Organizational inertia and excessive product proliferation

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Abstract: This study investigates the internal factors of excessive product proliferation. Since empirical literature on product over-proliferation focused on how to optimize existing product portfolio, the causes of excessive product proliferation have so far attracted little attention. This study employs a case study of Shiseido, a famous Japanese cosmetics company, with particular attention to product proliferation in the Shiseido chain store channel, because external factors are mostly absent from this case. My results indicate that intra- and inter-organizational inertia affects product line management. Due to Shiseido's effort in the 1990s, the company could maintain the advantage it and its cosmetics store channel held with much the strategy as had been used until the mid-1970s. This strengthen intra-organizational inertia at Shiseido. Inter-organizational inertia with cosmetics stores makes Shiseido's strategic change more difficult, which causes excess proliferation.

Keywords: product proliferation, product strategy, organizational inertia, channel management, multi-channel strategy

1 Introduction

Firms often increase the number of their brands and products to meet diverse consumer needs. This behavior, variously known as product proliferation, brand proliferation, or product line and variety extension, is found in many industries.[1] Given that there are diverse consumer needs, a firm that conducts product proliferation is thought to garner a higher market share than one that does not.[2] Recently, however, empirical examination of the relationship of product count to performance has shown contrary results. By executing product

1 Mainkar et al. 2006.
2 Roberts/Samuelson 1988; Kekre/Srinivasan 1990.

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proliferation, a firm does not necessarily increase its market share;[3] worse, product proliferation often reduces margins.[4] Indeed, the disadvantages of over-proliferation have attracted much attention.[5]

If excessive product proliferation may even weaken a firm's competitiveness, it is important to investigate its underlying causes in order to avoid it. The principal focus of the empirical literature on product over proliferation, however, has been on how to optimize existing product portfolios.[6] Though optimization is very important, without an understanding of the root causes of excess proliferation, we cannot hope to avoid the problem.[7]

In this paper, therefore, I investigate the causes of excessive product proliferation. I consider the connection between product proliferation and a firm's performance, focusing on inter-business relationships. In addition, I specifically address the firms' internal factors. I hypothesize that inter- and intra-organizational inertia affects a firm's product line management, and may cause excess proliferation.

2 Literature review

Research has revealed that product proliferation delivers not only advantages but also disadvantages – these can be broadly grouped into increased cost[8] and consumer confusion.[9] Product proliferation with these associated disadvantages can be regarded as excessive, since afflicted firms lose profit. In addition, product over proliferation can be classified into two types: the first is inevitably driven by external factors, such as addressing customer needs; the second one is caused by internal factors which cannot be explained in terms of competitors or customers.

In the former, the external factors behind a firm's product proliferation absent profit comprise competitors and buyers. Firms often add products in lines affected by competitors' product proliferation, especially in oligopolistic markets. Connor (1981) examined the relationship of market structure to the number of new products introduced in the food industry, and found a significant relationship

3 Gourville/Soman 2005.
4 Van Hoek/Pegel 2006.
5 Homburg et al. 2010.
6 Avlonitis 1983, 1984; Kumar 2003; Lim/Tang 2006.
7 As opposed to my perspective, some researchers provide frameworks for managerial decisions about optimal product variety (e.g., Ramdas 2003).
8 Lancaster 1979, 1990.
9 Aaker 2004; Huffman/Kahn 1998.

between the concentration of sales and brand proliferation. He concludes that imperfect market structures, like oligopoly, generate high levels of product proliferation. Putis and Bayus (2001), in another example, studied the computer industry, and note that when competitors offer multiple products to a heterogeneous consumer population in a competitive environment, a firm with only one or two products may be at a distinct disadvantage. Thus, these findings suggest that a prisoner's dilemma exists, in which all firms may have excessively broad product lines. When competitors' product lines proliferate, product proliferation may be an effective defensive strategy. In the Japanese nonlife insurance industry, for example, Satō (2011) finds that excessive product proliferation occurred as the industry became more competitive after the relaxation of regulation.

