



SECTION ONE

Partnering on Product and Service Portfolio Management

How can Supply Chain partner with the business to make better product and service portfolio decisions?

SECTION OVERVIEW

Companies typically add product and/or service features over time to drive sales, and then rationalize these features when the proliferation compromises operating efficiencies. Proliferation is expensive, but so is rationalization. A critical question arises when the organization agrees to rationalize the portfolio—How do we know we're eliminating the unprofitable products and/or services while keeping the profitable ones? The default often is to put these decisions off while proliferation increases and while the organization rationalizes periodically, it is costly and resource intensive. In an Activist supply chain, the number of products and/or services grows smoothly, because decisions about the product and service portfolio happen on a regular basis.

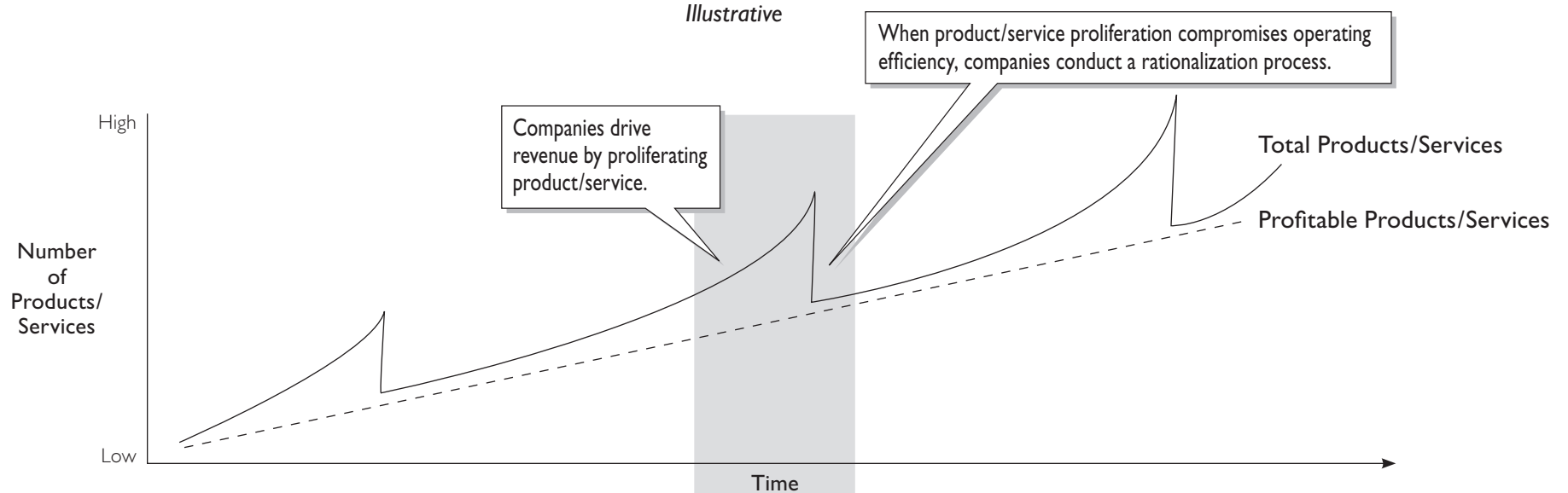
The case study that follows on Clorox's Good/Bad SKU Management shows how Supply Chain can quickly assess the value of differentiation and manage the portfolio with minimal resources, while providing flexible rationalization strategies to allow the business to account for changes in the market environment.

Membership Challenge

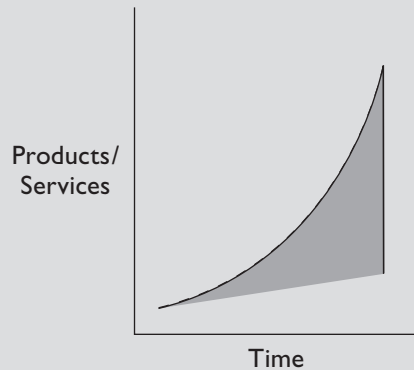
PAINFUL ILLNESS, PAINFUL CURE

Companies' Traditional Strategies for Differentiating Products and Services Are Costly and Inefficient

Typical Product/Service Rationalization Cycle



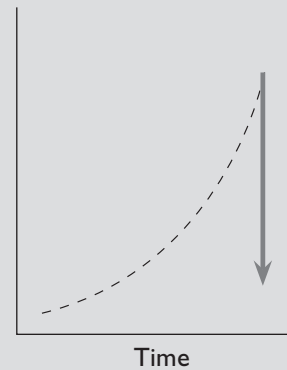
Costs of Product/Service Build-Up



Unprofitable products and services act as constant drains on resources by driving the following costs:

- Finished goods inventory
- Component inventory
- Additional production capacity
- Additional storage capacity

Costs of Product/Service Rationalization



Product and service rationalization incurs both cost and business risk, including the following:

- Commercial risk from lost products (market share, shelf space)
- Risk to shareholder equity from lost revenue and inventory write-offs
- Cost of rationalizing production and storage capacity
- Decrease in market responsiveness

Source: Supply Chain Executive Board research.

