, topic models could be extended in a way to form segments of shoppers as well. Including

the effects of socio-demographic attributes of shoppers and of marketing marketing variables (e.g., price, sales promotion) constitutes another possibility, if appropriate data are available.

## 1. Introduction

In text mining the use of topic models is widespread and quite successful (*Sun/Deng/Han* 2012). We investigate the application of topic models to market basket analysis. Consistent with extant work on analysing cross-category purchases we look at purchases of product categories made by individual customers. The overwhelming majority of relevant contributions in the marketing literature are based on either multivariate logit models (e.g., *Boztug/Hildebrandt* 2008; *Boztug/Reutterer* 2008; *Dippold/Hruschka* 2013; *Russell/Petersen* 2000.) or multivariate probit models (e.g., *Chib/Seetharaman/Strijnev* 2002; *Duvvuri/Ansari/Gupta* 2007; *Manchanda/Ansari/Gupta* 1999.). These models consider pairwise relations between product categories only. In probit models these relations are reproduced by cross-category coefficients. In probit models pairwise residual correlations serve the same purpose.

Using topic models we do not restrict attention to pairwise relationships between categories. Instead we focus on the association between observed purchases and underlying latent activities of shoppers. Activities constitute a major element in definitions of consumer behaviour. For example, consumer behaviour is equated with "activities people engage in when searching for, selecting, purchasing, using, evaluating, and disposing of products and services so as to satisfy their needs and desires" (*Belch/Belch* 2003, p. 105). Topic models applied to market basket data infer latent activities from observed purchases, i.e., they only need data which are available to many firms. This way additional costs of primary research by, e.g. surveys, may be avoided. Topic models conceive a basket which consists of the categories purchased by a shopper as random mixture of latent activities. Latent activities are distributed over product categories and reflect co-occurrence of categories in shoppers' baskets. In a grocery retailing context, for example, a latent activity may alternatively indicate which product categories are more important if a shopper wants to prepare a breakfast, intends to bake a cake or does the weekly purchase of beverages or personal care products, etc.

Our study is related to a paper of *Boztug/Reutter (2008)* who determine basket prototypes using purchase data for 65 product categories using an online version of K-means. Topic models differ from K-means and similar clustering techniques in several respects. Firstly, K-means associates each basket with a single prototype, whereas topic models sample the latent variable repeatedly within a basket. Therefore topic models allow that a basket

may be linked to several latent activities and reflect that a shopper may pursue several activities at the same time (e.g., that a shopper both prepares breakfast and does the weekly purchase of personal care products).

Secondly, in contrast to most clustering techniques topic models are based on a statistically defined objective function, e.g., a log likelihood function. Thirdly, topic models can be extended to measure the effect of predictors (e.g., socio-demographic or marketing variables), whereas clustering techniques exclude predictors.

Our main research goal consists in assessing whether basic topic models are appropriate tools for market basket analysis. To this end we use a data set which encompasses purchases referring to 60 categories. This number is much higher than the about five categories found in most multivariate logit and probit models estimated on market basket data sets.

We continue by explaining the structure of the two topic models, latent Dirichlet allocation (LDA) and the correlated topic model (CTM), by which we analyse market basket data. We discuss estimation of LDA models by blocked Gibbs sampling. Then we show how to evaluate the performance of topic models with respect to estimation and holdout data. The next section deals with the empirical study. It provides descriptive statistics, presents estimation results and gives an illustration of the managerial relevance of an estimated topic model. In the final section we summarize results, indicate advantages of topic models and discuss both limitations of our study as well as possibilities for future research.

## 2. Topic Models

In text mining applications topic models as a rule serve to relate words appearing in documents to discrete latent variables which are called topics. To the benefit of readers with a marketing background we will in the following only refer to product categories, market baskets and latent activities which take the place of words, documents and topics, respectively. We present and apply two topic models, latent Dirichlet allocation (LDA) and the correlated topic model (CTM).

Comprehensive descriptions of LDA and typical applications can be found in the text mining literature (e.g., *Blei* 2012; *Blei/Ng/Jordan* 2003; *Steyvers/Griffiths* 2007; *Sun/Deng/Han* 2012.). *Tirunillai/Tellis* (2014) present a marketing-related text mining study in which they extract latent dimensions of consumer satisfaction by LDA using consumers'

online product reviews.