Firms often enlarge products lines in response to buyers. For instance, when the bargaining power of buyers is relatively more powerful than that of suppliers, buyers often require that products be customized to their particular specifications. Little existing literature has mentioned this type of product proliferation, but I speculate that this indeed often occurs. Recently, the rate of product line increase has been greater than that of shelf space, with the adoption of product proliferation by many suppliers, leading to a further growth in the bargaining power of retailers.[10] Quelch and Kenny (1994) found that, from 1985 to 1992, consumer goods SKUs increased an average of 16% annually, while on the other hand, retail store shelf space increased only an average of 1.5%. In their study, retailers responded to the product flood by rationing their shelf space, stocking slow-moving items only when promoted by their manufacturers, and charging manufacturers slotting fees to obtain shelf space for new items and failure fees for items that do not meet sales targets. Indeed, powerful retailers such as Walmart sometimes require food manufacturers to produce products exclusively for them.[11]

The types of product proliferation noted above are inevitable, even though they decrease firms' profits. Unless they respond to the demands of the competitive environment, firms face difficulty in surviving; in such an environment, the case could be made that firms have no choice but to enlarge their product roster.

While the literature has shown that firms broaden their product lines in response to external environmental factors, this paper focuses on internal factors, which have so far attracted little attention. One of the few studies conducted from this perspective is by Leonard-Barton (1994), in which she examined the Japanese automobile industry, and pointed out that the reason for too much variety and unnecessary options was that the core capability,

10 Chu/Messinger 1995; Messinger/Narasimhan 1995.
11 Fishman 2006.

which had generated competitive advantage during the 1980s, had paradoxically become a core rigidity. Her research describes a situation in which internal factors such as organizational inertia cause excessive product proliferation. However, the specific process and underlying mechanism have not yet been addressed.

3 Methodology

The principal focus of the empirical literature on excessive product proliferation is its external driving factors. The current study focuses on the internal factors, which have not received adequate consideration. At this preliminary stage, qualitative research is appropriate.[12] Therefore, this study employs a case study of Shiseido, a famous Japanese cosmetics company, with particular attention to product proliferation in the Shiseido chain store channel.

Shiseido's case is a reasonable subject because it is less likely to be affected by external factors, for two reasons. The first is the tremendous bargaining power that Shiseido holds over its chain store channel. Second, competition within the cosmetic store channel is limited.[13] External factors are mostly absent from this case, and therefore the applicable internal factors can be more clearly recognized.

To analyze Shiseido's product line, I used Shukan Shogyo Corporation's *Cosmetics in Japan*, which contains information about trends in the Japanese cosmetics industry and on almost all cosmetics products sold in Japan. From that, I created a database including products from Shiseido, Shiseido International, FT Shiseido, and Shiseido FITIT. Annual reports, newspaper articles, and in-depth interviews with seven employees were used to confirm the corporate intent. I conducted semi-structured interviews, from one to three hours each.

4 Case analysis

Shiseido attained competitive advantage by building its own distribution channel, called the "Chain Store System" within Japan, beginning in 1923. Through it, the company sold its products for the same price and with identical

12 Edmondson/Mcmanus 2007.

13 Sakuraki (2013) examined competition within the cosmetics store channel.

service, and Shiseido could exercise stable management over that system. Shiseido solidified its position by introducing many brands and products in that period.

But with the emergence of drug stores in the late 1990s, consumers were able to buy the same products at lower prices than in chain stores. Most chain stores were small and their price competitiveness was therefore low. As a result, the less-competitive chain stores were weakened. To differentiate chain stores from drug stores, Shiseido introduced brands which were to be sold only at chain stores. Nevertheless, sales volume in the chain store channel continued to decrease. Considering this rationally, Shiseido could have decided to not invest further in the chain store channel; instead, Shiseido continued to introduce new products into the channel. In this section, I confirm the fact that Shiseido continued to proliferate products in chain stores, and then point out that this was caused by a sales department which had strong relationships with the chain stores.

5 Excessive product proliferation in the Shiseido chain store channel

Many researchers have examined the workings of the Chain Store System.[14] In brief, this was a system by which Shiseido assured those specialized "chain store" shops of access to the same product, the same retail price, and identical service. In the Japanese cosmetics industry generally at that time, cosmetics were sold at distressed prices. This was a serious problem for both cosmetics stores and manufacturers. The chain store system, which provided a win-win situation, therefore got strong support from many retailers. The number of cosmetics stores which entered into agreements with Shiseido gradually increased, and Shiseido built strong channel relationships with these chain stores through this system.