PRACTICE #1: GOOD/BAD SKU MANAGEMENT

Company Profiled: The Clorox Company



Industry: Consumer Products
FY2006: US\$4.6 Billion (€3.7 Billion)
Headquarters: Oakland, California

Situation

Between 1998 and 2001, Clorox increases its product portfolio by 50%, expanding into more diverse categories. While revenue grows with the launch of new products, spiralling complexity-driven costs lead to margin erosion and flat shareholder returns.

Action

The Clorox supply chain team helps the business manage differentiation through three Simple steps. First, Clorox separates its stock-keeping units (SKUs) into “good” or “bad,” where “good” SKUs add value and “bad” SKUs do not, and sets SKU-specific hurdle rates to evaluate a SKU’s performance. Second, Clorox uses scorecards to manage the process on an ongoing basis. Finally, Clorox develops “glide paths” to help the businesses manage their portfolios for success and responsiveness.

Key Lessons

- Identify a few simple hurdles to distinguish “good” from “bad” products or services.
- Flexibility in product and service portfolio performance is necessary for growth.

Results

Clorox experiences returns in many areas as a result of rolling out this new process. In the three-year period following the new process, Clorox reduces SKUs, increases the percentage of “good” SKUs, and increases revenue per SKU. The stock price over this same period also increases nearly 50%.

Returns on Investment

- Simple and effective tools distinguish between “value-adding” and “non-value adding” differentiation.
- Disciplined processes manage product and service portfolios with minimal resource investment.
- Flexible strategies for rationalizing non-value-added differentiation enable the capture of strategic growth opportunities.

Source: The Clorox Company; <http://www.hoovers.com>; Supply Chain Executive Board research.

More for Less

Back in 2002, Clorox was several years into rolling out a growth strategy that included a significant number of new SKU introductions. In just a few years, the number of SKUs increases by 50%, expanding across more diverse product categories. With every new product introduction, Clorox instills more complexity into its supply chain.

Revenue grows 40% during this same period, but at the expense of operating margin. The trade-off Clorox makes between increased revenue and costs is reflected in the flat stock price over the same time period. To summarize, Clorox is proliferating products, but not efficiently. Supply Chain sees an opportunity to better manage portfolio profitability on an ongoing basis.

The Clorox Company Challenge

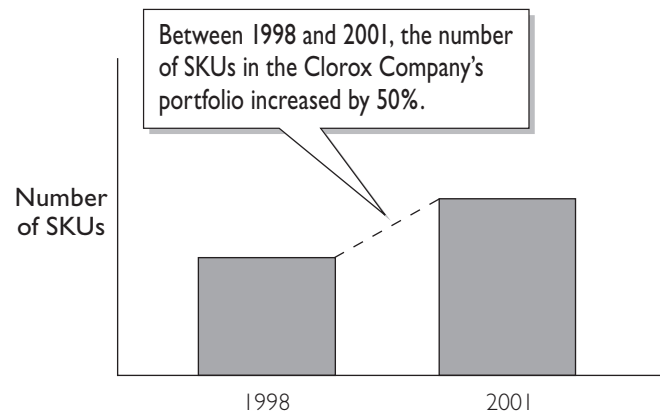


A PRESCRIPTION FOR GROWTH?

The Clorox Company's effort to drive revenue by increasing differentiation across its diverse categories of operation...

SKU Acquisition and Proliferation at the Clorox Company

The Clorox Company, 1998–2001



The Clorox Company's Product Portfolio—Sample

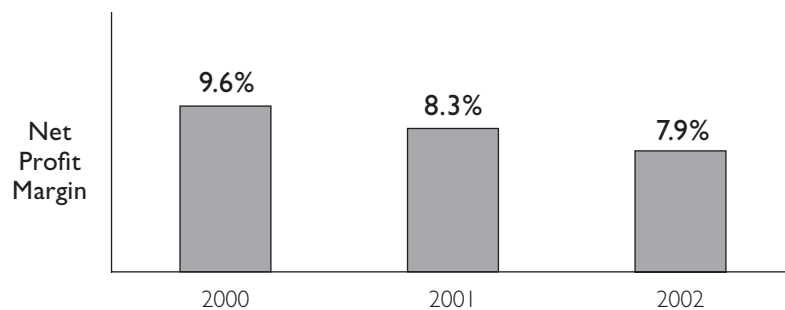
The Clorox Company

- Barbecue Sauce
- Bathroom Cleaners
- Bleach
- Car Care
- Cat Litter
- Charcoal
- Disinfecting Wipes
- Drain Cleaner
- Insecticides
- Plastic Storage Bags
- Salad Dressing
- Stain Remover
- Toilet Brushes
- Water Filters

...contributed to declining profitability and flat shareholder returns

Net Profit Margin

The Clorox Company, 2000–2002



Stock Price

The Clorox Company, 2000–2002



Source: The Clorox Company; <http://www.hoovers.com>; Supply Chain Executive Board research.

