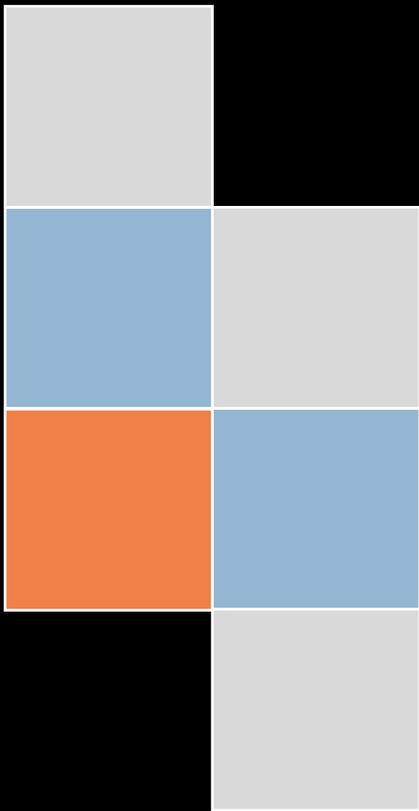


# Who's managing the right side of the product life cycle curve?

Why companies get 70% of their financial contribution from 30% of their products



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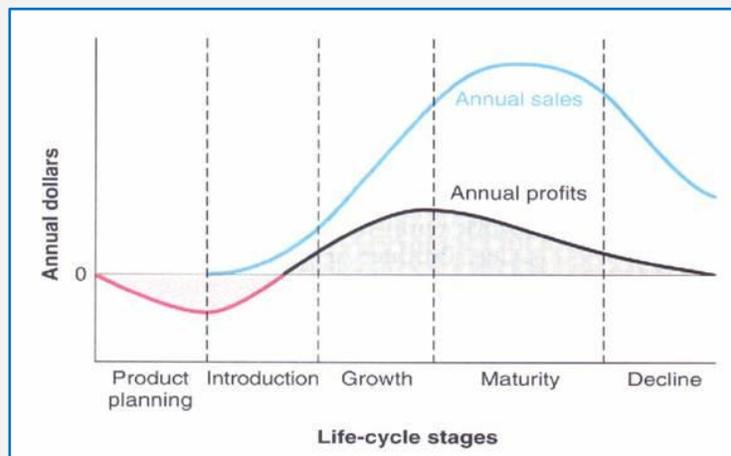
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## Life cycle management is not new

The traditional life cycle curve, and there are many variations, breaks down the life of a product into various stages, going from the introductory stage to its final demise under the name of end of life. The same concept has found application with businesses, governments and dictatorships so that even the world of politics is able to refer to it. With products, the stages are well defined and many authors have offered various ways of identifying at what stage a product is on the curve. For instance a drop in profits implies



to be able to modulate our strategies and tactics based on the phase in which the product is in. So what do you do when your product has crested?

Again we find various approaches, often generic in

nature. There are products on the market today that have been in the maturity stage for well over one hundred years. They have been able to avoid the decline stage all along. Take for example a product such as Kellogg's® corn flakes, which was patented in 1896 and has managed to remain one of the top selling cereals over its life. At what point did it reach maturity? Did

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anyone at Kellogg's suggest the product should be eliminated because it was eventually going to become a commodity?

### The SKU proliferation syndrome

There are many corn flakes examples we can refer to. Look around and you will see that many of the products we consume are in the maturity stage and others, are declining. Automobiles are always renewing themselves but they still answer the basic desire of increased independent mobility. I would argue that half of our economy is based on mature and declining products. We therefore have to distinguish between a market life cycle curve and that of a



product within a business. Interestingly you'll find companies that are still offering products that are truly at the end of their life and even past it. In other words companies can wilfully decide to relegate some of their products into the declining stage and never retire them from their offering. This is a business decision based on rational analysis and insight, right? Well, for most companies that is not the case. Who wants to eliminate a product and the sales that go with it? I've worked with companies in which 70% of their SKU's contributed less than 20% of their gross margins. They had accumulated decades of product numbers that were still available to customers. The impact on operating income was neither well evaluated nor taken into account. It's more factual to refer to it rather as operating loss. Unfortunately, the accounting and finance function averaged all the numbers so that the laggard products were not showing up as being a drag on business performance. Imagine a customer sending in an

