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Range Management

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Product Range Management

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Range Management

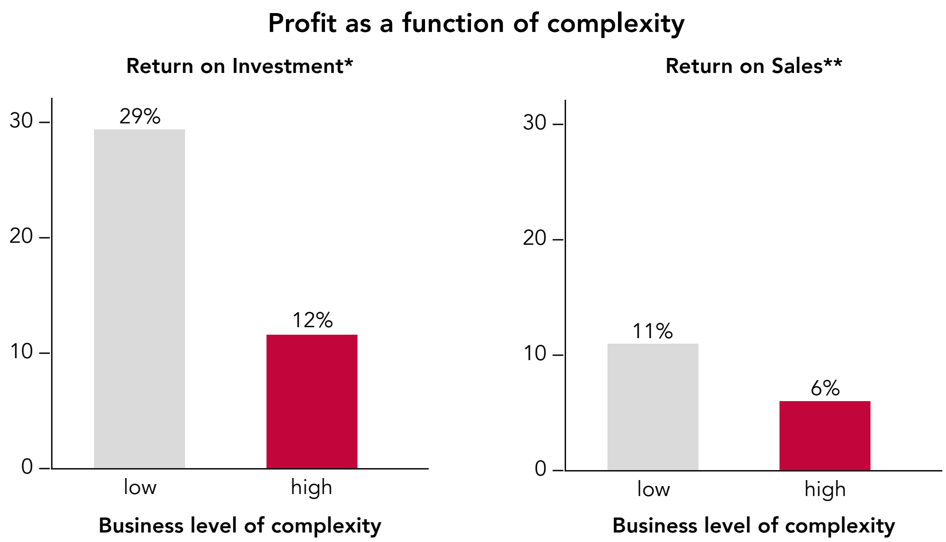
A lot of companies are experiencing that complexity is choking the development of their business. Complexity can be caused in many ways – some of which are outside your control. But one area that you definitely can address is your product range, and getting this under control will most certainly help you improve your performance.

You have undoubtedly asked yourself many times if you must have all those SKUs and variants, many of which have very low sales year after year. But far too often nothing really substantial gets done about them. Nobody seems to know for sure why these products still remain active, but the risk of losing revenue is enough to stop anything happening. To prove the case, there is also someone in sales somewhere in the world who screams blue murder if you suggest discontinuing one of those articles …

In the same way you may have similar concerns about your customer base. Do contacts with some of the old customers really pay off? They used to be large accounts but are they still profitable?

Long tails of products, and customers, with low sales volumes drive complexity. They require substantial indirect resources that are difficult to "grasp" but it feels very time consuming to start digging into all this. These products, and customers, are therefore simply often left on the "to do" list until next year … (the people handling them are on the payroll anyway, so the gross profit must give some positive contribution …)

However, different surveys and research show that the cost of complexity is a significant factor behind lower than average profit levels.



Analysis on the PIMS database (Component manufacturers)
* EBIT as a % of Investement (Investment = GBV + Working Capital)
** EBIT as a % of Sales

How efficient range management can improve you performance

One important finding from working with lean, is that most of the efficiency losses occur in the interfaces between functions. One way of solving the problem is to organize work more process oriented, and this is often a successful way of coping with daily operations and issues that are frequently repeated.

Other types of activities, often with strategic content, that are performed less frequently, are much harder to handle in a process oriented way since they cannot, or even should not, be fully standardized.

One example is range management. Range management includes a number of different activities with the aim of developing a competitive product range and keeping it live and healthy over time. Typically, organizational functions like R&D, marketing, sales, production and logistics all have a stake in range management, but if these functions are not well coordinated, the risk is high that sub-optimized activities are conducted in each of them separately.