Shiseido traded with chain stores in the Japanese way – based on relationships between the players and oriented toward long-term business relationships.[15] However, the overwhelming advantage of Shiseido was threatened by the emergence of drug stores in the late 1990s. The total sales volume of drug stores exceeded that of cosmetics stores in 2002, continuing to this day.

To differentiate its chain stores from drug stores, Shiseido introduced brands which were to be sold only at the former. Figure 1 shows Shiseido's exclusive

14 Sakai 1979; Kohara 1994a, 1994b.

15 Tamura 1986.

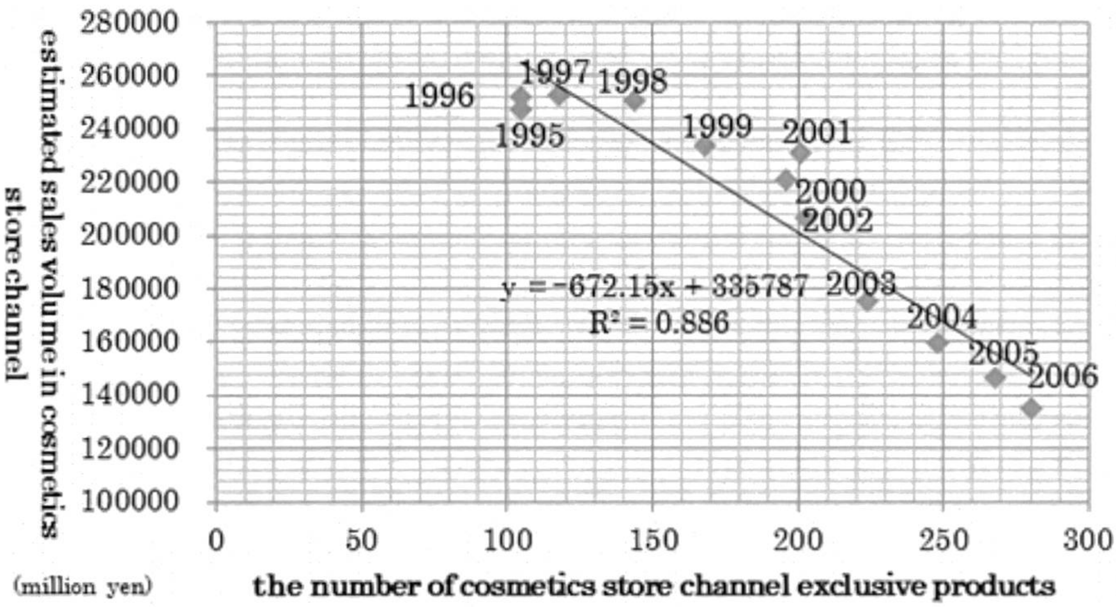

Figure 1: Shiseido's cosmetics store channel product counts and sales volume.
Note: The horizontal axis combines the "YOUR SHISEIDO," "Cosmetic House," "BENEFIQUE," "Qiola," and "Loseraire" product lines.

chain store product counts and the chain store sales volume. As the figure suggests, an increased variety of products tends to be accompanied by a decreased sales volume in this channel. The newly-introduced brand on which Shiseido focused most attention in this channel is "BENEFIQUE"; Shiseido continued to broaden the BENEFIQUE product line, increasing the SKUs in that brand from 11 in 1996 to 270 in 2007.

The total sales volume of chain stores in 1996, when Shiseido launched BENEFIQUE, was about 70% of that of the company as a whole, suggesting the importance of the channel to Shiseido. Given that, launching BENEFIQUE to differentiate chain stores from other channels can be seen as a reasonable decision. As shown in Figure 1, however, despite broadening its product line, the firm necessarily improve its performance. The decline in sales volume since 1999 is especially significant. Considering this rationally, Shiseido could have decided not to invest further in the chain store channel, or could have adopted a harvesting strategy.

