

Product Design Case Study

Homecolour

Homecolour was a paint manufacturer, based in the UK Midlands, which 20 years previously began supplying own label paints to 2 small DIY retail chains. The company grew with the expansion of the DIY market by concentrating primarily on supplying regional - and some national - chains with a proportion of their private label requirements. During the last 10 years, though Homecolour was still supplying own label products, the company had also developed a range of branded paint. Sales growth continued through the last 5 years, but increases in profitability were much more difficult to achieve, as Table 4A indicates.

Return on capital employed had dropped over the same period. The large capital investment programme instituted by Homecolour, to meet rapidly rising sales volumes, failed to provide the anticipated return and had declined from 38 per cent to 17 per cent over the 5 year period. The board of Homecolour were meeting to review the future of the company and were considering a document which provided the information on which they would take their decisions. Decisions on company direction would have considerable impact on the production plant, and the type of packaging that the company manufactured.

Table 4A . Homecolour 5 year sales - all figures in £million with most recent year 5.

| | Year | | | | |
|-----------|------|-----|-----|-----|-----|
| | 1 | 2 | 3 | 4 | 5 |
| Sales | 15 | 17 | 19 | 22 | 25 |
| Promotion | .6 | .8 | .9 | 1.3 | 1.5 |
| Profit | .8 | 1.2 | 1.4 | 1.5 | 1.6 |
| Capital | 2.1 | 3.0 | 3.5 | 5.5 | 8.9 |

The market

The market, valued at around £300 million at retail value - at an average of £2.25 per litre, a consumption of 120 million litres per annum - had become progressively more competitive. Paint production was concentrated by a series of industry takeovers into a smaller number of manufacturers. The result was that Homecolour faced a steady decline in profit margins as it could not effectively compete with the economies of scale, both in production and promotion, against the two market leaders. The company had spent approximately £1.5 million in promotion in the last year, this was significantly behind the market leader expenditure of approximately £12 million. The market had become increasingly price competitive as well; Nielsen audits revealed that price elasticities had changed from 6 to 4 over the past 5 years. There was little evidence that consumers bothered with price points or other psychological pricing effects; they tended to be buying paint along with other DIY products and saw paint as one of a range of products needed for decorating.

With sales totalling 15 million litres, Homecolour had a 12 per cent market share of the consumer sector, and was clearly the third largest manufacturer in the market. However the market shares of the two other companies accounted for well over 60 per cent of total sales. Homecolour had initially concentrated on supplying own label products and this still provided a substantial proportion of both turnover and profit as Table 4B indicates.

Table 4B. Homecolour percentage (%) turnover and profit contribution by sector, by year with year 4 most recent.

| | | Year | | | |
|-----------|----------|------|----|----|----|
| | | 1 | 2 | 3 | 4 |
| Own label | - sales | 55 | 57 | 63 | 68 |
| | - profit | 45 | 46 | 47 | 42 |
| Branded | - sales | 45 | 43 | 37 | 32 |
| | - profit | 55 | 54 | 53 | 68 |

Customers

Homecolour supplied consumer paints to the high street, predominantly to the main retailers. It supplied most of the own label paint lines to the major retailers, and four made up over 95 per cent of its total own label sales. These companies contributed approximately 20 per cent of turnover each over the past 5 years, even though there had been substantial fluctuations on a year by year basis. The company distributed its branded range, Homecharm, via a number of wholesalers, which had grown to 200 in the last year, and to the smaller specialist DIY outlets. There were an estimated 4000 of these nationwide. This range currently contributed 32 per cent of total turnover, but 58 per cent of total profit, and this followed a trend which had become established over the past 5 years, with branded products providing a steadily greater profit contribution as pricing pressures in the own label business became more intense.

The company had national coverage via these distribution channels and separated the country for control purposes into Midland and the North, and the South. Sales were evenly spread and related to population density. Wholesalers worked on a profit margin on sales of around 10 per cent, whereas the small specialist DIY outlets worked on 35 per cent retail margin.

