Sorting Out Efficient Assortment

By Ben Ball and Ray Jones

The explosion of category management onto the retailing landscape has spawned a dizzying number of adaptations, variations and iterations of the original concepts. Many of these evolutions have been useful. Others have merely been various groups' or individuals' attempts to "own" a piece of the action.

The area that has produced the most controversy, perhaps because it has been the most aggressively attacked concept thus far, is determining efficient assortment. Regardless of the variations in theory, proper assortment is crucial to all three of the constituents of category management: the consumer, the retailer and the manufacturer.

The Constituents

For **consumers**, the completeness of assortment (defined as "variety" or "choice") influences their perception of the "role" a category plays at a given retailer. For instance, suppose a retailer defines a category as "Destination" in its stores, yet stocks only 50% of the items consumers regularly want. Those stores will merely be seen as "Convenience" locations for that purchase at best.

If products in a group are sufficiently different in how (or which) consumers use them to be called a segment, then their assortment should also be evaluated separately.

For **retailers**, assortment equals money. Putting aside the host of emotions surrounding the proliferation of line extensions, the failure rate of "me-too" new products and the rationale for slotting fees, the simple fact is that increased assortment equals increased demand on all of the retailers' key resources. Space, labor and inventory dollars are all absorbed by increased assortment. Of course, the "Catch-22" for retailers is the consumers' perspective discussed above.

Few **manufacturers** have installed systems (ABC costing) and have dared to develop significant line rationalizations on their own. Most still rely on "100% distribution" of each years' crop of new items to reach their financial targets. Even if a manufacturer has "cleaned its own house," it can still be faced with a bitter pill when its rationale for adding a great new item to a major retailer's assortment doesn't overcome the Pareto analysis for the category.

The Golden Rule

Assortment analysis must always be done within the context of a sound, consumer-based segmentation of the category.

Making a rule is always dangerous. Business, in particular, has a way of making the old saying, "rules are made to be broken," come back to haunt you. But at Dechert-Hampe & Co. (DHC), we believe that assortment analysis should **never** be done at the total category level. A logical Consumer Decision Tree is the best foundation for a sound category segmentation. If products in a group are sufficiently different in how (or which) consumers use them to be called a segment, then their assortment should also be evaluated separately.

Some Definitions

For purposes of this discussion, the various approaches to evaluating assortment are defined below.

Efficient Assortment is defined as the classic process of setting a percentage of sales coverage target for the retailer and ranking all items currently carried, usually with a Pareto-type analysis. Items that don't "make the cut" are then evaluated qualitatively as being either unique to, or a duplication of, other items still in the mix. Unique items may or may not be retained; duplicate items are eliminated.

Effective Assortment starts with the results of the Efficient Assortment analysis. Some type of quantitative technique is then applied to identify high volume items in the segment not currently handled by the retailer. The universe of items may be the market, region or total U.S. New items being presented are also included at this stage. Judgments are then made as to what, if any, items need to be added or swapped out to achieve the best possible assortment from the consumer's perspective.

Item Optimization addresses the retailer's inability to carry complete assortments in every category and segment. Defining optimization criteria requires a knowledge of all the retailers' constraints.

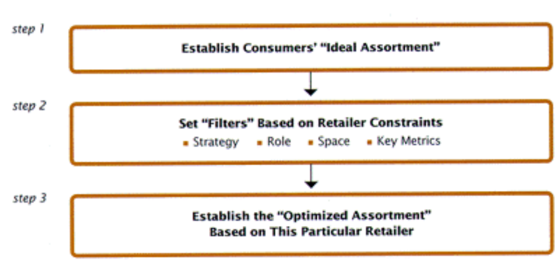
There are two main categories of retailer constraints. Strategy Constraints are the role a particular category will play, what strategies have been chosen, and whether or not the strategies are consistent by segment. Resource Constraints affect how much space, labor and inventory the retailer can actually allocate to the category.

The industry needs a consistent approach to assortment decisions that specifically recognizes that **both** consumers' and retailers' needs are at play. The approach also needs to clearly identify what is being "given up" in the optimization process and why.

So how do we sort out the varying needs of all the constituents in a sound, coherent and consistent manner? The approach we have developed at DHC does this by applying a combination of techniques in a process we call **Assortment Optimization**.

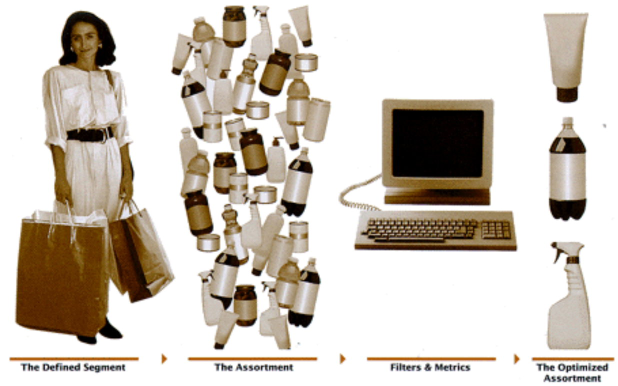
Assortment Optimization

Chart 7:



In simple terms, DHC's Assortment Optimization approach marries the Effective Assortment techniques with Item Optimization in a consistently applied methodology:

- Start with consumer-defined segments
- Determine the consumer's ideal assortment (Effective Assortment)
- Determine the appropriate filters and metrics for this particular retailer, category and/or segment
- Apply those filters to get an Optimized Assortment



The actual application of this methodology is somewhat more complex – and considerably more cumbersome – without the proper inputs and tools. Proper evaluation often requires key retailer metrics like profit/foot or GMROII, not just sales dollars.

Some of the other key issues our clients face in implementing this approach are:

1. Do you really have confidence in your consumer segmentation?

2. Does the retailer also buy into it?

3. What technique(s) can be used to identify items that should be added to the retailer's mix?

Why Assortment Optimization

DHC's Assortment Optimization approach has two significant benefits. First, it begins with a "pure" view of consumers' needs. This ensures that everyone involved in the process, particularly the retailer, has a clear understanding of how subsequent decisions may severely compromise what the consumer would truly like to have available in an ideal world. Second, it clearly identifies the conscious decisions being made in the context of the retailer's constraints. Coupled with consistent application of the resulting analytical techniques, this eliminates as much of the uninformed decision-making as possible from the process.

Ideally, retailers would share the results with the manufacturers who participate in the category. This would allow the manufacturers whose items didn't make the cut to know what changes they would have to make in product, pricing or programming to better fit this particular retailer's needs. Manufacturers can then feed this information into their own item rationalization process, make informed decisions as to what they can do (other than increase slotting), and whether it is a good decision for the brand. The manufacturers can thus become better business partners to the retailers in helping to achieve their goals, roles, strategies and metrics.