In addition to this poor performance, two serious problems emerged within Shiseido due to the excessive product proliferation. One involved the confusion of salespeople and beauty experts – they could hardly remember the features and specifications of all the products. Sometimes, even beauty experts couldn't answer customer questions about the difference between products. The second problem was the dilution of advertising and promotional budgets, which led to the situation in which the firm could not invest enough in each brand and product. Despite these difficulties, Shiseido continued to introduce new products into this channel.

In the following section, I detail the process of excessive product proliferation, as drawn largely from my interviews. My results indicate a three-part process of over-proliferation at Shiseido: First, exclusive chain store brands, such as BENEFIQUE, were introduced into select, powerful chain stores – not the complete chain store channel. Second, Shiseido strengthened its approach to the drug store channel while launching the exclusive chain store brands, provoking dissatisfaction among the powerful chain stores; salespeople were deeply conscious of dissent from the powerful chain stores. Third, brands and products were not adequately managed inside Shiseido, in the sense that managers did not necessarily need approval for new product introduction from top management and the sales department could easily push its opinions within the company without careful examination, mostly on the strength of its experience in overcoming the difficulties of structural change in the mid-1970s cosmetics industry. Out of these, Shiseido's product line proliferated to excess.

6 The introduction of channel exclusive brands into powerful chain stores

Shiseido had employed a multi-channel strategy, which meant that the firm offered its diverse channels the same products. This strategy led to conflict between channels, with cosmetics stores demanding a solution. Products which had been sold at identical prices with counseling in cosmetics stores came to be sold at discount prices in drug stores; cosmetics stores couldn't help but reduce prices in the face of competition from the drug stores. Drug stores can make up a decline in profit due to price reduction with their large sales forces. That is, they have many chain shops of their own, and also carry a wide variety of products. According to *Yakuji Nippo*, a Japanese drug industry newspaper, in 2006, cosmetics accounted for 21.7% of overall drug store sales; commodities accounted for 23.7%; medicines 28.7%; and all others 25.9%. Drug stores could even increase sales in other categories by promoting cosmetics as a loss leader.

In contrast, most cosmetics stores are small, mom-and-pop operations. The average sales of a drug store are estimated at 280 million yen, whereas those of an average cosmetics store are 37 million yen. This suggests the serious impact of price reduction on cosmetics stores. However, customers of cosmetics stores that held fixed prices with counseling services made their subsequent purchases of the same products at the discount prices available in drug stores.

To address this conflict, Shiseido launched exclusive cosmetics store channel brands. Not all the cosmetics stores qualified, but those meeting certain conditions could offer those brands. For instance, Shiseido set five criteria for sellers of BENEFIQUE: (1) their adherence to the company's management philosophy; (2) their commitment to the brand; (3) a competitive location and sales staff; (4) the stability of management; and (5) the importance of the store for Shiseido in specific areas. Initially, only 4,000 of the 25,000 cosmetics stores at that time met these criteria. The number of stores able to offer BENEFIQUE grew over time, but Shiseido consistently maintained those standards. Clearly, the selected stores were quite important to Shiseido.

Naturally, salespeople at Shiseido listened to the feedback from cosmetics stores, especially from the select, powerful ones. As discussed below, there existed frustration among the cosmetics stores about Shiseido's strategy for other channels, and the Shiseido sales staff was acutely aware of it.

7 The multi-channel strategy dilemma

In addition to cosmetics stores, Shiseido needed to strengthen its drug store channel, which had seen significant growth. Therefore, the company launched many low- and mid-priced brands. In this study, I define these as brands for the mass market, sold across multiple channels. In Figure 2, the bar chart shows the number of mass market and cosmetics store channel exclusive brands, and the line chart shows the number of products. As this suggests, Shiseido strengthened its mass market brands beginning in the late 1990s.

