SKU Optimization: A Proactive Approach to Drive Profitable, Risk-Optimized Growth for Consumer Products

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Initiatives: Supply Chain Head of Strategy Realization; Supply Chain Planning

Many CP companies cut their portfolios during the COVID-19 pandemic to optimize capacity but often realized increased profitability. Supply chain leaders can use this research to create a stronger SKU optimization process to reduce complexity and risk, optimize capacity, and drive profitable growth.

Overview

Key Findings

- Reducing SKU complexity in consumer products (CP) supply chains has always been an opportunity for cost optimization, but it has been very difficult to quantify the benefits to promote rationalization efforts across the organization.
- The COVID-19 pandemic forced many CP companies to rationalize their product portfolios in order to allocate limited capacity and maximize output to support increased demand and ensure performance management.
- While the biggest benefits of SKU rationalization during COVID-19 were maximized output and improved in-stocks, many CP companies were finally able to quantify cost savings due to increased productivity. This often led to higher profitability as well as increased agility to better respond to changing demands.

Recommendations

Supply chain leaders responsible for strategic portfolio planning at consumer products companies should:

- Gain support and alignment for SKU optimization by leveraging lessons and insights from other CP companies that have demonstrated significant benefits through SKU rationalization strategies.
Move from the traditional reactive approach of SKU rationalization by adopting a proactive approach of SKU optimization to drive overall performance and profitability. Ensure that the supply chain is an active partner along with sales, marketing and finance regarding decisions on both ends of the product life cycle management process.

Optimize the product portfolio by cross-functionally aligning on what constitutes a productive portfolio, by implementing a disciplined and consistent review process and utilizing the S&OP process to ensure governance.

**Introduction**

For several years running, growth has been the overwhelming top priority for CEOs and executive committees. This has led to expanding SKU populations across CP companies to drive that growth. However, according to the 2021 Gartner CEO and Senior Business Executive Survey, other top business priorities showed a significant shift from previous years for CP manufacturers and retailers. Although growth was still the highest priority for 2021/2022, the second — technology — was nearly equal. Growth actually decreased by 24% from 2020 to 2021, while the technology-related priority increased by 33% (see CEO Survey 2021: Consumer Goods and Retail Perspective).

E2open, a leading supply chain software company, regularly conducts a forecasting and inventory benchmarking survey that also examines SKU proliferation in consumer products. In its most recent study, E2open showed that the cumulative growth in SKUs has increased by 355% during the past decade. However, the growth in cumulative items dropped from 33% in 2019 to 26% in 2020 — the lowest level in the history of the study — representing a 20% reduction of SKU growth during 2020 (see Figure 1).  

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2020 was indeed very different. Most CP manufacturers were less concerned with creating growth and instead with how to fulfill the existing high demand for essential products within their available capacity. SKU rationalization is a key lever in overall performance management. We saw many CP supply chains literally forced to focus on their top SKUs to maximize their capacity and halting production on their slower moving products. This rationalization enabled these organizations to optimize their performance — not only by supporting the fulfillment of demand but also driving improved efficiency through simplification, enabling a more agile supply chain and increased profitability. For once, it wasn’t just supply chain leaders promoting SKU optimization. We saw support across the organization.

Many CP companies learned from this experience and worked collaboratively to avoid bringing back all of the lower volume products. This portfolio optimization strategy has proven successful. It not only supports increases of demand that we saw during the COVID-19 pandemic but also can reduce some of the risks that CP organizations are experiencing with the other supply disruptions. These include logistics capacity, labor and driver shortages, and port gridlock.

CP companies need to act on this quickly, because the window of opportunity for continued alignment and support with the organization regarding SKU optimization may be limited. CP leaders can use this research to gain insight on the key benefits that SKU optimization brings as well as how the supply chain can ensure an effective product life cycle management process.

**Analysis**
Gain Support by Sharing the Benefits of SKU Rationalization Efforts

Historically, managing SKU complexity has been a struggle for CP companies. It’s the age-old conflict of balancing supply chain efficiencies with the need to create new SKUs to drive growth and market share and gain entry into new channels. The constantly changing retail landscape has dramatically altered shopper behaviors, and the growth of e-commerce and direct-to-consumer (D2C) has driven the need for unique products, personalization options and specific packaging requirements. Organizations see the growing complexity of product portfolios impacting inventory, cost and service levels, as well as supply chain agility and responsiveness to demand (see Table 1).