A Targeted Approach to Portfolio Management

Clorox employs three main principles for portfolio management. These principles, in combination, essentially change the way the company looks at differentiation. Differentiation is now thought of as “good” or “bad,” a simplified approach to portfolio decision making.

Principle #1: Define when a SKU is non-value-adding (i.e., “bad”). Clorox develops simple SKU hurdles used to evaluate a SKU’s performance.

Principle #2: Employ “Good/Bad” SKU Scorecards to ensure that the business has the right information to make decisions.

Principle #3: Develop glide paths that provide a roadmap for success and responsiveness.

The following pages provide more detail on these three principles.



STEPPING STONES TO SKU PROFITABILITY MANAGEMENT

The Clorox Company Manages SKU Performance to Drive Improved Corporate Outcomes

Good/Bad SKU Management The Clorox Company

1

Simple SKU Hurdles

Description
A series of clarifying analyses is used to determine the criteria for “good” and “bad” SKUs.

Outcome
A simple set of hurdle rates allows understanding of “good” and “bad” SKUs.

2

Good/Bad SKU Scorecards

Description
Business unit leaders are assessed on the number of “bad” SKUs and their ratio of “good” to “bad” SKUs; this drives growth and profitability.

Outcome
Business leaders take ownership of SKU economics, driving the rationalization of “bad” and the creation of “good” SKUs.

3

Innovation Glide Paths

Description
“Glide paths” drive business cooperation with SKU management, freeing up resources to generate innovation and profitable SKUs.

Outcome
Continuous improvement in SKU economics is driven across all product categories.

Setting the Stage

For assessing SKUs, Clorox starts by establishing agreement on the decision criteria used to establish the hurdle rates. Contrary to the conventional approach that is very resource intensive, Clorox creates hurdle rates based on just a handful of credible factors requiring minimal resources. The ongoing SKU assessment also requires minimal resources—one analyst per product category using the systems already in place.

Clorox reviews five key process stages when creating the decision rules for evaluating when product (or service) differentiation adds value or does not. They also keep it very simple; if a SKU adds value, it is considered “good,” and if it does not, it is considered “bad.”

Clorox’s process for evaluating SKUs is both simple and credible. Supply Chain at Clorox works with the business units to agree on a simple set of decision rules that are standard across the company. Within each process stage they evaluate two criteria at most. The goal was to start as simple as possible and then see if more detail needed to be added in the future. The following pages describe how Clorox sets the hurdle rates (that determine whether a SKU is “good” or “bad”) and evaluates specific SKUs.

Component #1: Simple SKU Hurdles



KEEP IT SIMPLE, (NOT) STUPID

A Series of Clarifying Analyses Produces Simple “Hurdle Rates” for Distinguishing Between “Good” and “Bad” SKUs

SKU Assessment Process

The Clorox Company

Process Stage	Selection of Strategic Driver	Selection of Key Metrics	Categorization of Product Portfolio	Setting of Hurdle Rates	Assessment of SKUs	Resource Requirements
Conventional Approach	<ul style="list-style-type: none"> Product decisions may have multiple competing strategic drivers. Strategic goals are frequently supplanted by the needs of the moment. 	<ul style="list-style-type: none"> SKUs are assessed on a variety of performance and profitability metrics. Tracking numerous metrics for all SKUs increases the difficulty of setting hurdles. 	<ul style="list-style-type: none"> SKUs are grouped for analysis according to multiple sets of characteristics. Hurdles for each of several metrics must be set for each of several groups. 	<ul style="list-style-type: none"> Hurdle rates, which a SKU must meet to be considered “good,” are not employed. SKU assessment produces multiple categories of non-prescriptive conclusion. 	<ul style="list-style-type: none"> SKUs are assessed using a dashboard of metrics. Some business units may be unable to conduct the necessary analysis. 	<ul style="list-style-type: none"> Analyst team (12 to 20 analysts across categories) Dedicated systems for data collection and analysis Two to three weeks per business unit
	Clorox Approach	<p>One Key Driver</p> <p>Shareholder Return</p>	<p>Two Basic Metrics</p> <p>Profit and Volume*</p>	<p>Two Product Types</p> <p>Large Brand and Small Brand</p>	<p>Four Standard Hurdles</p> <p>Two Profit, Two Volume</p>	

* Defined in Project Acceleration Toolkit.

Source: The Clorox Company; Supply Chain Executive Board research.

SKU Evaluation

Clorox reviews two basic metrics, profit and volume, to establish hurdle rates. Clorox also takes into account whether the product is considered a small or large brand and establishes different hurdles for each. Profit and volume hurdles are established by the newly formed SKU Steering Committee, a task force led by Supply Chain with representatives from Finance, Sales, Marketing, and business unit heads.

To calculate a SKU's profitability, Clorox evaluates direct and indirect costs against revenue. For volume, they evaluate cases sold since this is what most affects Supply Chain's efficiency. Additional details for calculating these rates are included in the Project Acceleration Toolkit (see page 48). To be considered "good," a SKU needs to meet at least one of the profit or volume hurdles. This keeps it simple and also provides flexibility for evaluating a given SKU.