According to LDA the product categories contained in each basket are generated by a mixture of latent activities. All baskets share the same latent activities, but their proportions are specific to each basket and randomly drawn from a Dirichlet basket-activity distribution. For each activity assigned to a basket this way a product category is chosen randomly from its corresponding distribution. LDA forms activities in such a way that categories with higher conditional probabilities for an activity frequently co-occur with each other in baskets (*Crain et al.* 2012, p. 143).

Let  $I$ ,  $J$  and  $K$  denote the number of baskets, product categories and latent activities, respectively. Random parameters in a  $(J, K)$  matrix  $\phi$  and a  $(K, I)$  matrix  $\theta$  indicate the importance of categories for activities and the importance of activities for baskets, respectively. The  $k$ -th column of  $\phi$  holds the conditional probability of the categories conditional on latent activity  $k$  and therefore sums to one.

The probability  $p_{ij}$  that basket  $i$  contains category  $j$  is related to the importance of this category for activities and the importance of activities for this basket in the following manner (*Griffiths/Steinvers* 2004, p. 5228):

$$(1) \quad p_{ij} = \sum_{k=1}^K \phi_{jk} \theta_{ki}$$

$\theta$  and  $\phi$  are smoothed by Dirichlet hyperparameters  $\alpha$  and  $\beta$ .  $\alpha$  can be interpreted as prior count of the number of times any latent activity is assigned to a basket, before having observed any category contained in the basket. Low values of  $\alpha$  lead to sparse distributions favoring a low number of activities.  $\beta$  on the other hand can be seen as prior count of the number of times that categories are sampled from a latent activity before the purchase of any category is observed. Each category  $j$  in a market basket  $i$  is linked to activities by integer random variables  $z_i = 1, \dots, K$  which give the index of the generated activity.

We estimate LDA models by blocked Gibbs sampling, i.e. marginalizing out parameters in  $\phi$  and  $\theta$ . Blocked Gibbs sampling determines the posterior distribution over latent variables  $z_i$  (the assignment of categories to topics), given the observed categories. For each basket  $i$  the Gibbs sampling procedure considers each category  $j$  purchased in turn, and determines the probability of assigning the current category to each activity, conditioned on the activity assignments of all other categories. From this conditional distribution an

activity is sampled and stored as the new activity assignment for this category.

We denote this conditional distribution as  $P(z_j = k | z_{-j}, -j, -i)$ .  $z_j = k$  represents the topic assignment of category  $j$  to activity  $k$ ,  $z_{-j}$  the topic assignments of all other categories,  $-j$  and  $-i$  are indices of all other categories and all other baskets, respectively.

This conditional probability is proportional to (Griffiths/Steinberger 2004, p. 5229):

$$(2) \quad \frac{\max(n_{1jk} - 1, 0) + \beta}{\max(n_{1jk} - 1, 0) + \sum_{j' \neq j} n_{1j'k} + J\beta} \frac{\max(n_{2ki} - 1, 0) + \alpha}{\max(n_{2ki} - 1, 0) + \sum_{k' \neq k} n_{2ki'} + K\alpha}$$

Count variables  $n_{1jk}$  and  $n_{2ki}$  contain the number of times category  $j$  is assigned to activity  $k$  and the number of times activity  $k$  is assigned to the categories of current basket  $i$ , respectively. The terms  $\max(n_{1jk} - 1, 0)$  and  $\max(n_{2ki} - 1, 0)$  in expression (2) show that the current category and the current basket are not relevant for computing this conditional probability.

The left part of expression (2) equals the probability of category  $j$  under activity  $k$ . Its right part equals the probability of activity  $k$  under the current distribution of activities for basket  $i$ . Once a category has been frequently assigned to activity  $k$  across all baskets, it will increase the probability of assigning any instance of that category to activity  $k$ . At the same time, if activity  $k$  has been used many times in a basket, it will increase the probability that any category in that basket will be assigned to activity  $k$ . Therefore, categories are assigned to activities depending on how likely the category is for a activity, as well as on how important an activity is in a basket.