Table 1: How Product Portfolio Complexity Impacts the Supply Chain
(Enlarged table in Appendix)

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<td>Increased failure points = risk</td>
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Source: Gartner (November 2021)

Key Lessons From SKU Rationalization During the COVID-19 Pandemic
The SKU rationalization strategies that CP companies were embracing during the initial onset of the COVID-19 pandemic became big news. A slew of articles in the media touted the benefits seen not only by manufacturers but also retailers who were looking to unclog their supply chains and drive simplicity in stores. This was especially true for retailers that experienced increased activity with buy online, pickup in store (BOPIS). It seemed that almost all CP companies were implementing some sort of rationalization. P&G narrowed its production focus on its core SKUs to ensure supply flow despite an influx of demand. Jon Moeller, P&G CEO, communicated that the efforts to prioritize and focus its supply chain could have lasting effects. He said, “There's potential for this to result in a cutting of the long tail of inefficient SKUs and brands in our categories.”

Coca-Cola extended its SKU rationalization efforts from individual products to entire brands. Simplification strategies inspired the company to expand and accelerate the cutting down of variety to improve operational execution, margin and sales. CEO James Quincey said that “at the outset of the pandemic, our goal was to ruthlessly prioritize core brands and SKUs to strengthen the resilience of our supply chain. The lessons from the last several months and the insight from our already accelerated SKU rationalization convinced us to go even deeper on this opportunity by streamlining brands.”

Unilever also rationalized its SKU portfolio during COVID-19. At a certain point, it had reduced its portfolio upward of 40% — often only producing its high-volume A and B items. This strategy not only supported the demand of its top-selling SKUs but also created other key benefits. These included reducing size and product changeovers by 30%, increasing responsiveness by 12%, reducing costs by €200 million and generating cash of €500 million.

“At the outset of the pandemic, our goal was to ruthlessly prioritize core brands and SKUs to strengthen the resilience of our supply chain.”

— James Quincey, CEO, Coca-Cola, Supply Chain Dive (22 July 2020)
Another key finding that Unilever uncovered was that its lower-volume C and D SKUs required three times the capacity and seven times the inventory and drove six times the waste. Recognizing these demonstrated benefits, Unilever wanted to ensure that it did not bring back all of the C&D SKUs that it had rationalized during the pandemic. So it worked cross-functionally in order to limit the SKUs that would be brought back to the portfolio and ultimately worked to reduce the overall SKU count by 25% by the end of 2020 (see Video: Unilever — Building a Future-Fit, Purpose-Driven Supply Chain).

Simplifying Product Portfolios Can Also Enable Agility and Resilience in Supply Chains to Help Minimize Risk

With the increased levels of disruption experienced globally during the past two years, we are seeing CP companies focused on increasing agility and resilience in their supply chains in order to minimize risk. According to Gartner’s 2020 Future of Supply Chain Survey, 88% of the CP respondents said they were investing to become more agile, and 85% to become resilient by 2022. In the same survey, 61% of CP respondents identified product and portfolio complexity as a key barrier in making their supply chains more resilient (see Figure 2). ⁴
Figure 2: Product and Portfolio Complexity Is the Top Barrier to Resilience for Consumer Products Supply Chain

Product and Portfolio Complexity Is the Top Barrier to Resilience for Consumer Products Supply Chain
Percentage of Respondents

- Product and Portfolio Complexity: 61%
- Balancing Trade-Offs Between Cost Efficiency and Resilience/Risk Mitigation: 58%
- Organizational Silos and Contrasting Metrics Across Different Functions: 48%
- Investment Costs (E.g., Qualifying Alternate Suppliers, Duplicate Tooling): 46%
- Lack of Advanced Digital Technologies for Increased Visibility and Coordination: 41%

n = 277; all consumer products (CPG, fabric/apparel, and food and beverage)

Q. What barriers do you face in making your supply chain more resilient?
Source: 2020 Gartner Future of Supply Chain Survey
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The same research also shows that 86.8% of CP respondents say they are investing to reduce product and portfolio complexity by reducing variety as well as increasing common components in order to allow more resiliency.

These risks and disruptions are continuing. Gartner research shows that 75% of organizations are reporting that the rate of disruptions is increasing. In 2021, the world experienced a continuing pandemic, extreme weather, trade disputes, blockages of major transport arteries and large-scale cyber events, all of which have demanded high levels of attention to manage the negative effects. This increase in velocity means that supply chain leaders have little or no time to implement mitigating actions and review their effectiveness before the next event happens 5 (see Leadership Vision for 2022: Chief Supply Chain Officer).
CP supply chains need to reduce complexity not just as a short-term fix to better manage during disruptions but as a long-term strategy to drive profitable growth and minimize risks.