Supply Chain specifically adds analytical rigor to the hurdle rate process to make it credible, but manages to communicate the guidelines to business partners in a simple enough manner that they can understand and use to make portfolio decisions on an ongoing basis.

Component #1: Simple SKU Hurdles (Continued)

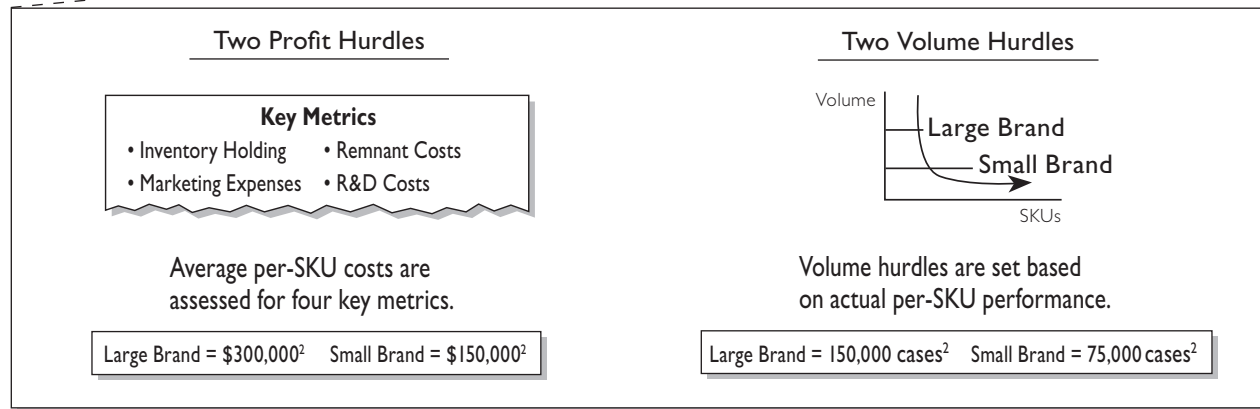
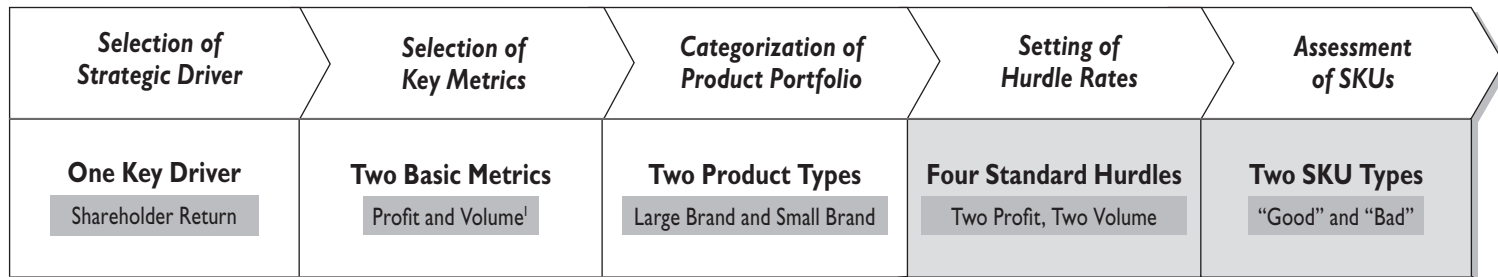


A CLEAR DISTINCTION

Supply Chain Leverages Its End-to-End Cost Visibility to Identify Value-Adding SKUs

Identification of Good/Bad SKUs

The Clorox Company



“Good” SKU Definition

A “good” SKU is one that meets either the relevant profit hurdle, volume hurdle, or both.

—AVOID PERFECTION—

“It’s more important to *have* your hurdle rates than to worry about getting them exactly right. It’s better to make a few educated choices and act on them consistently than to struggle with accurately evaluating every single possible factor for a single, one-time rationalization.”

Kevin Pegels
 Director of Supply Chain Planning
 The Clorox Company

¹ Defined in Project Acceleration Toolkit.

² All numbers illustrative.

Portfolio Management

Clorox embeds the SKU evaluation process into the business through dashboards and individual scorecards designed to give businesses the information they need to make better-informed decisions about where and when to differentiate. To develop the SKU dashboard, the SKU Steering Committee, together with business units, creates a ratio of “good” SKUs (SKUs that meet at least the profitability or volume hurdle) to the total SKUs for each product category. The results are gathered by analysts from Clorox’s ERP system and published monthly. Although hurdle rates are standard across the company, the ratios and targets can vary by category.

This is intentional; some product categories need more innovation to thrive and grow. In these cases, the ratio of good SKUs to total SKUs would be lower to allow for more low volume or low profit SKUs. Other categories, such as bleach, a commodity category, would have a much higher expectation for the percentage of good SKUs. However, Clorox does not set the ratio of good to total SKUs to 100%. They are not trying to eliminate all SKUs that don’t clear the hurdle rates. There is a need to have some “bad” SKUs, to account for newly launched products or complementary products.