Based on count variables  $n_{1jk}$  and  $n_{2ki}$  posterior estimates of parameters  $\phi_{jk}$  and  $\theta_{ki}$  can be computed as (Griffiths/Steinberger 2004, p. 5230):

$$(3) \quad \phi_{jk} = \frac{n_{1jk} + \beta}{\sum_{j=1}^J n_{1jk} + J\beta}$$

$$(4) \quad \theta_{ki} = \frac{n_{2ki} + \alpha}{\sum_{k=1}^K n_{2ki} + K\alpha}$$

The correlated topic model (CTM) allows for arbitrary correlations between activities which may be of advantage if activities are highly correlated (Blei/Lafferty 2007). In this respect the CTM differs from LDA which implies very small negative correlations between activities (Blei/Lafferty 2007, p. 21).

The generation of baskets according to the CTM occurs in the same way as for the LDA except that activity proportions are drawn from a logistic normal (Aitchison/Shen 1980) rather than from a Dirichlet distribution. For each basket a  $K - 1$  dimensional vector

of random variables  $\mu_{1i}, \dots, \mu_{ki}$  is drawn from a multivariate normal distribution with complete  $(K-1, K-1)$  covariance matrix. The latter allows for correlations between activities.

Activity proportions result from the following multiple logistic transformation of these random variables (similar to *Blei/Lafferty 2007*, p. 20):

$$(5) \quad \theta_{ki} = \begin{cases} \frac{\exp \mu_{ki}}{1 + \sum_{k=1}^{K-1} \exp \mu_{ki}} & \text{for } k = 1, \dots, K-1 \\ \frac{1}{1 + \sum_{k=1}^{K-1} \exp \mu_{ki}} & \text{for } k = K \end{cases}$$

Like for LDA models we estimate CTM models by blocked Gibbs sampling, but to this end we have to add an appropriate data augmentation step for Bayesian logistic regression developed by *Polsen/Scott/Windle (2013)*. We do not explain the CTM in more detail because its estimation is technically more involved and in the empirical study CTM models did not perform better than their LDA counterparts.

We evaluate the performance of topic models by log likelihood values both for estimation and for holdout data. We apply models determined on the basis of estimation data to holdout data to assess whether models are prone to overfitting.

The log likelihood  $LL_e$  across baskets and categories for the estimation data is defined as (*Newman et al. 2009*, p. 1811):

$$(6) \quad LL_e = \sum_{i=1}^{I_e} \sum_{j=1}^J y_{ij} \frac{1}{S} \log \sum_{k=1}^K \sum_{s=1}^S \phi_{jk}^s \theta_{ki}^s$$

$I_e$  is the number of baskets in the estimation data set.  $y_{ij}$  is a binary indicator variable which equals one if basket  $i$  contains category  $j$ , otherwise it is zero. The log likelihood is defined as average across  $S$  parameter samples ( $\phi_{jk}^s$  and  $\theta_{ki}^s$  denote parameter samples with  $s = 1, \dots, S$ ).

The log likelihood  $LL_h$  for the holdout data set is computed in an analogous manner:

$$(7) \quad LL_h = \sum_{i=1}^{I_h} \sum_{j=1}^J y_{ij} \frac{1}{S} \log \sum_{k=1}^K \sum_{s=1}^S \phi_{jk}^s \theta_{ki}^s$$

$I_h$  is the number of baskets in the holdout data set. To evaluate the holdout data the category-activities distribution remains constant by setting  $\phi_{jk}$  parameters to their average sampled values for the estimation data. For blocked Gibbs sampling on the holdout data therefore the left part of expression (2) is replaced by the corresponding constant estimate of  $\phi_{jk}$ . Only the  $\theta_{ki}$  parameters which describe the activities to basket distribution are estimated according to equation (4).

