



## A bloated portfolio keeps production costs high and threatens growth

ToolCo, a major professional tool manufacturer, had gone through several SKU rationalization exercises in the past. These efforts targeted only the bottom 5% of low volume products, were disruptive, and did not achieve the desired cost reduction benefits. ToolCo had been unable to control a constantly growing SKU portfolio, with newer generations of products coming in, and older generations not being phased out. Their analysis showed that 99% of their sales came from 35% of their SKUs, and most of the low volume SKUs were unprofitable at the gross margin level. Furthermore, ToolCo's growth plans require a significant increase in manufacturing capacity and a significant investment in CAPEX.

### Understanding the Cost of Complexity

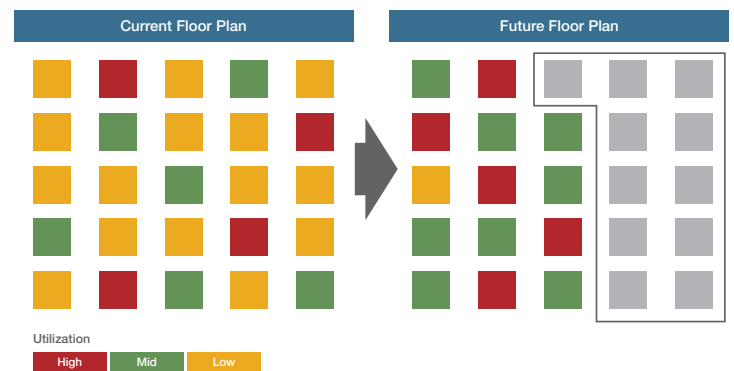
A complex SKU portfolio meant higher costs in the form of frequent manufacturing changeovers, low asset utilization, extra employee training, and high inventories, among others. Manufacturing facilities were incentivized based on volume and standard costs, and thus had no true understanding of how to tackle the costs associated with complexity. Headquarters overhead was not accurately allocated to products, so the true cost of adding further SKUs to the portfolio, let alone the benefit from eliminating them, was not evident on the surface. ToolCo realized that labor, as well as variable and fixed overhead costs needed to be reallocated to each individual SKU. This would help identify true profitability per product as well as the minimum number of units that need to be produced for a product to be profitable.

### Complexity Adjusted Costs

Reallocation of costs demonstrated that low volume products were consistently under costed, as high volume products were disproportionately absorbing the majority of overhead costs. In one example, the standard cost of a low-volume SKU was 5% lower than a similar high-volume SKU. It turned out that the low running SKU should have been allocated 4 times higher overhead costs, making it in reality 30% more expensive than the higher volume product. Newly calculated costs demonstrated that many products were actually eroding profits from the business, with reallocation of labor and overhead being the major drivers of this cost difference. The products which previously appeared to be low cost, actually were not, which started raising the right questions about their role in the portfolio. The analysis showed that the portfolio could be reduced by 40%, to allow for ToolCo's ambitious growth plans.

### Asset Utilization

A reduction in its portfolio also meant that ToolCo could concentrate its manufacturing in fewer production lines with higher utilization, increasing plant and staff productivity. Plant CAPEX for machinery and floor space would also be avoided by redeploying underutilized assets to make room for growth. They estimated that this represented a 45% growth opportunity with minimal investment at just one of their manufacturing plants, and would encounter a similar picture in the rest of their plants.



**Figure:** A 45% growth opportunity was identified through asset redeployment (grey cells) and floor space utilization of the manufacturing cells

### Results:

Beyond the additional benefits to their operating costs, growth capacity opportunities, and order fill rate improvement, ToolCo identified savings representing 15% of EBITDA from smart SKU rationalization, overshooting management's ambitious goal by three times.