Range management itself is also an activity in the company that cannot always be clearly defined, since the nature of the business may require quite different focus. Range management means very different things in different business cases:

- Wholesale and retail of traded products
- Contract manufacturing of products where the customer owns the design
- Manufacturing of standard products of own design for stock
- Manufacturing of standardized base "products" finally designed upon order
- Manufacturing of systems composed of standardized components from stock
- Customized projects, even tailor made from scratch and installed on site

To describe range management in this document, and the methods and tools that we often apply, we are therefore primarily describing the situation in a traditional manufacturing company, producing and selling own products through channels where it has a fair amount of control. This does not mean that range management is not relevant in other cases, but some of the methods and tools might have to be applied differently!

If we assume that the company in question has prepared an overall company strategy, laying out in which business areas it is going to be active, general growth and profitability targets e t c, the next step is to develop and maintain the product range.

A. Strategic range management

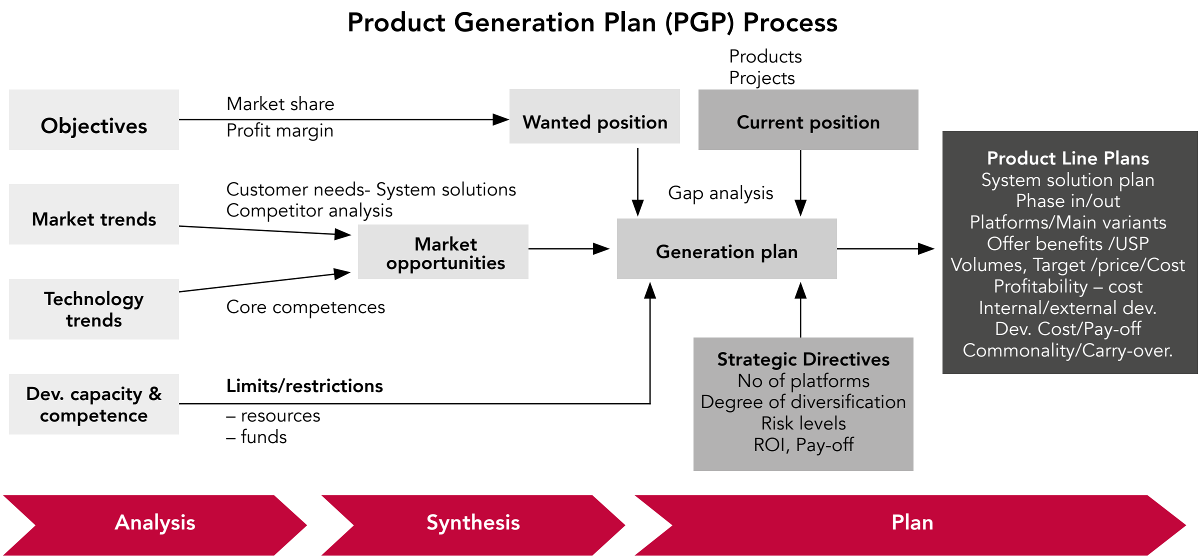
Every business needs a strategic view on the development of its range of offerings. To be successful the way of working has to bear sign of:

- An innovative climate leading to better understanding of customer's spoken and unspoken wants and needs.
- Ability to transform market- and customer needs into competitive offerings in a cross-functional and also cost efficient way over time.
- A co-operative and cross-functional working model, towards clearly communicated common objectives.

Too often "one man shows" within one department might be theoretically right, but disastrous in practice, since the rest of the company do not "understand" and act accordingly.

Our preferred method for strategic range management is PGP, Product Generation Planning. PGP is a way of working where all functions get involved and the 3–5 year plan for the product portfolio is defined. PGP is a way of cross functionally developing and "translating" the business strategy into a next, more concrete, format, before the functional organization takes over the implementation.