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order for a product that had last been made five years ago. The company had to set up the manufacturing line, order the raw materials, update the costing, find new suppliers of raw materials, and so on and so on. This was not a good deal for the business. On the other hand it seemed a good one for the customer. Unfortunately, it wasn't since the product could only be delivered past the customers required date. Yes the dreaded backorder in which the customer was unhappy because of a late delivery. -So much for a positive customer experience-. Internally, the vendor didn't understand how keeping a product available to satisfy customers, could result in the opposite state, an unhappy one. The sales manager's solution was to ask for the inventory to be built in case another customer ordered the products. Great idea, stocking a product that sold maybe once every five years and increase our warehousing space for it! Digging into this situation, we found that the problems originated from the lack of accountability and functional alignment when it came to deciding what to do with products apparently being in the decline and end of life stages. Everyone had an opinion and a different perspective. Sales and marketing didn't want to lose the top line sales, the actual cost of making the products was not captured, and operations were unable to build a case concerning the issue. Although finance complained about the high level of inventories, it aggregated the numbers and top management was concluding that overall the business was doing well since the indicators showed growing sales and profits. What was happening is that the money was coming in the front door but an unknown amount was escaping from the back. This type of not so uncommon situation brings along important questions for a business:

- Why do SKUs proliferate over time?
- At what point does a product become obsolete to a company?

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- Why should a company care?
- What process do you use to identify and focus on those products?
- Who owns the process and has the ARA (accountability, responsibility, authority) for it.
- How do you get the departments to collaborate?
- How do you replace those revenues and margins?
- What do you do with the obsolete inventory?
- How do you keep stakeholders involved in the process?

### The need for a multi-criteria analysis

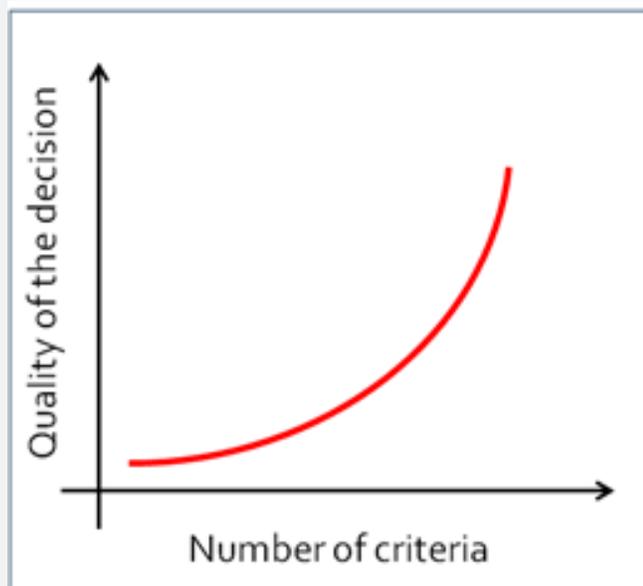
Clearly some products reach the end of their life by their very nature, such as fashionable clothing while others are, voluntarily or not, classified to be retired by a company. I did forget to mention the simple act of forgetting about them that also happens. The decision to render a product obsolete should be based on multiple criteria. These are to be defined with the input from various departments inside the organization itself. On the other hand the business can decide to let a product live on under the principal of the status quo and hope for the best, a bit like tossing a message in a bottle out to sea with all the good luck in the world. In the absence of a clear process, the corporate culture will probably decide on the "natural" approach to use. One being proactive while the other is avoiding the issue



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and hoping it'll go away. We would tend to prefer the use of an active resolution of problems so that we can improve the business and move on to other things. Given this, we have two avenues open to us. At one end the decision is made on one or very few criteria. For instance, the single use of the sales volume, the increase in cost or some other frequently used measure. Using them would have made *Kellogg's* corn flakes obsolete a long time ago. In other words, using limited criteria doesn't make for a very solid foundation for taking a decision. I witnessed a meeting once where a group had to decide on eliminating products following an acquisition.

Since upper management wanted to show progress as quickly as possible in this activity, there was pressure on the group not to delay decisions by asking for too much information during the proceedings. A flat screen showed an excel listing of the products from both merging companies with unit and dollar sales and gross margins. As each



