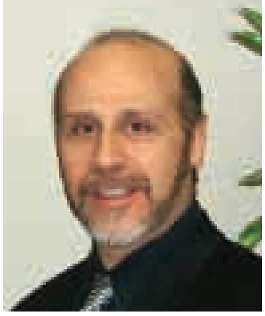

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GLOBAL COSMETIC INDUSTRY

MANUFACTURING EXCELLENCE BY C. RICHARD PANICO

Product Rationalization

Are you mining for coal instead of gold? It is critical to choose the right targets and focus precious resources on them.

The concentration of time, energy and resources to a specific endeavor exponentially increases the probability of success.

Most every company is faced with a challenge that is as old as the concept of business: a limited number of people, expertise, intellectual property and assets. Although successes provide the opportunity to grow resources, they are always limited. Assuming that success is defined as the ability to achieve desired results in an optimal manner, focus—the concentration of time, energy and resources to a specific endeavor—exponentially increases the probability of success. However, while focus may dramatically increase your likelihood of "hitting the target," it certainly won't guarantee you will choose the right target.

Product rationalization is far from a new concept or innovation. Quite frankly, it's about applying common sense to deciding what products in which you choose to invest. Many companies, as they grow, age and become consistently profitable, become less disciplined in assessing elements that comprise the total investment required to deliver a product to the market. As the number of products and correlating volumes increase over time, it becomes ever more complex to make the common sense decision to focus resources to those products offering the greatest returns.

All products experience a life cycle, the period from introduction to growth, then to maturity and through decline. This may be a very short period—months—for some products and, in other cases, may extend indefinitely. Long life cycles present obvious advantages and commensurate challenges. The challenges come in the form of competitive influences: everyone wants "a piece of the pie." Most of you probably work for companies that are searching continually for ways to make your piece bigger. Product performance improvements, aesthetic enhancements, packaging innovations and, of course, lower costs are conventions routinely applied to increase market share.

As competition increases or the demand life cycle approaches decline, it becomes more important for a company to understand the costs versus the value of current investments, as well as projecting the investment and value that it will realize if it continues to service a particular market.

Consider the case in which a company has hundreds or thousands of products or variations of products at different stages of their life cycles. Imagine the effort required to manage raw material inventories, production scheduling, manufacturing, finished goods warehousing, customer service, marketing, sales, accounting, etc. Can a company manage this type of scenario? Actually, most do. But, very few do it efficiently because there is too little focus. Resource dilution, the reciprocal of focus, is the single most debilitating influence within companies today—not just those that produce goods.

Although all of this is simply common sense, the complexity of most businesses requires organizations to have sound processes and a lot of discipline to determine "what to hold and what to fold." To accomplish product rationalization, the following is minimally required:

- A reliable standard cost system
- Product life cycle information
- Understanding of competitive influence
- Knowledge of the strategic plan and specifically marketing strategic priorities
- A cross-functional team with representatives from finance, marketing, operations, logistics (warehousing and distribution), sales, information services and research.

Experience indicates that most companies could improve the processes used to calculate the true cost of each SKU accurately. Activity-based accounting methods typically are best suited to allocate fixed and variable manufacturing costs and all other burden to products. However, "garbage in, garbage out." The larger the company, the greater the number of SKUs, the more complex the undertaking. Modern Enterprise Resource Planning (ERP) systems certainly have the capacity and capability to support the efficient operation of a standard cost platform; however, as is often the case, ERP systems are poorly implemented and underutilized. There is a belief in some organizations that implementing an ERP system will address process inefficiencies automatically. Yet, processes should be reengineered prior to implementing ERP. In any case, developing good product cost information is essential.

Given that cost is critical, don't overlook the other elements identified. A low volume product with a good margin may be worth retaining; however, it may also be a great candidate for outsourcing if it is restricting your organization's abilities. Understand the total impact of committing resources to a product.

Product rationalization may be viewed inaccurately as an event. It needs to be a recurring process, a natural tendency whose frequency is determined by factors that include your specific market dynamics. As an example, if you are producing high-tech products with one to three year life cycles, you will want to address product rationalization at least once per year. There will be a very limited time to make adjustments to impact those critical margins.

If you take the time to research the reams of case studies and information available on product rationalization, you will readily recognize a common conclusion: the 80/20 rule is alive and well. That is, 80 percent of companies' profits ordinarily are wrapped up in 20 percent of their products, yet resources typically are not aligned to this priority. Studies indicate that by focusing on the most profitable and promising products, business can grow at 20 percent a year and sometimes faster.[1]

If you are one of the fortunate few who belong to an organization that has a regularly applied product rationalization process supported by an accurate standard cost system, managed by an informed, empowered cross-functional team, keep up the great work. You're probably an industry leader. If, on the other hand, you're "one of the others," you owe it to yourself to start mining for value. Maximize your capability and potential through focus. It never fails. GCI

C. Richard Panico is president of Integrated Project Management Company, Inc., a professional project management firm in Burr Ridge, Illinois. IPM plans and leads execution on client objectives, helping companies meet them faster and more effectively. Panico is a frequent guest speaker and author on the subjects of business management, leadership and ethics in academic and business settings, and he is chairman of the Institute for Business and Professional Ethics at DePaul University, Chicago.

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