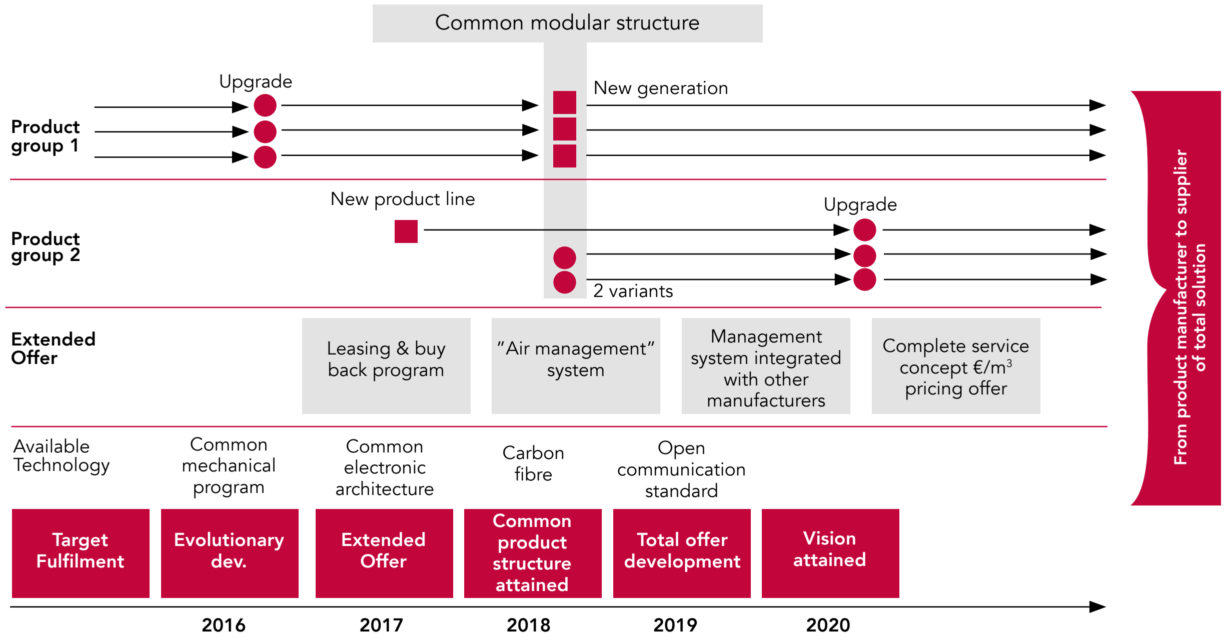
An example of the process to prepare a Product Generation Plan is displayed below:



The process is designed to take into consideration facts and findings from market, technology, production and our own performance vs. competition, in order to prepare a plan that is visible to all functions and also calls for commitment from all parties involved. The product generation plan should consider not only technology, design and logistics, but also who should buy. Sales and marketing needs to contribute with their knowledge and intentions regarding customer and channel development as well as general knowledge on market trends and shifts.

If sales has asked for the development of a certain product range, the viability of the request is scrutinized, and when the decision is made, sales also has to commit to expected sales volumes and accept an agreed development time-schedule before it can be launched. If all parties stick to their commitments a lot of fruitless internal frustration can be avoided.

The outcome, the Product Generation Plan, could look like this.

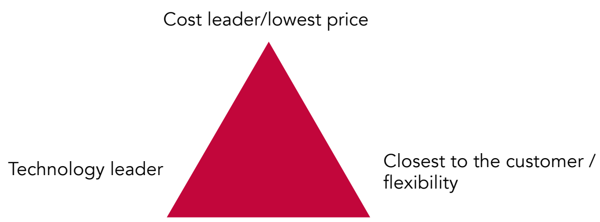


When the product range is developed, it is always important to keep in mind why a specific product is in the range and what makes the customer buy it. One method to evaluate buying criteria is **PIMS® Customer Value Analysis (CVA).**

CVA is a way of evaluating how important different criteria in your offering are to customers, and also how well you and other suppliers are performing on each criterion. CVA is described in detail in another of our Ohde Solutions documents.

RANGE DEVELOPMENT

First you need to decide which part of the market you want to target and where you want to be perceived as being active. One model frequently used is in this connection is Porter´s generic strategy triangle.



It is more or less impossible to be everything to everyone, and before trying to be, it is worth considering your real priorities!