To increase ratios, Clorox employs three strategies: 1) add new “good” SKUs to the portfolio, 2) improve “bad” SKUs so that they meet the hurdles, or 3) remove “bad” SKUs from the portfolio. Clorox doesn’t simply eliminate SKUs that don’t meet the hurdles, though this is an option. Clorox also works with customers to cross-check SKUs targeted for elimination to ensure elimination doesn’t happen in a vacuum.

Individual Incentives

Every general manager is held accountable for reaching their target ratios. SKU management is part of the GM’s performance scorecard and is one of the critical performance metrics they’re incented on. In addition, individual GM performance is circulated every month so GMs can see how their performance compares to that of their peers across the company and to follow trends over time.

Component #2: Good/Bad SKU Scorecards



ONE METRIC TO RULE THEM ALL

Dividing SKUs into “good” and “bad” gives business leaders additional insight into their products...

Clorox’s SKU Dashboard

Illustrative

	Category A	Category B	Category C	Category D
Total SKUs (#)	49	48	54	46
Good SKUs (#)	43	43	44	44
Good/Total (%)	88%	90%	81%	96%
Bad SKU Target (#)	5	4	9	2
Bad SKUs (#)	6	5	10	2
Gap to Target (#)	1	1	1	0

1 Ratios vary across categories to allow for needed bad SKUs.

...and additional incentive to manage SKUs effectively

Clorox’s Business Unit Leader Scorecards

Illustrative

	Total SKUs	Bad SKUs	Gap to Target
Category A	47	3	2
Category B	26	6	3
Category C	34	4	0

2 A monthly scorecard gives visibility into category performance across the business.

Business Unit Leader Assessment	
Revenue Growth	<input checked="" type="checkbox"/>
Operating Profit Margin Goal	<input checked="" type="checkbox"/>
SKU Management Target	<input checked="" type="checkbox"/>

3 SKU management is on the short list of top performance metrics upon which business leaders are assessed.

Critical Levers for Improving SKU Portfolios

Good/Bad SKU Analysis Offers Business Leaders Three Distinct Avenues for Improving Category Performance

Profitable Innovation

Adding new “good” SKUs to the portfolio

SKU Improvement

Improving existing “bad” SKUs to meet hurdles

Targeted Rationalization

Removing “bad” SKUs from the portfolio

Using Glide Paths

Clorox develops product category glide paths to allow for flexibility in the good/bad SKU ratio across the year as well as to help manage the number of bad SKUs over time, to meet continuous improvement goals. Different categories will have different glide paths; a more seasonal category will have a more variable glide path while a less seasonal category will have a smooth glide path. For example, Category A in the page below is a business that is more seasonal such that sales increase between April and August, when packaging and promotions are important for a strong retail presence. In the winter months, the target number of bad SKUs is low, spikes in the summer, and then drops back down at the end of the year. On the other hand, Category B is less variable across the year, so the glide path is more stable. However, both lines trend down over time to ensure continuous improvement and no major sudden write-offs.

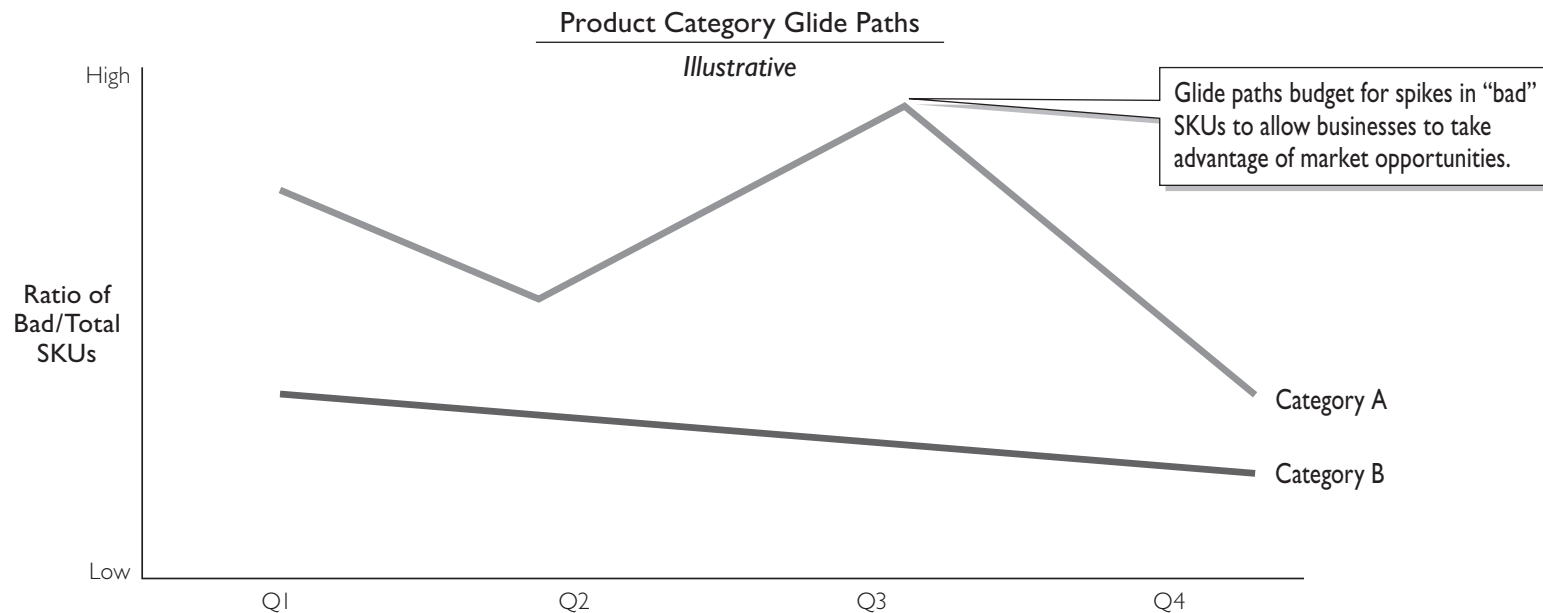
Setting glide paths is a regular part of the business's annual planning process. The SKU Steering Committee establishes glide paths for the year and meets quarterly to review performance and make adjustments as necessary. As a result, Clorox has fewer SKUs that are more productive.

