IDEA
rethinking retail

# Determining the Optimum Retail Product Variety

By: Thomas Norbert DeMuth

## Introduction

Why is it sometimes so difficult to get a straightforward answer to a simple question? This happens repeatedly with product variety – how much variety on the shelf is too little, just right and too much? Many manufacturers and retailers enlist so-called "experts" to help answer this question, only to be totally frustrated with the fuzzy replies.

Consider an example of shades of eyeliner. (The same dilemma applies equally to lawn fertilizer, bicycles, televisions – in fact, to most products sold today.) Your goal is to maximize sales of your products in this category. The retailer has given you a fixed amount of shelf space, but would be willing to expand the space if sales per square foot results are acceptable. So you call in your panel of experts.

Within your panel, if you are "fortunate" enough, you can afford to have marketing gurus, experts on women's buying habits, consultants who specialize in the make-up category. You even engage a psychologist, and are willing, if all else fails, to consult a psychiatrist! The answer you need is finite – 6 shades, 10 shades, 20 shades of eyeliner…. A better answer would give you the actual shades. After a few weeks of procrastination, you say to yourself, "I don't care what the answer is – just give me a definitive answer!" Instead, what you get are statements such as, "It depends on the shopping patterns and changing behaviors…..". "We need an in-depth analysis and national survey of the markets….". The answers are often not answers, but procrastination spelled with a capital "P" standing for a huge consulting Price tag for inconclusive research.

We believe that there is a much simpler way to answer the question. That is the subject of this article.

## The Challenge of Adding Variety

When you have a finite physical shelf space, there is an implication of adding SKUs within a category. Unless you can rearrange the space, the results will be less space available per SKU. Since your goal is to increase overall sales, this implies:

- You must be able to cover sales of existing products with a smaller quantity of inventory. To cover the same volume of sales with a smaller quantity of inventory per SKU, distributors and manufacturers sometimes need to change their method of replenishment. The correct approach is to move from a push system, based on forecast, to a pull system, based on actual consumption1. The results

[1] For more information, see the TOC Insights into Distribution, available as a self learning download, at www.toc-goldratt.com, under the heading *Learning TOC*.

are typically 30% or more reduction in inventory with a simultaneous staggering increase in availability.

- The new SKU must not cannibalize sales of existing products. While this sounds obvious, our experience suggests that this analysis is not done consistently. Inventors of ideas for new products are often so enthusiastic about their idea that they ignore the downside – new products eating into sales of existing products. Also, market research on real client needs is often limited or non-existent. In such a situation, new products can make sales worse, by encouraging consumers to buy products that they end up hating.
- The display must remain attractive and "simple" enough to make it easy for consumers to find what they are looking for and to buy. For every product, there is a point at which increasing variety has a negative impact on sales.

## Determining the Correct Amount of Variety

The only way that we have seen to effectively determine how much variety is correct is by experimentation. This is far quicker and usually much less expensive than studies and calling in experts. Our experience shows that no one can accurately predict end consumer behavior in a deterministic way. Be prepared to go through trial and error, continuing to increase variety until you see the negative impact. **This must be systematically tracked from the moment the SKU configuration changes, to judge the impact NOT JUST on the new SKU, but on sales of existing SKUs.**

### The Upside of Increasing Variety

There are several ways that sales increase by adding variety:

"With less inventory and therefore less inventory space required per item, the distributor and retailer are able to stock a greater variety of items, thus increasing throughput from the same physical space."

"With less inventory per item, sales to get rid of excess inventory are required much less frequently. This means that both the margins and the sales revenue are increased. It also implies that sales of older products do not spoil the market for new products."

"With less inventory per item, there is less obsolescence, leading to greater satisfaction among consumers and therefore increased sales. The products on the products on the shelf are newer and therefore more appealing. This can have a huge impact on throughput with items that have expiration dates[2]."

For the manufacturer, increased variety can mean increased market share, if the variety adds broader coverage to an existing product set. This was common in the auto industry, for example. For North American manufacturers, however, variety has not provided the ultimate answer. Market shares continue to erode, as consumers look for other necessary conditions to meet their needs.

## Conclusion

[2] From "Viable Vision, Transforming Total Sales into Net Profits," Gerald I. Kendall, J. Ross Publishing, Boca Raton, FL 2003

No one can safely predict how end consumers will react to increased variety. Remember that adding variety, unlike introducing a brand new product, is broadening choice in an area where the consumer already has a product that meets their needs. For this reason, experimentation is the recommended way to determine how much variety is needed. Add variety, closely monitoring sales of all related SKUs, until total sales start to decline. At the same time, companies will do well to extend their market research beyond surveys to better understand underlying customer needs, rather than superficial complaints.

### IDEA's Way of Thinking

- *Neither an accurate forecast nor changing vendors is required for success*
- *There is a way to both increase sales and reduce inventory*
- *Supply chains sell less when clogged with inventory*
- *In the long term, unless the supply chain sells more no link can sell more*
- *We must help clients gain buy-in internally and with supply chain partners*
- *The majority of our fees are based on improved return on inventory*

### IDEA's Method

- *Verify the existence of inventory imbalances and the benefits of moving from a "Push" to a "Pull" system*
- *Gain top management buy-in to the assessment and support of the approach*
- *Build knowledge and understanding across the supply chain, at all levels*
- *Utilize systems that deliver actionable information, integrated with existing software*
- *Work with you until expected results are achieved*
- *Share the tools and know-how to continually improve results*

IDEA, LLC Contact: Tom Demuth, President TomDemuth@ideallc.com