The next step is to figure out which role each product in the range is playing towards each defined customer group. Some frequently used classifications are;

- Volume products (the product normally sold to the focus customers)
- Products needed as building blocks in forming a complete system/range
- “Eye openers” (competitively priced products to attract new customers – sometime referred to as “strategic” ...)
- Products to demonstrate ”Angebotskompetenz” (innovative or highly specified products to give credibility as supplier, or the highly priced version that shows how “low” the price is for your standard product)
- Standard assembly accessories (necessary as service?)
- Consumables (regularly replaced components)
- Spare parts (occasionally replaced – what is required, and for how long?)

Combining this classification with your classification of customers or sales channels might indicate where you have “holes” in the portfolio or where you have more products than is really necessary to satisfy your customer needs.

PREFERRED AND EXTENDED RANGE

Another model we use to structure your range is to define a “preferred range” and an “extended range” of products.

The preferred range consists of all the products and services that you really “want” to sell. This is the range that includes your profitable products and which solves the majority of customer needs and, if needed, available from stock, or with very short lead time. It also includes selected spare parts and consumables and might include some eye openers if different from above, as well as one or a few ”credibility” products to boost impression in catalogues e t c. When making this classification the first time, a rule of thumb is to limit the preferred range to products making up 80% of sales, but probably a much smaller percentage of items.

The remaining products belong to your extended range. These are the products that you “are able to sell” if asked for. These products should only be available upon request / order (from own factory or directly from suppliers). They should be displayed in separate catalogues or written in italics, and be priced at a higher level or possibly only quoted on demand. The extended range products can also include limitations like; only sold/produced in minimum quantities and with delivery times depending on larger orders coming in e t c.

B. Operational range management

With the Product Generation plan outlining the long term intentions the range also needs attention in the short term.

The introduction of new products is often managed by some kind of product management committee where decisions are taken on if, when and how new products should be launched. If a well-run Product Generation Plan is in place, this becomes a fairly straightforward process, since everyone knows what and " when" new products are in the pipeline. The process of introducing new products to the market is, however, a separate subject, and is not covered here!

If launching new products is the exciting side of operational range management, pruning tail ends of the range, and agreeing to phase out a product, is the dull side. In theory, most companies state an intention to review their range once or twice a year to close down sales and production of non-performing products, but our experience tells us that this is not always the case. A common reason for this is the fear that since the old product is still bringing in some revenue, the new products might not capture 100% of the old customers, and you therefore might lose sales if you close the old product down completely.

If there is one single source of efficiency improvement that you can find in almost every company this is the one, how boring it might sound. Pruning old products also release time and resources for the introduction of new products!

The same is valid for customers and channel management. Since it is a well-known fact that finding and convincing entirely new customers is much harder than maintaining existing ones, the risk is high that the sales force spends too much time and attention on known customers, even though they have low sales and low potential to grow, just because they are known. Finding better ways of keeping in touch with customers where the most expensive modes of contact simply cannot be justified, is another way of improving efficiency.

All these areas of improvement can be supported by some simple analytical tools.

CREATING A FACT BASE FROM OUR ABC^2 AND ABC^3 ANALYSES

Product Generation Planning, channel management, operational range management of new products and pruning of tail ends and other product discontinuation are all far easier to perform if you have access to relevant and meaningful data on sales and profitability of the products and customers.

We have developed a set of tools and models to support these activities which have been used in projects within a wide range of industries and countries. A sound fact base is especially useful in areas, like these, where there is a risk that short lived trends, the highest voice or simply rumours, will create an ad hoc behaviour that is very costly and yet still not successful.