The attraction of the own label business was that the company produced on long term contracts and did not need to hold stock, supplying their customers at regular and determined intervals. This was in contrast to the branded sector, which suffered from both a high level of seasonality and considerable fluctuations in demand. Whereas external paints tended to be most in demand during the summer, indoor paints were usually bought in the winter. This pattern could, and was often changed by alterations in the weather patterns - a poor summer could drive demand of indoor paints up within a short period of time. The pattern of the last 2 years by month is detailed in Table 4C.

Table 4C. Sales activity by month in two previous years.

Sales percentage by month by activity - previous year - months 1 to 12

| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
|-----------|---|---|---|---|---|----|----|----|----|----|----|----|
| Own label | 7 | 7 | 8 | 9 | 9 | 9 | 9 | 9 | 10 | 6 | 9 | 8 |
| Branded | 4 | 3 | 4 | 5 | 9 | 12 | 16 | 15 | 8 | 7 | 7 | 10 |

Sales percentage by month by activity - current year - months 1 to 12

| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
|-----------|---|---|---|---|---|---|---|---|----|----|----|----|
| Own label | 7 | 7 | 8 | 9 | 9 | 9 | 9 | 9 | 10 | 6 | 9 | 8 |
| Branded | 7 | 5 | 4 | 5 | 5 | 6 | 6 | 9 | 11 | 14 | 15 | 13 |

Weather was not the only major influence on demand - changing disposable incomes and

mortgage levels also had some impact on total sales. When the house market slowed down, people tended to spend more on DIY activity to improve the attractiveness of their houses, with an inevitable effect on the level of paint sales. For the branded product range, alterations in colour demand meant that sales volumes needed to be continually monitored. The trends in demand are in Table 4D.

The current branded product range had ten colours produced in two tin sizes, one and two litres. Sales varied considerably within the range with the best selling line over the past 5 years varying between brilliant white, Table 4D. Five year branded sales history by type - 000's litres, with year 5 most recent.

| | Year | | | | | |
|-----------------|------|---|------|------|------|------|
| | 1 | 2 | 3 | 4 | 5 | |
| Brilliant white | 400 | | 425 | 500 | 600 | 750 |
| Magnolia | 325 | | 400 | 420 | 400 | 425 |
| Oyster | 200 | | 220 | 250 | 275 | 325 |
| Sand gold | 260 | | 280 | 280 | 270 | 260 |
| Black | 225 | | 380 | 380 | 400 | 550 |
| Lime green | 160 | | 120 | 200 | 160 | 125 |
| Clear blue | 450 | | 400 | 450 | 550 | 650 |
| Aluminium | 500 | | 200 | 350 | 440 | 640 |
| Bitumen | 200 | | 300 | 450 | 700 | 600 |
| Textured white | 300 | | 300 | 300 | 500 | 450 |
| Total branded | 3020 | | 3025 | 3610 | 4795 | 4775 |

aluminium, and bitumen. Homecolour had a reputation in the trade, and among the more knowledgeable customers, for producing higher quality exterior paint than the competition, and it was in this sector of the market that the company achieved its highest sales. Market surveys suggested that the company had around a 5 per cent quality advantage over the competition. The own label production was much more varied in colour and tin size - the company, over the past 2 years, had produced around 50 different colours in up to 5 different tin sizes. Currently there were considerable variations in the type of packaging that was provided in the own label and branded sectors. The company had yet to standardise on a single branded theme and the level of instructions on the packaging varied considerably throughout the product range. Each pack had the Homecolour logo, and limited instructions.

As the recession worsened, there was a steady increase in the number of consumers turning to DIY for their decorating. A considerable number of consumers without experience of decorating were now buying paint. A survey had revealed that an increasing number of customers were finding paint quality dissatisfying because of their failure to properly prepare surfaces. This survey revealed that 46 per cent of current customers failed to remove current paint from surfaces; and over 50 per cent expected that one coat of paint would be sufficient to cover all previous paint or wallpaper products. In order to remain competitive, against the two major companies in the market, Homecolour had to ensure that a high level of stocks were maintained in the major outlets. The pressures on selling space within most retail outlets were becoming intense, and shortage of stock had in several cases ended in the company being de-listed by three regional DIY chains. The current sales pattern had shown that the company was experiencing major problems in certain of the outlets with sales significantly below plan. Own brand sales were 20 per cent down on plan - which had envisaged a 5 per cent increase in volume; while branded products were within 2 per cent of plan - based on an 8 per cent volume increase over the previous year.