Move From Reactive SKU Rationalization Toward Proactive Portfolio Optimization

The same E2open benchmark study identified that, in addition to significant item proliferation in the past decade, CP companies have also seen their “tails” (lowest-volume SKUs) grow significantly. Figure 3 provides the analysis of the long tail in CP product portfolios, where 81% of the SKUs only make up 20% of sales, and where the fastest-moving items, which generated 80% of the volume, accounted for only 18% of the SKUs.

Figure 3: The Long Tail Comprises the Majority of the Items in the Portfolio

It’s Not Just About Cutting the Tail

Source: E2open 2021 Forecasting and Inventory Benchmark Study
In today's competitive environment, SKU complexity is inevitable for most CP companies, so it's critically important to understand the best way to manage it. In the past, supply chains have approached this from a reactive perspective — narrowly focused from an operational perspective in their efforts to manage this complexity because increased supply chain costs were often the biggest impact of SKU complexity. A common reaction was an effort to “cut” the lower selling items that made up the SKU “tail.” Unfortunately, this cost-driven SKU rationalization mindset could often end up eliminating products that were essential or strategic to the product assortment without significantly reducing supply chain costs.

A better approach is to move to a more proactive mindset: overall SKU optimization, with supply chain ensuring they are active partners on both ends of product life cycle management. This applies not only to SKU-retirement-process decision making but also to the SKU development process.

**Differentiate Between Good and Bad Complexity**

Because new products can provide growth and entry into new markets, it's important for CP companies to clearly differentiate between SKUs that provide strategic growth and SKUs that lead to proliferation and dilute profitability (see Table 2).
Table 2: Good vs. Bad Complexity

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Source: Gartner (November 2021)

CP companies must work collaboratively during the SKU development process to ensure they bring in new items that exhibit “good complexity” characteristics. Will the SKU optimize and be part of the important business core? Is it highly innovative and fulfilling a currently unmet customer need? Is it a premium product that drives higher margins? It’s also important to assess the supply chain impact during this process to determine if resources are being maximized — for example, using common raw materials and packaging platforms across product groups. Are you able to optimize manufacturing capabilities? Bottom line: Good complexity should increase the profitability of your portfolio.

Bad complexity is the result of product proliferation that occurs without a strong cross-functional SKU development process. You must review portfolios on a regular basis to ensure they are productive. From a commercial side, it’s important to bring in SKUs that add overall value to the portfolio and do not dilute value or margin through cannibalization. As portfolios become more expansive, the ability to predict which product choices are needed and when deteriorates. From a sourcing perspective, there are more materials and a greater number of suppliers to manage. Overall, as we’ve seen with the COVID-19 pandemic, SKU proliferation can significantly impact capacity, reduce agility and resilience, and increase supply chain risk.
Optimize the Portfolio Through Cross-Functional Alignment and a Disciplined Review Process

CP companies leading in portfolio management are guided by the goal of overall portfolio health. They designate clear ownership and targeted metrics that are aligned on what the organization constitutes a healthy and productive SKU. Supply chain leaders understanding product-level margin contribution can balance this insight with the strategic importance of products to influence portfolio decision making with business partners.

What Constitutes a Productive and Healthy SKU?

You can quantify the impact of product and portfolio complexity in many ways to help make portfolio decision making more data-driven. One method is SKU density analysis, as depicted in Figure 4. This entails plotting the cumulative revenue or margin contribution of products in descending order to identify the critical few that represent the majority of contribution. Once you have identified these products, you can build the results into solutions that guide sales teams to offer higher-volume, more profitable SKUs that are targeted based on buyer demographics. You can also leverage the results as part of a more detailed product portfolio management (PPM) process that identifies candidates for renovation and rationalization from the portfolio.

Figure 4: Example of Density Analysis

Source: Gartner (October 2017)
Some companies evaluate the relative margins of the products in their portfolio against the velocity of sales, as represented by inventory turns. Quantifiable characteristics are commonly used to measure overall SKU health because they are easier to track and they represent key organizational goals like volume, growth and profitability. But just like assessing “good” and “bad” complexity, there are also less tangible, qualitative characteristics that you should often consider for a balanced view of a product’s position in the marketplace. The most advanced approach is to plot products based on a combination of quantitative and qualitative characteristics (see Table 3).

**Table 3: Productive SKU Considerations**

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Source: Gartner (November 2021)

Based on the quadrant area that products fall into, you can take appropriate actions. You can discontinue some, monitor others over time to leverage the sales they can generate, and refresh or renovate others to improve portfolio productivity and reduce complexity cost.