Fruits	.312	Bread	.308	Vegetables	.257
Tropical Fruits	.257	Yogurt	.216	Periodicals	.212
Milk	.194	Chocolate	.152	Soft drinks	.148
Cigarettes	.142	Beer	.141	Juices	.131
Cheese	.125	Butter	.125	Long-life milk	.110
Fat & oil	.109	Pickles	.105	Soups & sauces	.103
Water	.102	Sliced cheese	.101	Baking ingredients	.095
Spice	.093	Seasonal	.093	Sweets	.092
Snacks	.079	Rolls	.079	Coffee	.078
Foil	.076	Confectionary	.073	Pasta	.072
Rusk	.072	Hygiene	.070	Eggs	.067
Hair care	.066	Condensed milk	.060	Gifts	.060
Body care	.059	Delicatessen 1	.059	Canned vegetables	.056
Toilet articles	.052	Cat food	.051	Dental care	.051
Sugar	.050	Canned fish	.050	Dried fruits	.048
Sparkling wine	.047	Wholemeal bread	.046	Flour	.042
Rice & legume	.041	Tea	.041	Delicatessen 2	.040
Spread	.039	Salt & Vinegar	.038	Frozen poultry	.035
Red wine	.033	Canned fruits	.033	Office supplies	.032
Liquor	.031	Greeting Cards	.030	Cleanser	.028

*Table 1: Relative univariate frequencies of analysed categories*

### 3. Empirical Study

#### 3.1. Data

The data of the empirical study consist of 18,000 market baskets of purchases made at a medium-sized supermarket. The median number of categories purchased per basket equals four. 25 % of the baskets contain eight or more product categories. Out of a total of 209 categories, we analyse the 60 categories with the highest univariate purchase frequencies (see *Tab. 1*). We randomly divide the 18,000 baskets into two data sets and estimate topic models using the larger data set of 12,600 markets baskets. The remaining 5,400 baskets serve as holdout data.

#### 3.2. Estimation Results

For each model the respective blocked Gibbs sampler performs 4,000 iterations for the estimation data and 400 iterations for the holdout data, respectively. Note that one iteration includes a complete pass over all market baskets in the estimation and holdout data set, respectively. The first half of these iterations is used for burn-in. Log likelihood

# of latent activities	Model type			
	LDA		CTM	
	Estimation Data	Holdout Data	Estimation Data	Holdout Data
2	-120,460	-50,897	-120,631	-50,932
3	-118,851	-50,231	-119,303	-50,421
4	-118,048	-49,904	-118,621	-50,132
5	-116,906	-49,439	-118,186	-49,962
6	-116,569	-49,282	-117,648	-49,714
7	-116,071	-49,115	-117,359	-49,593
8	-115,663	-48,949	-117,065	-49,505
9	-115,354	-48,814	-116,787	-49,396
10	-115,019	-48,676	-116,566	-49,316
11	-115,296	-48,828	-116,198	-49,206

values rounded to nearest integer

Table 2: Log likelihood values

values and parameter estimates are arithmetic averages across iterations of the second half.

For Gibbs sampling we set the the hyperparameters  $\alpha = .4$  and  $\beta = .01$  after trial runs with several values. Especially higher values for  $\beta$  (e.g.,  $\beta = .1$ ) lead to much lower log likelihood values. These results are in accordance with the study of *Asuncion et al.* (2009) who investigate how sensitive the performance of topic models is with respect to values of hyperparameters.

*Tab. 2* gives the log likelihood values of LDA and CTM models with a minimum of two and a maximum of eleven latent activities both for the estimation and holdout data. These models all perform better than the independent model which is based on marginal frequencies only and attains log likelihood values of -123,056 and -52,035 for the estimation and holdout data, respectively. We obtain the best log likelihood values both for estimation and holdout data for the LDA with ten latent activities. Results turn out to be quite robust as the ranking of models with different numbers of latent activities for the estimation data set does not change if these models are applied to the holdout data. At each of the investigated number of latent activities the CTM model attains lower log likelihood values than the corresponding LDA models. This results is in agreement with the very low estimated correlations between latent activities estimated for the CTM models. With respect to correlations of latent activities LDA and CTM do not really differ and LDA has the advantage of a lower number of parameters (e.g., for ten latent activities LDA has 36 parameters less). In view of its superior performance we only present and