Component #3: Innovation Glide Paths



GETTING BETTER AT BEING BAD

By Setting “Glide Path” Targets for Product Categories, the Clorox Company Is Able to Support Innovation While Driving Continuous Improvement in SKU Economics



SKU Steering Committee

Meeting Agenda

1. Seasonality Demands
2. Proposal for Innovation
3. Top Customer Demands

Glide Path Setting

Annual

- The SKU Steering Committee approves glide paths proposed by business leaders.

Quarterly

- Once a glide path has been set, the SKU Steering Committee holds meetings with business leaders to discuss progress toward goal.

Monthly

- The SKU Steering Committee assesses glide paths to track progress and ensure adherence to SKU targets.

It's Working

Clorox experiences positive performance as a result of rolling out the Good/Bad SKU Management Process. Over the three-year period following roll out, Clorox reduces the number of SKUs, increases the percentage of good SKUs in the portfolio, and increases revenue per SKU. Clorox improves existing SKUs and adds new good SKUs over this period. The stock price also increases 48% over this same time period.

Results

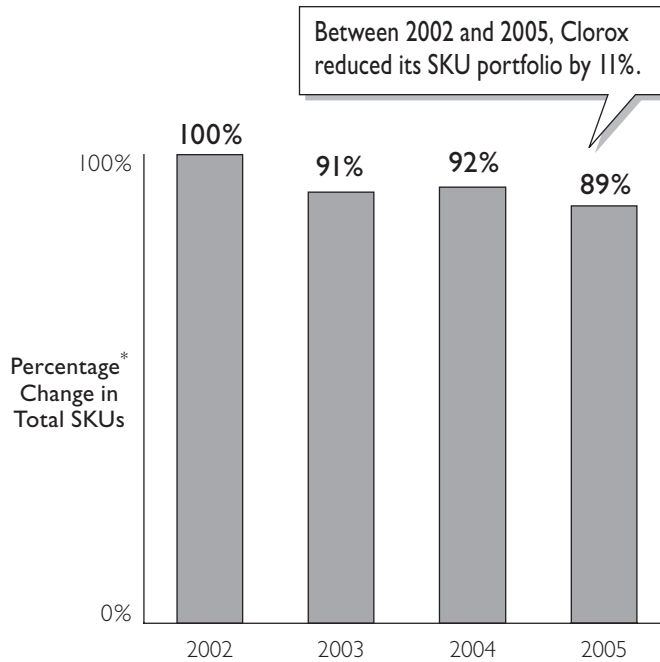


THE RIGHT KIND OF GROWTH

The Clorox Company's Good/Bad SKU Management Process Drives Profitable Growth

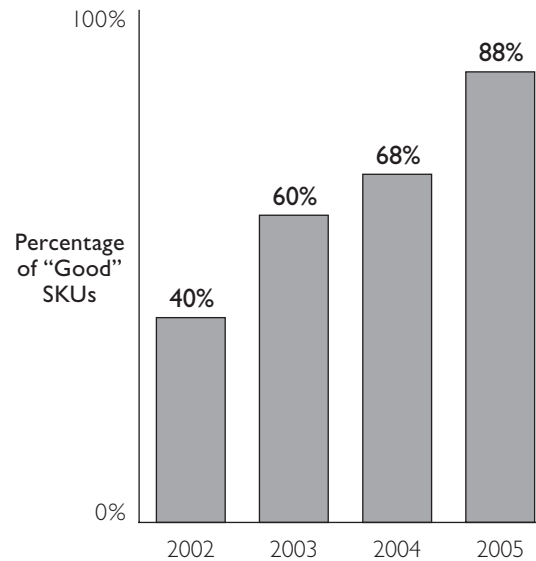
Total SKUs*

The Clorox Company, 2002–2005



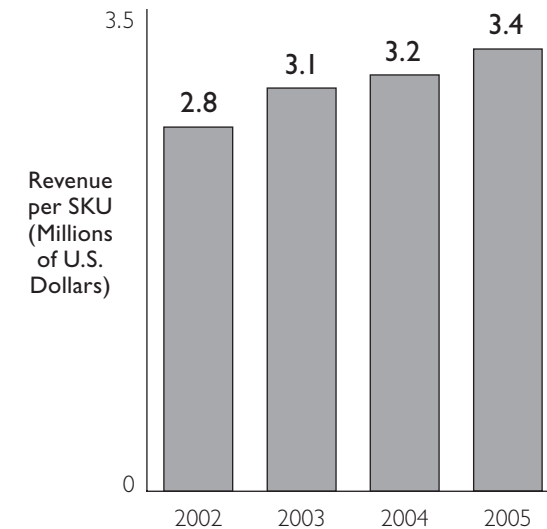
Percentage of "Good" SKUs

The Clorox Company, 2002–2005



Revenue per SKU

The Clorox Company, 2002–2005



A WHOLE-COMPANY VICTORY

“While we were never able to accurately calculate all the cost savings from this process up front, in the end we experienced returns in many different areas, including improved quality of our P&L and balance sheet.”

SVP, Consumer Products
The Clorox Company

* Indexed to 2002.

Source: The Clorox Company; <http://www.hoovers.com>; Supply Chain Executive Board research.

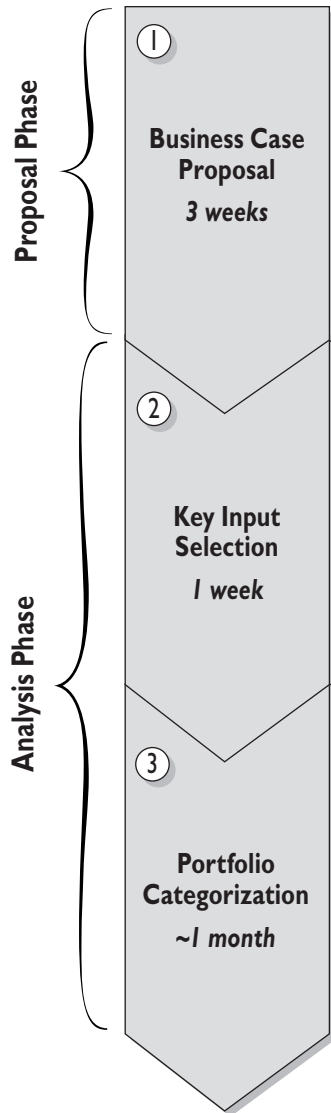