The new marketing manager was being asked to suggest how the company could react to the changes that were taking place in the market by proposing a range of sales promotions and how and when they should be implemented. The company had developed a range of promotional concepts, provided in Table 4E.

Table 4E. The available sales promotion alternatives, their speed of introduction in months, cost per litre in £ and likely sales increase in volume.

| Type | Time | Cost/litre | Sales increase % |
|------------------------|------|------------|------------------|
| Competition | 2 | 0.10 | 3 |
| Coupons | 1 | 0.20 | 7 |
| Extra pack | 3 | 0.10 | 4 |
| Banded pack | 2 | 0.40 | 6 |
| Discount | 1 | 0.30 | 10 |
| Self liquidating offer | 3 | 0.10 | 3 |
| Sample pack | 4 | 0.60 | 8 |

Historically the company had spent around £500,000 per year on adhoc sales promotions to boost volume. This year senior management had demanded that the marketing team be more systematic in its approach which should focus on the trade distribution agreements that the company had with their major distributors. As a result, marketing management had not spent anything in the early part of the year, and was able to develop sales promotion campaigns for both the existing products and some of the new developments that were currently under consideration.

Production and warehousing

The company had invested heavily in modern, flexible manufacturing facilities, about 5 years previously, to meet the forecast steadily increasing demand for paint. The production plant could switch within 30 minutes from the production of one type or colour of paint to another, with a set up cost of £550, a figure substantially below the competition. With its microprocessor control systems the plant was able to operate on a 24 hour day, with low staffing requirements. In the current year the plant was continuing to operate substantially under capacity producing only 15 of the possible 28 million litres. This inability to achieve production targets meant that the company failed to achieve the return on capital that the senior management had initially expected.

The company had, as part of its expansion programme, a new warehouse alongside the production facility. The integration of the warehouse with the production facility, and advanced automation, allowed filled paint to be moved from the manufacturing point to the warehouse storage point with the minimum of physical involvement by factory or warehouse staff. The company currently used a range of outside contractors to handle distribution, though this had substantially raised costs as the number of wholesalers supplied with branded paints expanded. The average cost of delivery was £350 per round trip for their fleet of one 40 ton; and £250 for the three 20 ton lorries that could carry 32,000 and 15,000 litres of paint respectively. One of the advantages of the private label business was that Homecolour could maximize vehicle utilisation into the 55 central depots of the DIY multiples, whereas deliveries of branded products tended to be only 35 per cent full. Expansion into other areas, involving smaller volumes to individual customers, would mean that the average cost of delivery for a litre - currently £0.10 - would rise substantially.

Current salesforce and promotional plan

The company employed five sales representatives. Two of these negotiated with senior buyers at the major multiples for the supply of own label products; the other three were responsible for ensuring that the 180 main wholesalers in the country stocked the branded paint that the company produced. The salesforce had been recruited from a variety of backgrounds, but had considerable skills in selling paint and paint products. The company felt that the current team could be retrained, if necessary, to concentrate on the new areas of development, the most important of which are described below.

At present, the company negotiated annually with the multiples on price, and had loose agreements with the wholesalers which primarily consisted of attractive discounts on quantity. The price position of the company over the past 5 years is given in Table 4F; with Homecolour pricing related to the weighted market average in the various distribution channels of 100.

Table 4F. Relative pricing of branded Homecolour by distribution channel, weighted market average of 100 in each channel, by year, with year 4 the most recent.

| Channel | Year | | | |
|----------------|------|-----|-----|-----|
| | 1 | 2 | 3 | 4 |
| AG Stanley | 98 | 99 | 100 | 102 |
| B & Q | 96 | 97 | 96 | 101 |
| Woolworths | 101 | 103 | 104 | 105 |
| Texas Homecare | 97 | 101 | 101 | 102 |
| Homebase | 100 | 102 | 103 | 103 |
| Midlands | | | | |
| Independents | 94 | 94 | 95 | 95 |
| Wholesalers | 97 | 96 | 98 | 97 |
| South | | | | |
| Independents | 95 | 93 | 93 | 94 |
| Wholesalers | 97 | 98 | 99 | 100 |

The advertising budget for the current year was £1.5 million and was to be spent entirely on television during the months of September, October and November. The company had received the following information about the consumer and the relationship between coverage and exposure to help plan the campaign. Each £1000 spent would on average achieve one rating point; the relationship between expenditure and achieved viewing levels is provided in Table 4G.

