

Rationalizing SKU Introductions: The Sensible Approach to SKU Rationalization

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Would you like to be friends with a cannibal? Sure, they may be good company on occasion, but when push comes to shove you might just have to watch your back, literally! Your products are the same way. Allowing unlimited SKU's not only slows down your company but also hurts sales among your other product lines, which end up competing with their lethargic counter parts. The focus should be getting out of this death spiral.



The New Product Development Death Spiral

SKU rationalization has been a popular tactic among supply chain practitioners for the past decade as a way to take control of unwieldy operations, operations that have often evolved to support thousands of non-productive products. In fact, some companies are surprised to find that the old 80/20 rule is actually even more extreme when they stop and do an analysis of SKU profiles and the productivity of the SKUs in their current portfolios. For example, one company we recently worked with had 80% of the revenue come from just 3% of their products. So why do companies fall into the trap of constantly pushing out new products, only to stuff their warehouses with additional burden of slow moving SKUs which ultimately fail after millions of dollars were spent on the new product introductions?

In many companies, marketers chase the dream that they will invent that "next blockbuster product" which will take the marketplace by storm. But, they are dealing with consumers who have a tendency to shift from one focus to another with unbelievable speed. Companies, in turn, create a variety of products to quench the thirst of fickle consumers who are the foundation of the consumer product industry. For many, the key strategy employed is to flood the market with a breadth and depth of products, hoping the payoffs of the successes will outstrip the cost of the failures.

Let's take Coke for example. For more than half of its history Coca-Cola had one product in one package. The 1950's brought the advent of packaging choices and various flavor introductions. On top of that, the beverage giant made a bold move in its first formula change in 99 years by introducing 'New Coke' in 1985, which was rallied against by the consumer market and within months discarded.¹ A walk down the local grocery store aisle reveals dozens of SKUs of Coke branded product ranging from the good old Classic Coke to exotic flavored versions. In fact, Coke reports that today it maintains more than 450 brands in over 200 countries worldwide. The market may not be necessarily flooded, but it is hard to deny that a company's list of products may be relying on the success of a few to cover the costs of the many.

As more companies adopt this strategy, the problem only gets worse for the entire industry, a virtual death spiral for over 90 percent of new products. Just how big is the death spiral? Let's look at some simple facts that reveal just how big of a problem new product introductions have become.

- The failure rate of consumer products is 95 percent in the U.S and 90 percent in Europe.²
- Research shows fewer than two hundred of the hundreds of thousands of products introduced over a recent ten-year period earn sales of more than \$15 million a year.³
- Only 45 percent of new products experience an on-time launch, a key driver in the long-term success and future viability of a product.⁴
- At most, only 10 percent of new products are successful after three years. This includes products in various sectors including consumer package goods, telecommunications services, even Hollywood movies.

Simply put, the problem is that most of the products that are released into the marketplace fail and thus create costs, and an unbelievable amount of costs at that.⁵

So what can this mean for your business? It's analogous to being friends with a cannibal. Allowing unlimited SKUs not only slows down your company by bogging down its supply chain, but it also hurts sales among your other product lines, which end up competing with their lethargic counter parts. What should be kept in mind is that each of these creations requires new SKU's, which often are not removed from the system after the promotional (or product life) time has ended and is also not removed by the retailer/distributors, leading to complexity throughout the supply chain. And what is worse, companies are investing millions of dollars in product development and new product introductions, just to compete with themselves.

The Traditional Approach: SKU Rationalization

In recent years, supply chain practitioners have brought focus to this problem. Warehouses are bulging at the seams as the number of SKU's go up, causing inventory turns to go down, clogging the supply chain.⁶ As companies come under intense cost pressures, operations leaders are stepping up and winning the SKU



proliferation battle, cutting SKUs to make supply chains more efficient. For most companies this means adopting some form of SKU rationalization efforts where analysts try to weed out poorly performing SKUs.

But we would argue that putting energy into SKU rationalization alone is a poor approach because the damage has already been done and huge investments in product development, marketing and product launch costs have already occurred. The truth is that flooding products into the market causes substantial strains upon all divisions of the company, particularly the supply chain –and these become sunk costs once the product is launched. Indeed, as more and more products are introduced, organization complexity increases exponentially and a significant portion of the growing pain is felt by every company in the supply chain. Every product line that a company creates requires product roll-outs, more SKU's, employees to work with that product line, and future rationalizations (performance analysis) of the line as the products become obsolete or fail, as most do.

A Change in Attitude, Rationalized SKU Introduction

To really get ahead companies need to solve the real cause and do a better job at introducing new SKUs, thereby getting ahead of the curve and nipping the need for SKU rationalization in the bud. This calls for a change in mentality, from one where products are rushed to market into one where products are verified as actually contributing to corporate vision and profitability and are truly satisfying customer needs. We outline three proactive approaches that companies can use to help rationalize SKU introductions.