Project Acceleration Toolkit Overview



SETTING HURDLES FOR SKU MANAGEMENT

SKU Analysis and Management

The Clorox Company



- Supply Chain creates a business case to present the critical benefits of SKU management to executives and business leaders.
- Supply Chain conducts a “road show” to present its business case for SKU management to the CFO, other key executives, and business leadership.

Business Case¹

SKU Management Business Case

SKU Management's Role in Cost Strategy

- Continuous pruning of less productive SKU's creates capacity for growth
- Reducing complexity cuts costs everywhere
- Higher SKU productivity vs. the competition enables us to outsell our competition
- Increasing volume/SKU allows the company to more effectively service customers
- Fewer, higher volume SKU's enable more effective forecasting and inventory management, which ultimately improves FPOC
- A "lighter load" of highly productive SKU's allows more rapid execution

Basic Principles of SKU Management

A SKU management program must:

- Be simple and easy to understand and administer
- Drive meaningful improvement over time
- Support growth of high performing SKU's
- Ensures tension against low performing SKU's
- Be flexible enough to meet SBU specific business dynamics
- Be fact-based and metric-driven
- Involve participative target setting, with commitment and accountability from the business.

- Supply Chain meets with Finance and Sales to form a project team to select one to two key drivers which best capture the company's executive agenda (e.g., stock price, revenue growth, improved operating margin).
- The project team identifies a small number of basic operational metrics to serve as proxies for the key strategic driver in assessing SKUs (e.g., profit, volume, revenue).

Key Metric Definitions¹

Metric Definitions

The Clorox Company employs "profit" and "volume" as hurdle metrics. These are defined as follows:

Volume

Clorox assesses volume as the total number of cases sold.

