

# Partnerships in SKU Rationalization

## Situation

A major distributor to the convenient store class of trade and the manufacturing category captain had similar issues; inventory turn performance and activity costs. The manufacturer had successfully implemented a SKU rationalization project within several of its brands. Their results included improved turns, lowered activity, and increased overall sales!

Could the SKU rationalization methodology be applied to this category within the distributor? The trading partners decided to pursue a SKU rationalization of the category, led by the manufacturer who was the category captain. Costs would be shared.

Obviously, the distributor had much to gain. The manufacturer believes that their product line was the most efficient within the category because of their previous category management and SKU rationalization tactics. Therefore, the manufacturer would gain recognition of their position and, most likely, improved allocation of facings for their already high selling SKUs.

## Solution

DHC recommended a SKU evaluation and rationalization technique. One division of the national distributor was selected as a test case. The DHC teamwork with the distributor to extract SKU metrics for the category from their legacy database systems. Data on shipments, inventory levels, pricing [wholesale and retail], handling costs, manufacturing trade funds, retail points of distribution, order frequency, order lines, etc., were extracted.

DHC went to the distribution center and corporate headquarters to develop high-level activity cost estimates for allocation within the SKU rationalization tool kit. After scrubbing and validation of key data points, the first pass information was reviewed with both the distributor and manufacturer. Hurdle rates based on key business performance measures [sales, profits, turns, number of customers] were agreed upon by the trading partners.

The SKU rationalization team then went back to load the hurdles into the tool kit. Running the tool kit provides the list of SKU's within the current active portfolio that are not meeting the underlying performance requirement of the business. These SKU are reviewed and categorized as part of the analytic process. The model also predicts, in a static case, the impact on inventory and activity costs of reductions in the SKU base.

What the model does not do is recognize the reality of SKU rationalization on top line sales. Although marketing and sales associates are many times convinced that the process must reduce the top line, experience proves this is not the case.

## Results

The SKU rationalization data indicated that of the over 800 SKU's within the category, the bottom 36% only generated 3% of sales and 2% of profit for the distributor. With activity costs loaded, the static model projected a reduction of over \$123,000 annually in activity costs.

Execution of the SKU rationalization recommendations would reduce the inventory of this operation by \$92,000 or 8%. Corporate implementation of process was projected to reduce inventory carrying costs by over a million dollars. The distributor also had the option to reallocate existing space and avoid expansion vs. taking cost reductions.

The manufacturer, as suspected, was the category leader in productivity by SKU for the distributor. In fact, of the three leaders in the category, this manufacturer generate 2X the profits per SKU of the next best competitor.

Incremental analysis of the data also indicate a huge opportunity for the distributor to consider vendor consolidation. The bottom 50% of suppliers were generating only 1/2% of sales.