**Implement a Disciplined and Consistent SKU Portfolio Review Process**
Conduct this analysis and review process to evaluate portfolio health on a regular basis, and synchronize with business planning and innovation cycles to govern portfolio productivity. In the past, this process was managed less consistently. But there has been considerable progress by CP companies in increasing this frequency. Gartner’s Product Life Cycle Management (PLM) Best Practices and Challenges Survey, conducted in 2019, found that 87% of CP companies were reviewing the health of their SKU portfolios at least once a year (see Figure 5).

**Figure 5: 87% of CP Companies Review Their SKU Portfolio Health at Least Once a Year**

![Pie chart showing frequency of reviewing the health of product SKUs and portfolios.](image)

- 52% More than once a year
- 35% Annually
- 6% Only when we have to
- 7% Less than once a year

Q. How frequently does your company review the health of its product SKUs and portfolios?

Source: 2019 Gartner Product Life Cycle Management (PLM) Best Practices and Challenges Survey 750532_C

n = 95 consumer products manufacturers, excluding “don’t know”

Gartner recommends that organizations conduct product portfolio reviews at least once a year — potentially reviewing 25% of the total portfolio each quarter. Companies at a higher maturity or with more complex supply chains will often conduct this review more frequently.
As part of the S&OP process, the product portfolio planning (PPP) meeting is the forum where decisions about changes to portfolios are made — in regard to adding new products and discontinuing existing items. Higher maturity organizations are utilizing cost to serve (CTS) to manage products’ life cycles to decide to retire products that are no longer profitable. By understanding a product’s cost and its relative contribution to the organization's profitability, supply chain leaders can have a more informed discussion on portfolio management (see How to Meet Gross Margin Targets Using Cost to Serve to Reconcile S&OP and Financial Plans).

Case in Point: Diageo SKU Optimization

Diageo, one of the world’s largest producers of beer and spirits, has made tremendous progress not only in optimizing its overall SKU portfolio, but also establishing a robust, cross-functional process to ensure that the portfolio remains productive. The key enabler of the success that Diageo has seen with its SKU optimization initiative is that it’s built on the foundation of its product segmentation strategy.

Diageo’s product segmentation strategy clearly identifies the SKUs that are most important to its business, and allows for cross-functional alignment across the organization (see Video: Diageo’s Product Segmentation — Investing in Never-Be-Out SKUs to Improve Service). Diageo has four distinct segments, and each is managed differently from a supply chain perspective:

- **Never Be Out (NBO)** — These are broken down into three different categories: priority SKUs that are its biggest volume SKUs; strategic SKUs that may be lower volume or unpredictable demand; and agile SKUs that require more flexibility.

- **Transform** — These are SKUs with service issues that need supply chain intervention to improve service levels.

- **Core** — These are SKUs that are a healthy part of the business and have strong performance but not as critical as NBO SKUs.

- **Discontinue** — These are products with lower volume that it is looking to discontinue and manage cost-effectively.
The cross-functional alignment on this segmentation strategy has allowed the organization to focus on the SKUs that are driving both growth and profitability. It has also allowed Diageo to implement a highly disciplined SKU optimization process where every product in its portfolio is reviewed four times a year. Each SKU must pass hurdle rates for both minimum volume and profitability targets. In addition, any product that does not meet these thresholds must have a valid business case “exception” raised by the brand team to prevent it from being moved to a discontinued status.

This quarterly review process keeps the focus on SKU optimization across the organization and has demonstrated significant results. Since implemented, Diageo has reduced approximately 40% of its global portfolio. It has increased profitability by prioritizing higher margin products. It has minimized complexity, which has increased its supply chain agility to better manage its NBO SKUs. It has also allowed Diageo to increase its investments in capacity and innovation.

**Summarizing the Key Recommendations**

Ultimately, SKU optimization is a lever that supports an overall performance management process, including profitability. The pandemic created constraints that gave CP organizations little choice but to utilize this lever to ensure performance. At that point in time, it wasn’t discretionary. But in the future, when there isn’t an industrywide capacity crunch, it will be. It’s important for CP supply chain leaders to do the following (see Figure 6).

- Learn from leaders and optimize the products that are core to your business.
- Eliminate products that are redundant to the customer and end consumer.
- Increase usage of common raw materials and packaging across product groups.
- Carefully reassess what products to bring back that were rationalized during the COVID-19 pandemic.
- Permanently remove products that were rationalized during the pandemic and not missed by customers.
- Ensure that supply chain is an active partner on both ends of product life cycle management.
- Utilize both quantitative and qualitative characteristics in determining a product’s health or productivity.
- Incorporate SKU optimization and governance as part of your organization's S&OP process.