1		2		3		4	
Beer	.284	Tropical fruits	.117	Milk	.041	Vegetables	.143
Soft drinks	.240	Vegetables	.117	Pasta	.041	Tropical fruits	.143
Water	.235	Fruits	.057			Fruits	.073
Juices	.071	Milk	.050			Bread	.058
Periodicals	.063						
Cigarettes	.061						
5		6		7		8	
Vegetables	.171	Baking ingredients	.127	Bread	.096	Hair Care	.087
Tropical fruits	.171	Dried Fruits	.078	Yogurt	.085	Body Care	.084
Fruits	.096	Sugar	.058	Fruits	.073	Dental Care	.072
Bread	.091	Fat & Oil	.056	Milk	.066	Hygiene	.063
Milk	.077	Flour	.053	Cheese	.050	Chocolate	.055
Sliced Cheese	.068			Juices	.050	Fruits	.055
Yogurt	.066						
9		10					
Cigarettes	.103	Chocolate	.120				
Periodicals	.090	Sweets	.089				
Bread	.060	Periodicals	.081				
Sparkling wine	.059	Rusk	.075				
Gifts	.058	Cigarettes	.075				
		Fruits	.071				
		Bread	.068				
		Confectionary	.060				
		Soft drinks	.051				
contains all $\phi_{jk} \geq .05$							

Table 3: Product categories' importances for latent activities 1-10

discuss estimation results of the LDA model with ten latent activities in the following.

Tab. 3 gives importances of the product categories (i.e., the estimated  $\phi_{jk}$  parameters) which are at least equal to .05. Most of the inferred latent activities are well defined and different from each other. In addition the latent activities of table 3 are intuitive and interpretable.

Activity 1 focuses on beverages and also includes periodicals and cigarettes, activity 3 focuses on milk and pasta. Activity 6 refers to various products appropriate for baking. Activity 7 comprises bread and dairy products which are often purchased for breakfast. Activity 8 is related to purchasing personal care products. Cigarettes, periodicals, bread, and sparkling wine are important categories for activity 9. Activity 10 shows an inclination towards luxury food, i.e., sweets, chocolate, confectionary, and cigarettes.

Several of the important categories for activities 2, 4, and 5 are identical, namely vegetables, tropical fruits, and fruits. On the other hand activity 5 reflects a much broader assortment of shoppers as it also includes dairy products. Overall the latent activities inferred turn out to be more distinctive than the 14 prototypes chosen in *Boztug/Reutterer* (2008). Five of their 14 prototypes focus on dairy products, three on beverages and one

Rank	Bread, Beer	Bread, Tropical Fruits	Bread, Flour
1	Soft drinks	Vegetables	Baking Ingred.
2	Water	Fruits	Dried Fruits
3	Cigarettes	Milk	Fat & Oil
4	Periodicals	Yogurt	Sugar
5	Juices	Sliced Cheese	Butter
Rank	Bread, Hair Care	Bread, Cigarettes	Bread, Sweets
1	Fruits	Periodicals	Chocolate
2	Chocolate	Soft Drinks	Periodicals
3	Body Care	Chocolate	Fruits
4	Periodicals	Beer	Cigarettes
5	Dental Care	Fruits	Seasonal
Rank	Chocolate, Milk	Chocolate, Fruits	Chocolate, Juices
1	Baking Ingred.	Periodicals	Periodicals
2	Bread	Bread	Cigarettes
3	Yogurt	Sweets	Bread
4	Fruits	Cigarettes	Sweets
5	Butter	Seasonal	Fruits
Rank	Chocolate, Baking Ingred.	Chocolate, Hair Care	Chocolate, Cigarettes
1	Dried Fruits	Body Care	Periodicals
2	Sugar	Fruits	Sweets
3	Fat & Oil	Sweets	Bread
4	Flour	Periodicals	Fruits
5	Butter	Dental Care	Seasonal

Table 4: Recommendations conditional on selected market baskets

prototype on personal care categories.

### 3.3. Managerial Relevance

To illustrate the managerial relevance of topic models we sketch the core of a recommender system which processes estimated parameters of a LDA. Recommendations to a shopper are based on the categories already purchased and consist of categories with higher conditional probabilities. Such a system is of obvious interest for cross-selling programs of online retailers (see, e.g., *Mild/Reutterer* 2003 for an overview of recommender systems), but could also be used by brick-and-mortar retailers if they get online information about market baskets of shoppers via electronic cash registers. In such a situation product recommendations may be added to the receipt printed out at the POS.