The cosmetics stores did not welcome this approach because the Japanese cosmetics industry at that time had become a scramble for pieces of a finite pie. They raised objections: "Your company is expanding business toward China, isn't it?" "I heard that the company has plans to launch new brands for drug stores," "You always focus on drug stores," and the like.[16]

16 Interview with Mr. Kohei Yanagida, channel development department, domestic cosmetics division of Shiseido.

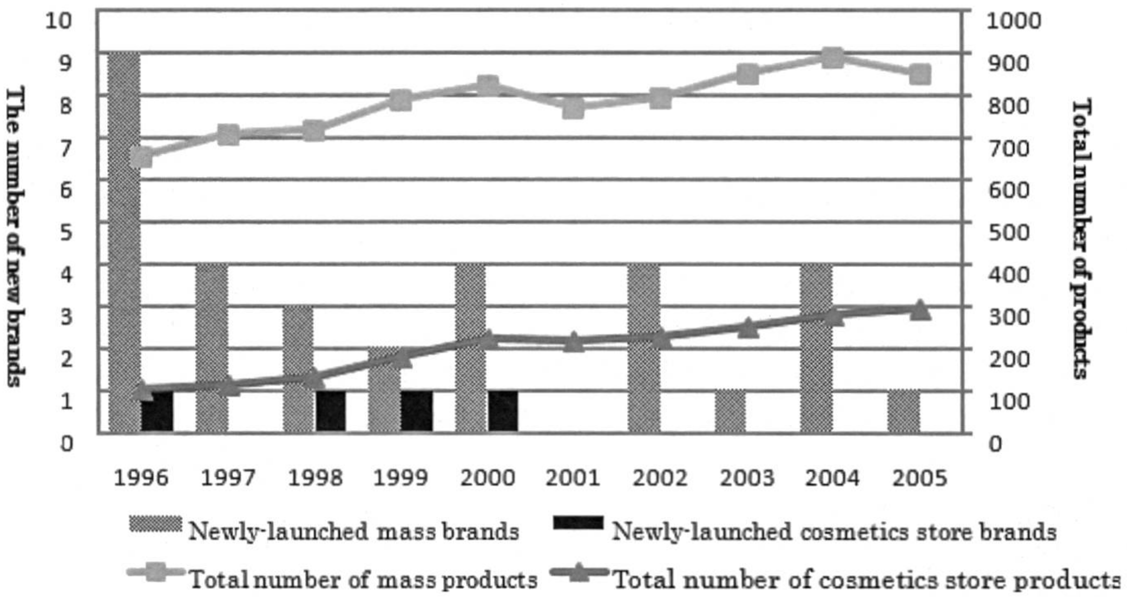

Figure 2: Shiseido's brands for drug stores and cosmetics stores.
Notes: Mass brands include all cosmetics products, except for high-priced brands and cosmetics store exclusives. The price range for each brand is determined from Fuji-Keizai Corporation's *Cosmetics Marketing Directory*, 2007.

8 Organizational Inertia at Shiseido

Excessive product proliferation cannot take place as long as the head office properly controls new product introduction. At Shiseido, however, two factors interfered. The first one was the company's successful experience with increasing sales through new brand launches and product introduction. Most Shiseido employees had experienced the success of its product proliferation strategy during the period of high economic growth in Japan. Managers from that era continued to introduce new products out of inertia, without careful consideration. Mr. Toshihiko Tatsuguchi[17] talked about the difficulty of changing that practice, even though the organization was aware of the strategy's dysfunction. "The reason Shiseido continued to spend on introducing new brands is that the company dwells on its strategy as it was during the period of high economic growth. We know that intellectually; however, we can't easily change this deeply-ingrained style."

Shiseido's strategy during the economic boom years meant the development of sales networks and expanding its product line. This gave Shiseido a competitive advantage, for two reasons. First, a low car diffusion rate and

17 Chief of the brand planning department, domestic cosmetics division of Shiseido.

undeveloped public transportation limited the transfer of consumers at that time. To assure product sales, it was important to expand the sales network to local markets.

Second, almost all consumers bought cosmetics at cosmetics stores, receiving counseling from beauty experts. As long as consumers came to the company's beauty counter, the experts could listen to their needs and recommend products from the company's product line. Therefore, broader product lines were required to meet diverse consumer needs, lest consumers look somewhere else.

In general, the strategy which worked successfully then shouldn't have worked after that time because the Japanese cosmetics market changed in the mid-1970s. For instance, the range in application of a cosmetics resale system decreased, growth of the industry slowed, and general merchandise stores (GMS) emerged as a new distribution channel. However, Shiseido could exercise stable management after the late 1970s, due to its efforts to insulate the existing vertical price system from price competition.