- Systematically review the cost of complexity and allow simplification where SKU proliferation doesn't add value.

**Figure 6: Summarizing the Key Recommendations**

**Summarizing the Key Recommendations**

- Learn from leaders and optimize the core products of your business
- Eliminate products that are redundant to the customer
- Increase usage of common raw materials and packaging across product groups
- Reassess when to bring back products that were rationalized during the COVID-19 pandemic
- Permanently remove products that were rationalized during the pandemic that were not missed by consumers
- Ensure that supply chain is an active partner on both ends of product life cycle management
- Utilize both quantitative and qualitative characteristics in determining a product's health
- Incorporate SKU optimization as part of the S&OP process
- Systematically review the cost of complexity and allow simplification where SKU proliferation doesn't add value

Source: Gartner
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**Evidence**

1. *The 2021 E2open 20201 Forecasting and Inventory Benchmark Study*, E2open.

2. *Coca-Cola, Mondelez Trim SKUs as CPGs Tackle Pandemic Stresses*, Supply Chain Dive.
3 Coca-Cola Expands ‘Ruthless’ SKU Rationalization Strategy to Cut Entire Product Lines, Supply Chain Dive.

4 Gartner’s Future of Supply Chain Survey, 2020. In September and October 2020, Gartner Supply Chain Research sent invitations to complete an online survey to its community members, to Gartner clients and to a wider group of practitioners in supply chain and other functions globally. We received 1,346 completed responses during the survey period for this 2020 Future of Supply Chain Survey. We had participants across industries — for example, high tech (20%), healthcare and pharma (14%), CPG (11%), industrial (10%), food and beverage (9%), and retail (9%, 115 respondents). Most worked in supply-chain-related functions — for example, supply chain (49%), logistics/transportation and distribution (9%), purchasing/procurement (9%), and operations (7%). Of the respondents, 57% were from North America and South America, 29% were from EMEA, 13% were from Asia and Australia, and others were from the rest of the world. Of the participants, 63% were from companies with revenue of more than $10 billion. Of the participants, 63% were at VP/director level or above.

5 2020 Gartner Supply Chain Signature Series Risk Survey. The Gartner Supply Chain Research team conducted more than 70 interviews with CSCOs from large and midsize enterprises to study various approaches that supply chains take to mitigate risk. Additionally, throughout December 2020, the research team sent out invitations to complete an online survey to a wide group of heads of supply chain globally. We received 262 completed responses during the survey period for this Gartner Supply Chain Signature Series Risk Survey. We analyzed the data using a variety of statistical methods (for example, t-test, regression analysis and factor analysis).

6 2019 Gartner Product Life Cycle Management (PLM) Best Practices and Challenges Survey. This study was conducted online from 9 July through 9 August 2019 to better understand how PLM is currently viewed and practiced among manufacturing enterprises. We aimed to learn more about how companies define the scope of PLM activities and the metrics used to track the performance of different PLM activities.

In total, 295 respondents were interviewed in their native language across the U.S. (n = 109), Canada (n = 15), Germany (n = 38), France (n = 45), the U.K. (n = 47) and Mexico (n = 41).
Qualifying organizations are manufacturers (high tech, industrial, consumer products) with enterprisewide annual revenue of at least $500 million (and at least $1 billion in the U.S.) or equivalent. These companies either already have implemented digital activities in at least one function of the business (such as digital marketing) or have plans to implement within the next two years.

Qualified participants are executive management and/or have a role in a supply chain function, are personally knowledgeable about cross-functional PLM activities, and are involved in activities or strategies related to PLM at their company.

The survey was developed collaboratively by a team of Gartner analysts who follow these markets and Gartner’s Research Data and Analytics team.

*Disclaimer:* Results of these studies do not represent global findings or the market as a whole but do reflect the sentiment of the respondents surveyed.

The organization profiled in this research is provided for illustrative purposes only, and does not constitute an exhaustive list of examples in this field nor an endorsement by Gartner of the organization or its offerings.

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**Recommended by the Author**

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- 2021 Gartner Supply Chain Top 25: Consumer Products
- Strengthen Supply Chain Planning’s Role in PLM for Improved Cross-Functional Collaboration
- Quick Answer: How to Enhance Supply Chain’s Support for Product Life Cycles
- Differentiate Product Portfolio Planning From Demand Planning in Your S&OP Process
- S&OP Process: Product Portfolio Planning
- How to Meet Gross Margin Targets Using Cost to Serve to Reconcile S&OP and Financial Plans
- Future of Supply Chain: Consumer Products Must Transform Amid Accelerating Change
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