Analysis without action is informative but unfortunately does not add to performance! The analyses from our ABC models are extremely useful when outlining hands-on improvement activities. Potential actions to mitigate problems could be:

- New and more precise pricing or discount policy
- New pricing of tail end products
- Scrutiny of your cost calculation model from production and onwards to show real profitability
- Development of a better fact base in the sales organization to improve precision in selecting mode of contact towards different customers or groups of customers
- Stricter range control procedures like evaluation and elimination of slow movers faster or controlled range development of new products ("mercy killing and birth control")

ABC² AND ABC³ ANALYSES

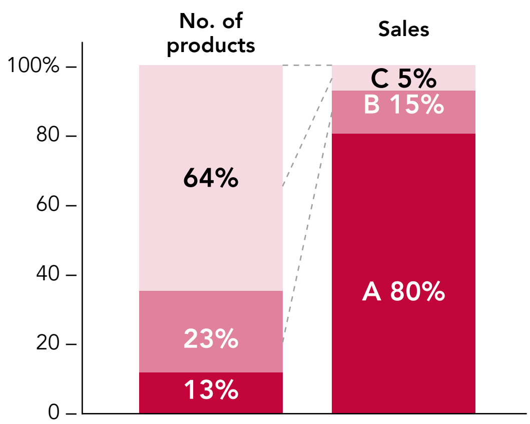
Our analysis methods are built on well-known pareto analysis and the thinking behind Activity Based Costing, to which we add the combination of the product and customer perspective.

ABC² and ABC³ analyses are particularly useful when:

- Volume growth targets are general (not focused); i.e. new customers and products are added with limited strategic considerations as long as they generate volume
- Pruning has been slow and the range contains long tails
- Products and/or sales channels require different use of indirect resources
- The proportion of indirect cost as a share of total product cost is high or increasing
- Indirect costs are not allocated at all, i.e. Gross Margin targets only
- Indirect costs are allocated as a general percentage of sales or direct working hours only

ABC²

In order to conduct an ABC² analysis, all products and customers are listed by sales volume with the first group classified as A reaching 80% of all sales, the next 15% as B and the last 5% as C. The example below shows how it often looks. The question is, do we really earn money from the C-group of products (and customers)?



The combined classification of customers and products, which is the key to the ABC² analysis, can be shown as a matrix:

ABC² Analysis – Example

Customers		Products									
		A 164 articles 160 MEUR Revenue 70 MEUR GM			B 207 articles 30 MEUR Revenue 7 MEUR GM			C 1 057 articles 14 MEUR Revenue 3 MEUR GM			Total 1 428 articles 204 MEUR Revenue 80 MEUR GM (39% GM)
A	130 customers		45%			26%			24%		
	163 MEUR revenue	130	134	142	130	22	179	130	7,5	646	
	67 MEUR GM		59			5,5			1,7		
B	240 customers		41%			30%			18%		
	27 MEUR revenue	190	18	86	170	2,7	87	190	3,4	366	
	9 MEUR GM		7,4			0,8			0,6		
C	1 200 customers		39%			21%			14%		GM%
	16 MEUR revenue	910	8,8	84	940	4,2	118	1 110	2,8	655	# Custo-mers / Revenue MEUR / # Articles
	5 MEUR GM		3,4			1			0,4		GM MEUR
Total 1 570 customers											

Tail end products and tail end customers should generate a higher than average margin since they almost certainly require more indirect resources as percentage of their sales "value", The matrix of ABC customers and products raises a number of interesting questions to ask yourself.

- Do you have a general range issue? (long tail with very small volumes)
- Do you have a tail end pricing issue? (lower gross profit in the tail end)
- Do you have a pricing issue with small customers (lower gross profit in the tail end)?