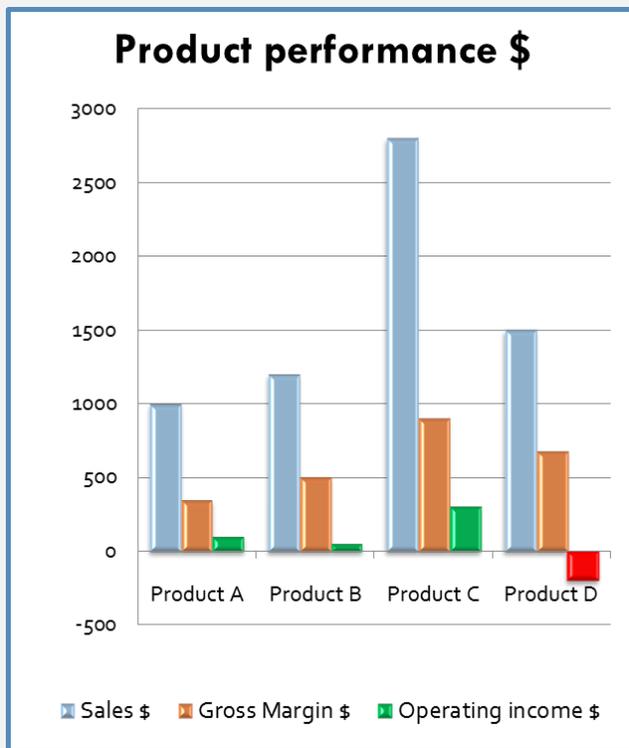
product was called out, a discussion lasting a few minutes ensued. Ironically, not all the product managers were attending so that the products eliminated tended to be those of the absentees. In the end the work was done but the question remained: Did they make the best selection? Were the customer, the suppliers, other departments considered? This graph above illustrates the importance of having multiple criteria when determining the elimination or positioning of a product in the life cycle curve. The more information you have and the more elements are

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taken into consideration, the better the decision will be.

### A best practice to implement

**O**ur experience has been that product deletions don't happen as often as needed. Why would that be? The first reason is the lack of a process to do so while the second relates to misunderstanding the true financial impact of not undertaking such work. Imagine getting

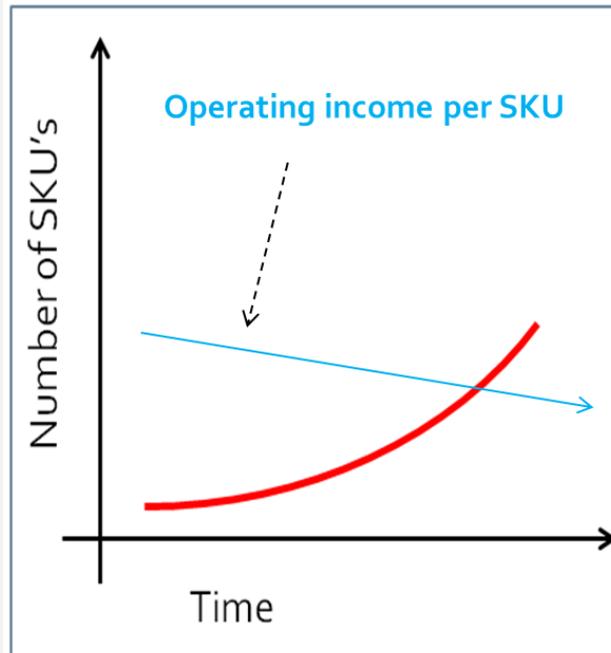


the department heads together in a room and asking two questions. Do we have the optimum number of products? How do we analyse this? The first question will create a lot of discourse and opinions with each person bringing about a different perspective on the issue but there is probably going to emerge a consensus that there are some products that are passed their prime and should be eliminated. The

second is where the big debate will happen. Why? The reason is that very few businesses have a clear analysis and end of life process. A process that starts with accumulating the proper data but that will also bring it to the point where the product will no longer exist in computer systems; there will be no inventory of finished goods, WIP or raw materials. Within organizations there is also a strong focus on innovation. Developing a new product and

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launching it carries much more prestige that eliminating them. How many times have you seen awards for product deletions? It's closer to cleaning the basement of a house rather than adding a second floor to it. Product rationalization is equated with cleaning up the mess from the past. This is rarely a career building enterprise. In other words most of the energy and resources is spent on



the left side of the product life cycle curve. We are advocating the better management of the right side of the curve, the one where we find mature, declining and obsolete products. The stuff we hide in the basement. The table below shows the true impact of a product sale on operating income.

### **The cost of poorly performing SKUs**

**W**hat is the cost to a business of carrying inventory of obsolete and inactive products? On average it's 30% of its value, every year. Take for example, inventory valued at \$10 000, costs \$3 000 every year. In three years you've just about paid twice for it. Another way of looking at it is that if you sell this product after a year and your gross margin is 40%, your true margin on this transaction is closer to 22%, hence the importance of fast inventory turnover. The longer the inventory is inactive the more it's heading towards offering negative returns.