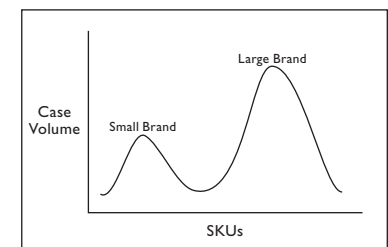
Profit

Clorox assesses profit as "adjusted contribution":

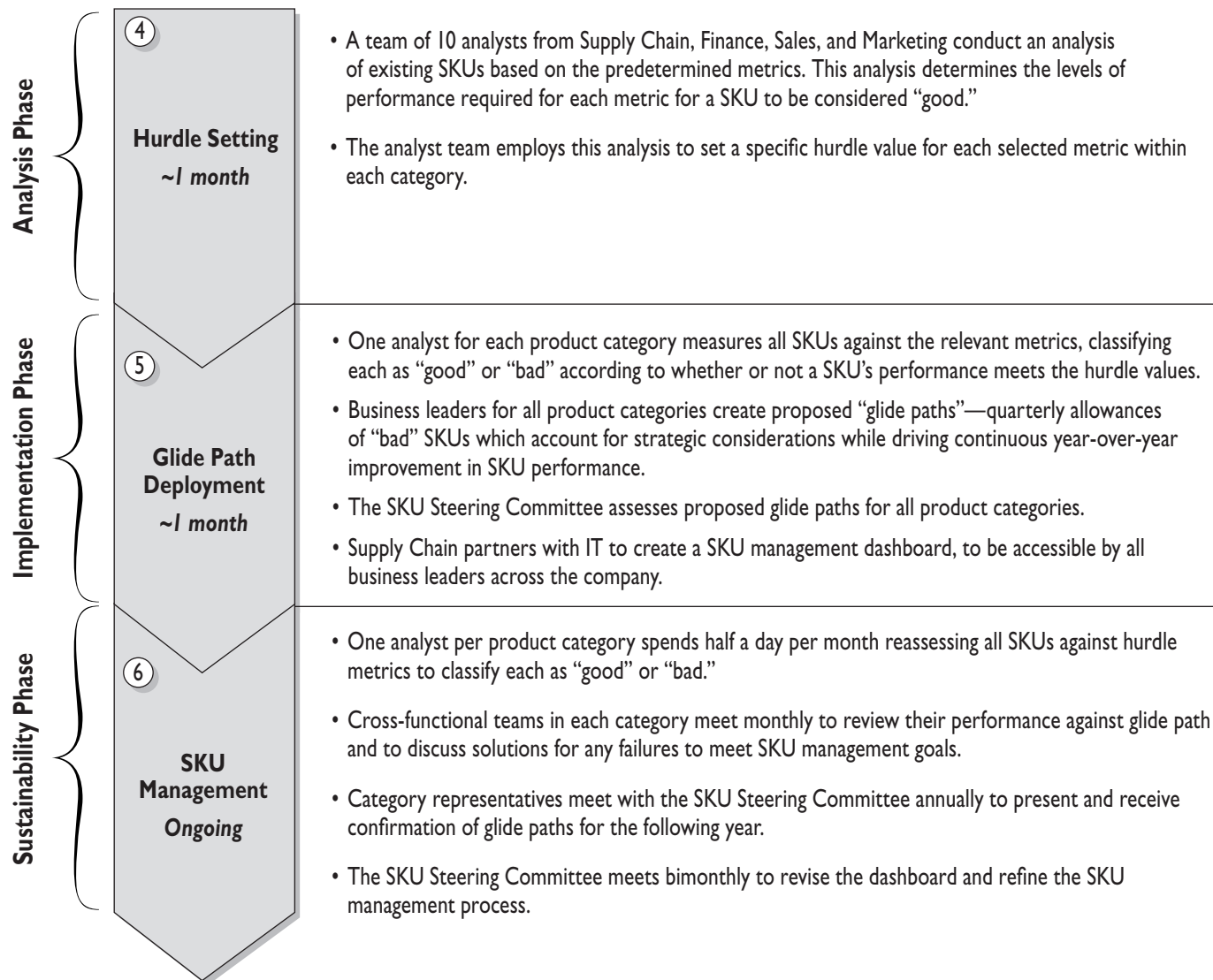
Adjusted Contribution = Net Contribution from Sales - Variable Expenses

- The project team analyzes the portfolio of existing product categories to determine whether a single performance standard for selected metrics may be applied uniformly (e.g., whether a single value for SKU profitability is both acceptable and realistic for all categories).
- If it is not possible to apply a single standard across all categories, Supply Chain divides the existing product portfolio into groups of SKUs which can be held to the same standard for the determined metrics.

Product Portfolio Analysis



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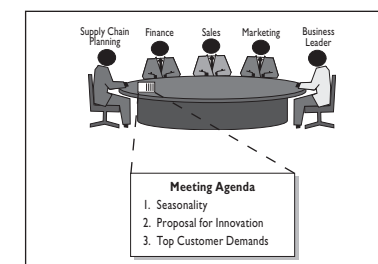


Hurdle Rates²

Hurdle Rates	
Profit	
Large Brand =	\$300,000
Small Brand =	\$150,000
Volume	
Large Brand =	\$150,000 cases
Small Brand =	\$75,000 cases

SKU Management Dashboard¹

SKU Steering Committee



¹ Available in Supply Chain Executive Board Project Acceleration Toolkit.

² Numbers are illustrative.

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Source: The Clorox Company; Supply Chain Executive Board research.

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