We explain the working of such a recommender system for initial baskets of two categories  $j_1$  and  $j_2$ , the extension to baskets of larger size being rather straightforward. The purchase probability of any other category  $j_3 \neq j_1, j_2$  conditional on purchases of categories

$j_1$  and  $j_2$  is defined as:

$$(8) \quad pr(j_3|j_1, j_2) = \frac{pr(j_3, j_1, j_2)}{pr(j_1, j_2)}$$

$pr(j_3, j_1, j_2)$  and  $pr(j_3, j_1, j_2)$  symbolize joint probabilities of the given three and two categories, respectively. For the LDA we finally obtain with  $pr_k$  denoting the probability of latent activity  $k$ :

$$(9) \quad pr(j_3|j_1, j_2) = \frac{\sum_{k=1}^K \phi_{j_3k} \phi_{j_1k} \phi_{j_2k} pr_k}{\sum_{k=1}^K \phi_{j_1k} \phi_{j_2k} pr_k}$$

Expression 9 shows that the conditional purchase probability of category  $j_3$  increases if  $j_3, j_1, j_2$  have high(er) importances for the same latent activities. On the other hand, if these categories are related to different activities, a low conditional probability of category  $j_3$  results

The fact that after estimation such conditional probabilities can be computed based on  $K - 1 + K \times J$  parameters constitutes a big advantage of LDA. An alternative direct approach needs  $J$ ,  $\binom{J}{2}$  and  $\binom{J}{3}$  univariate, bivariate and trivariate frequencies, respectively. For ten latent activities and 60 categories this amounts 609 parameters for LDA versus 36,050 frequencies for the direct approach. In addition the sparseness of higher order frequencies causes the direct approach to provide unstable estimates of conditional probabilities. LDA is free of these problems because it smoothes low frequencies by means of hyperparameters.

*Tab. 4* lists five recommended other categories for each of twelve selected baskets with two categories each. Six of these baskets contain either bread or chocolate. The recommendations are ranked according to conditional probabilities computed on the basis of the LDA model with ten latent activities (rank 1 gives the category with the highest conditional probability).

#### 4. Conclusions

Our main research goal consists in assessing whether basic topic models are appropriate tools for market basket analysis. A LDA model with ten latent activities performs much better in terms of log likelihood values both for estimation and holdout data than the CTM with a maximum of eleven latent activities. Most of the inferred latent activities by this LDA model are well defined and different from each other. In addition the latent

activities are intuitive and interpretable, e.g., related to shopping of beverages or personal care, to various products appropriate for baking or to a tendency towards luxury food. To illustrate the managerial relevance of estimated topic models we sketch the core of a recommender system which ranks purchase probabilities of other product categories conditional on the basket of a shopper.

In addition to interpretability we notice two important advantages of topic models compared to other models of market basket analysis, namely parsimony and scalability. Topic models are more parsimonious than logit and tobit models with pairwise coefficients and correlations, respectively. For our data constellation of 60 product categories topic models with ten latent activities require about 1,100 parameters less than the multivariate logit and probit models often applied in marketing. Scalability means that topic models are capable to deal with a very large number of product categories. Text mining studies with topic models which process a vocabulary of several thousand words provide clear evidence for this property (e.g., *Blei/Laferty 2007*, pp. 27; *Blei/Ng/Jordan 2003*, pp. 1008).

We see our paper as a first attempt to use topic models in market basket analysis. That is why we note several limitations of this study which on the other hand indicate interesting avenues of future research. The data set investigated refers to individual market baskets, but does not identify individual shoppers. Therefore the topic models estimated here take latent heterogeneity across baskets into account, but cannot consider latent heterogeneity across shoppers. The data set also does not contain shoppers' attributes (e.g., socio-demographics) and marketing variables (e.g., price, sales promotion, etc.). Though such a data constellation can be found frequently in grocery retailing, we think that future research efforts should extend basic topic models by including latent heterogeneity of shoppers and by measuring the effects of predictors on latent activities.

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