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This doesn't mean that an active product with decent turnover is a better one. The concept of cost to serve is here essential in understand the other costs involved in keeping a product active. What are we to think about a sales force spending time on a declining product? You have talented and expensive people talking to customers about a product that perhaps has limited future with your company, is under price pressure and available through multiple vendors. We can go through many cost drivers that would help to demonstrate that gross margins alone are not really presenting the true picture suffice it to say that the only way to know is to fully analyse each product to determine its real contribution to the business.

### A model for SKU analysis

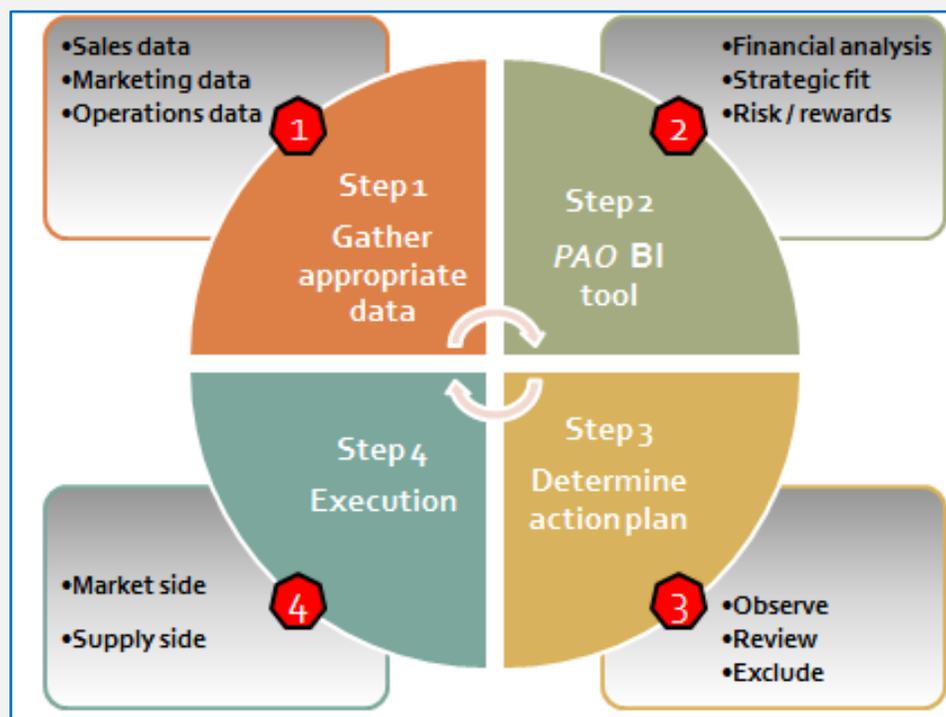
**A** solution does exist. Combining data and information from the various stakeholders within the organization is the key to an effective process that will make sure that the analysis will enable the identification of well performing products and more importantly those that are a drain on the activities. This process employs a business intelligence (BI) tool designed around the input of objective as well as subjective information. The key is to be able to transform subjectivity into numerical values. The final results are only the beginning of the process since the actual financial gains can only be recouped in the execution stage. Focusing the company's resources and energies on the winning products is what optimization seeks to do. The fundamental metric is capturing the effect on operating income. The analysis is really a snapshot of product performance at a given time. As time goes by, a regular analysis must be done in order to continue fine tuning the products. This is to be expected as the products relentlessly move along the life cycle curve towards potential demise. Going back to my

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discussion about corn flakes, at one point the *Kellogg's* management decided that this product has a future. They went ahead and took the actions necessary in order to keep the product a success. This shows that even so called mature and declining products can have a strong contribution with any organization.

Executing the optimization is in itself challenging if not the most difficult part of the exercise.

Two initial problems must be addressed beforehand, lack of willingness to address the need for



optimization and entrenched habits. Management must support the exercise and the consequences and insure the various departments work together to facilitate the outcome. This is why such a project must be driven by upper management since at some point trade-offs will be necessary such as when advocate the elimination of a product which results in lower sales

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but increased operating margins.

Finally, the use of the analysis tool has given us the ability to uncover additional areas of business optimization. In essence the POA tool is really a diagnostics tool helping to steer the solutions towards the proper causes. The problems identified through this are the symptoms. Let's drop the allusions to the medical field and simply say that the word (living) organism has a link to organizations. By the way, *Corn-flakes* was invented to help improve people's health. It's also been good for the financial health of the company.