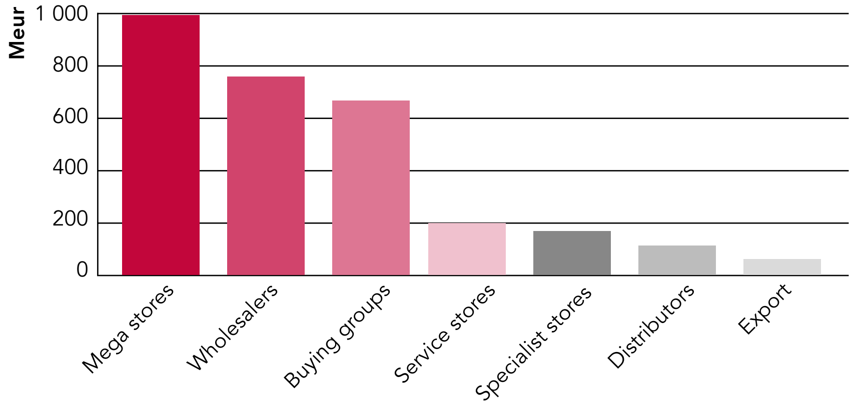
ABC³

The next step is to take a look at your indirect resources. For many years the trend has been towards lower and lower direct cost and increasing indirect cost in many companies.
The risk of taking a wrong decision, without realising it, is thereby increasing.

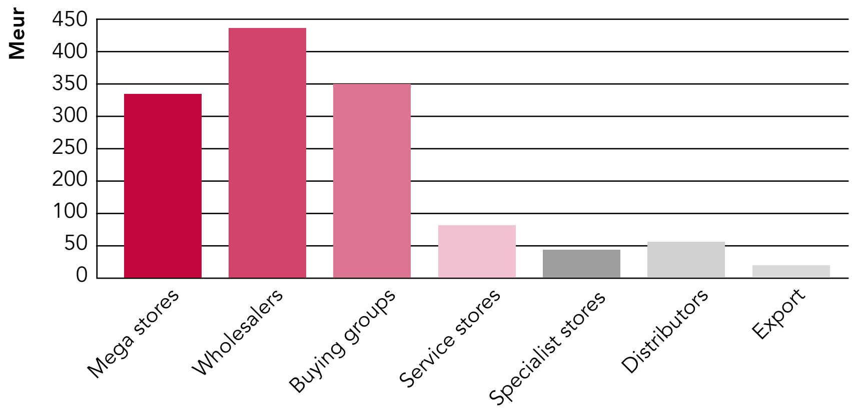
If we allocate the indirect resource consumption to products/product groups and/or customers/sales channels we get a much better understanding of where the company´s net profit really comes from. When making this distribution of costs we strive to apply pragmatic and simple allocation keys. The aim is not to reach perfection but to get a good enough indication from the analysis.

An example from an actual project illustrates the findings. It turned out that the business area with only the third largest revenue in reality provided the vast majority of net profit! How does it look in your company? Would you prioritize future R&D and channel development in the same way as before?

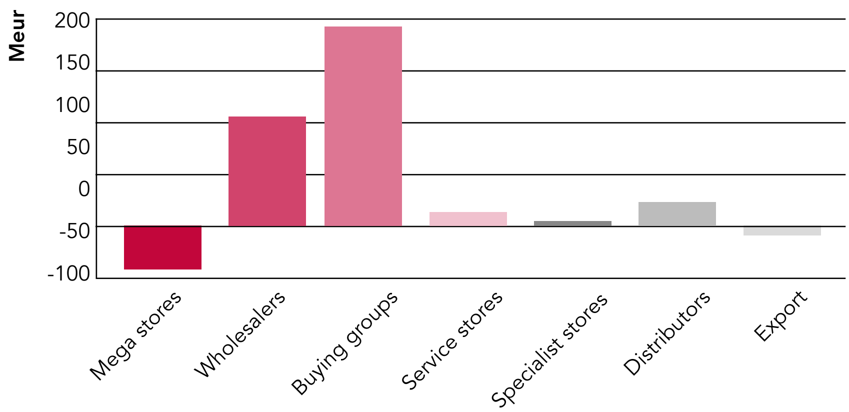
Revenue by channel



Gross profit by channel



Net profit by channel after distribution of indirect cost



OHDE & CO was founded in 1993 and we are today about 15 consultants. Most of us hold masters degrees, and all of us have long experience from both operational management positions and management consultancy. Typical customers are mid-sized companies in manufacturing and services.

We cooperate with Malik Management, St.Gallen and PIMS Associates, London. Through this cooperation we have access to a well known and extensive database and business model simulation tool; PIMS – Profit Impact of Market Strategy.

If you would like to learn more about range management, please contact us!

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