Market Testing

Market Testing involves a trial production of a product in order to determine market capabilities before a company-wide roll out. Distilling a product to its basic goals, the purpose of a product is to deliver profits to a company, increase company market share, and add to brand image. Testing gives a company the ability to obtain a better idea of whether or not the product will succeed in the market and meet these goals. It also offers the added bonus of being able to demonstrate the potential issues of the product's marketing, packaging sizes, compatibility, etc. Lastly, market testing allows for collecting end-consumer feedback. By using testing, a company can not only ensure that it only delivers products which stand a chance in the market, but it also helps strengthen the full product launch to be as successful as possible. Going one step further, the product should not be entered into the company's IT systems until it has passed this phase, in order to negate the need for removing a failed test later on.

Indeed, products should align to the supply chain (or vice-versa) which distributes them. 'Functional' products (basic necessities, e.g. toilet paper, water) should be incorporated into "efficient" supply chains (focused on delivering/stocking ubiquitously with the lowest cost at a given service level). On the other hand, 'innovative' products (new, leading edge, e.g. laptops, game consoles, processors) should be incorporated into "responsive" supply chains (higher cost, focused on fast replenishment and immediate forecasting at a given service level). By incorporating the product into the correct supply chain the product can be launched properly and the system is set-up to easily handle the product's needs in the future.⁷

CFT's

Cross-Functional Teams (CFT's) have gained traction over the last decade as a way for companies to streamline product creation and mitigate the obstacles that were present when the divisions of a company operated as individual units (silos) and did not work in tandem. Using the CFT medium, divisions help each other to create the best product possible, which contributes to market success. A mentality that should be considered when either using pre-existing CFT's or implementing new CFT's is that the team should have a system for filtering out products that have limited long-term prospects, and have no reason to be introduced. When multiple divisions of a company offer perspective into the potential success of a product, unnecessary projects can be avoided and more time can be spent on products with higher chances of success.

A New Way of Thinking

Probably the biggest obstacle for a company to overcome is culture. We advocate a new way of thinking about product introductions and product portfolio or lifecycle management. As mentioned, product rollouts are usually coveted as opportunities for rapid growth. While this may be true depending on the situation, the majority of products are hidden daggers cloaked in a marketing guise of profits and success. When these products fail, the dagger is revealed and strikes at the core efficiency of the supply chain. A recent idea gaining traction is separating product development into early and late stages with the help of computer software. These software packages either model or work in tandem with stage gate and commercialization processes that have evolved over the past 20 years. Early stages are geared toward research and eliminating bad apples (aided with computer heuristics, analysis, and forecasting), and late stages are for maximizing value and inculcating the product line into the supply chain. While research on this new trend is sparse, the early-adopting (specifically pharmaceutical) companies implementing computer-aided staged product introductions have experienced tremendous gains in efficiency and higher launch success rates.⁸ It is also a critical area for high tech companies whose product lifecycles can be very short.

Rather than just pumping out new products and seeing what sticks, products should be introduced with the expectation that they have a finite life and are to be actively managed throughout a defined lifecycle. The lifecycle is criteria-based and considers the total effect on the product portfolio as well as the supply chain. In addition to implementing a defined stage gate process to get products to market, leading organizations actively manage the portfolio and have defined exit strategies for every product. Strategies and plans for managing the portfolio are now often being integrated into the monthly Sales & Operations Planning (S&OP) process. A structured Portfolio Review often starts the S&OP cycle and is designed to not only evaluate the portfolio in a structured and objective way, but also to ensure coordination with demand and supply planning. This is especially critical to consumer goods companies and others who deal with managing thousands or tens of thousands of SKUs.

Moving Forward

New product introductions should be fully considered before being brought to fruition. It is said that the excellence of a supply chain will become the definitive advantage for companies operating in the decades ahead. It is therefore necessary that all ramifications of

product introduction, especially those with regard to potential success and effects on the supply chain, be carefully considered. Only after careful analysis should a product be introduced. This analysis may include various cost projections, potential direct (sales) and indirect (brand awareness, retail space, slotting revenue) revenue projections, compatibility studies with current products (being careful of cannibalization), and supply chain compatibility and complexity issues. Product introductions should also consider the effect on in-stock rates of all products, IT/facility efficiency issues, and transportation limitations. If, in the long term, the product can generate significant profit for the company without putting undue stress on the supply chain then it may be a keeper, but if not it should go under serious scrutiny within the context of the principles of product portfolio/lifecycle management and customer service. As rationalized SKU introductions gain more traction, companies and supply chains alike will begin to experience the benefits of simplicity, efficiency, and competitiveness.

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