Specifically, Shiseido reduced wholesale prices and strengthened the progressive commission system to ensure retailers' profit. To do this without decreasing the company's profit as well, it needed to reduce cost or increase sales volume. To increase sales, the approach of the sales and product planning departments was important: the employee evaluation system in the sales department was changed to reflect sales to retailers, while the product planning department launched many high-functional and age-based brands to set product prices higher.

In this way, Shiseido could protect its sales network of cosmetics stores from fierce price competition with GMS. As a result, the company could maintain the competitive advantage it and its cosmetics store channel held with much the same strategy as had been used until the mid-1970s.

The second reason that the head office couldn't properly control new product introduction was the power of the sales department within Shiseido. Traditionally, the sales department had relatively high power. For new product introductions, decisions by top management were not required. Mr. Shinsaku Suguyama, ex-President of Shiseido UK, stated: "The sales department, named the chain stores sales division, traditionally exercised strong control within the company. Mr. Fukuhara, the first chairman of the board had created a product development department, which became the marketing department now, but the department didn't cooperate with the sales department well. There was a large barrier between them."

Indeed, in 1995, the marketing department, and then, in 2001, the cosmetics business strategy department were established to design brand strategy on a company-wide level, but the influence of the sales department on corporate strategy remained strong until recently. Mr. Toshihiko Tatsuguchi, the manager of the brand planning department, remarked on the sales department, as below.

> The sales department had acted on its own discretion until about 10 years ago; therefore I think there was inefficiency in product management such as revision or abolition of products and new product introduction. For instance, in case a newly launched product did poorly in sales, it was difficult to discontinue the product if it had a longtime important customer. We called those "powerful $n = 1$," like the sample number "n = 100" in a survey. Sometimes "powerful $n = 1$" is an end customer and other times it is a cosmetics store. We sometimes ignored efficiency and continued to produce a product due to the voices of "powerful $n = 1$."

The sales department, which could exercise control over the company, heard the voice of the cosmetics stores. As a result, the problems of introducing new products without careful consideration and of maintaining dying products arose. In this way, Shiseido committed excessive product proliferation, especially in the cosmetics store channel.

9 Discussion

The present case study is an examination of the causal factors behind excessive product proliferation at one company. It helps to address the dearth of research on excessive product proliferation, with a particular focus on the internal factors underlying over-proliferation. At Shiseido, excessive product proliferation began with the launch of exclusive cosmetics store channel brands as a solution to channel conflict between cosmetics stores and drug stores. Behind this lay intra- and inter-organizational inertia: Shiseido had long-term relationships with cosmetics stores, which gave the company a competitive advantage. In addition, Shiseido's new product introduction process reflected the inertia of having carried it out successfully in the past. Shiseido had experience in overcoming the crisis of change in the Japanese cosmetics market in the late 1970s, which, however, only reinforced its corporate strategic and organizational inertia.

This study suggests two situations in which companies proliferate products to excess due to organizational problems. The first is when an existing channel with which the company has a long-term relationship is threatened by the emergence of a new channel. In this situation, the company needs to address both an existing channel and a new channel. The greater the competitive advantage of the existing channel, the greater the number of good customers. Therefore, the company tends to respond to a good customer already in place.

When the appearance of a new channel does not indicate market expansion, a competition for pieces of a finite pie begins, provoking a channel dilemma for the company.

The second situation is when organizational characteristics make it easy for the company to introduce new products. It is often the case that a company experienced success via its product proliferation strategy during its growth phase, because barriers to the introduction of new products could be low for such a company. This situation can also arise if the sales department has relative strength within an organization, because it tends to point out the product itself or the absence of a product meeting customer needs as a reason for a slowdown in sales.

These situations already arrived with the appearance of the Internet as a sales channel. A company which had a competitive advantage in an existing channel needs to consider its product strategy carefully.

Although I provide qualitative descriptions, there are some limitations. The first one is a problem of generalizability. Whereas I investigated a firm in the Japanese cosmetics industry, future research can attempt to test my findings statistically, across many industries. Another limitation of this study is that I did not consider the ways to respond to channel conflict. Additional research is needed on this important topic, from the perspective of product proliferation strategy – for example, to what extent companies should separate their products along sales channels.

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