



Complexity cost reduction and portfolio optimization

Challenge

The case company has experienced a substantial growth during the last 10-15 years within one of their segments. The increase in revenue has been realized through a mix of organic growth and a long history of mergers and acquisitions, while serving more markets and consumer segments within the area than ever before. This has resulted in an expanding and complex range of products that satisfies the varied requirements that wholesalers have in terms of unique accessory kit configurations and compliance with regional variance in power grid.

Annual SKU (Stock Keeping Unit) rationalization initiatives have helped to control the expansion of the product range. These initiatives were mainly based on revenue targets in order to ensure that the least selling product variants were discontinued or substituted on a regular basis.

In order to further the effort of the existing SKU rationalization process, CPC was approached by the case company project team and asked to assist in developing a method for optimizing a consumer product range - using more than revenue targets - in order to reduce the total costs of complexity across the entire product range. The work took its starting point in the proven 5-step CPC-method to complexity cost reduction in order to develop a methodology especially tailored for the case company.

Approach

The 5-step CPC-method to complexity cost reduction allowed the project team to reveal the true product costs. Most often, the standard-unit-cost found in ERP-systems does not reflect the costs of complexity incurred throughout the value chain. In combination with local governance of sales prices, the gross profitability of every product variant was not clear on a corporate level. However, gross contribution margins do not include the costs of complexity that a diverse range of products naturally incurs from component suppliers in Asia and all the way to retailers selling the products to the end-consumer. Therefore, the project team applied a set of advanced cost allocation techniques intelligently allowing for a more precise distribution of fixed costs across individual product variants.

Results

The result of the project was the transparency of cost on an individual product variant level that allowed for a smart rationalization of the complete consumer high pressure washer range. By basing the SKU rationalization on the true product costs including the costs of complexity throughout the value chain, it was possible to optimize subsequent season's product range by smart substitution of product variants. The efforts promised to minimize the costs of complexity with prospects for several percentage points increase of EBIT margin.

Moreover, by calculating the costs of complexity implied by an early configuration of product variants, the project led the way for the establishment of a postponement center for late customization in order to decrease inventory costs while maximizing market responsiveness.

The case company

The case company is one of the world's leading manufacturers of professional equipment and machinery with production sites and sales companies across 43 countries worldwide. The main product lines are designed for professional use in industrial applications, and for a number of consumer applications.