Table 4G. Current relationship between percentage of the population OTS and ratings.

| Ratings | OTS | | | | | |
|---------|-----|----|----|----|----|----|
| | 1 | 2 | 3 | 4 | 5 | 6 |
| 50 | 30 | 20 | 15 | - | - | - |
| 100 | 45 | 35 | 25 | 20 | 15 | 5 |
| 150 | 65 | 50 | 35 | 30 | 25 | 15 |
| 200 | 85 | 75 | 60 | 50 | 40 | 20 |
| 250 | 92 | 78 | 72 | 55 | 50 | 35 |

Market research had suggested that the company needed to achieve 4 OTS to reach the maximum potential sales threshold; the advertising decay rate over the past 3 years had been in the range of 40 per cent per month. The most expensive period for advertising was over Christmas; space was around 50 per cent more expensive than during the summer.

Senior management were very concerned that the structure of the campaign had not been sufficiently considered; and that the company should think about transferring some of the budget to other media types.

Other possible avenues of activity

The company had especial expertise in the production of technical paint products. The production department had one of the best reputations in the country and this had helped in the acquisition and maintenance of the own label products. Homecolour was looking for avenues of activity that would exploit this technical strength, improve profitability and improve the current sales volumes. The main options were thought to be in the following sectors.

Standard industrial metal work paints. There were an estimated 6000 consumers of standard metal working paint products in the United Kingdom, ranging from the smallest metal bashing firm operating from under a railway arch, to some very large concerns like GKN. The total market had an estimated value of around £17 million, at the average price of £3.5 per litre, or a total of 5 million litres. Small firms tended to buy product from the 120 industrial wholesalers in the country that stocked this type of paint. But the larger firms all bought direct from the manufacturers, who were mainly small regional companies. Price sensitivity was significantly lower than the consumer market, and margins in consequence higher. Estimates of the Homecolour production department suggested that 55 per cent margins could be achieved when the company sold direct to the end users though using wholesalers would mean that margins would drop towards 40 per cent. The range of colours that was generally in demand was limited: black accounted for over half the volume and brilliant white, aluminium and beige made up the remainder. Research had also shown that the majority of users tended to hold low stocks of the relevant paint and would generally wish to receive new stocks within 2 days of starting a new production run of metal production. Homecolour would have to produce a new product formulation to service this market, and would have to decide on the size of the container, the name of the product and the type of instructions, guarantees and service support that the company should provide.

Vehicle paints. Paints especially formulated for vehicles were, on the surface, an attractive outlet for specialist paints. There were an estimated 7000 outlets that carried out some vehicle paint work, though this varied from minor repairs to the seven or eight vehicle manufacturers that used paint in large quantities for original vehicle manufacture. The size of the market was estimated to be around £45 million, the bulk of which was accounted for by the vehicle manufacturers (an estimated £35 in paint per vehicle for the 1.2 million manufactured in the UK). The manufacturers determined which paint manufacturers were listed to supply both them and the repair market. The gross margins on the product that was supplied was high - estimated at 65 per cent - with a per litre price of £5. The small repairers tended to order the product via the spare parts departments of the vehicle manufacturers which held stock of all the colours currently used by the company. There was also a small retail market where consumers bought product for 'touching' up small defects in the paint work of individual vehicles.

Homecolour would face a number of problems in this market sector. First, there was a demand for a wide range of colours - in the current year a total of 45 would be required to service 85 per cent of the vehicles currently on the road in the UK. The large vehicle manufacturers also demanded both exceptionally high technical specifications - resistance to chipping, scuffing being especially important; and absolute guarantees on quality. Because of these requirements they preferred to deal with large manufacturers who also

could provide the technical expertise required. In addition, the introduction of computer assisted manufacturing systems, such as Just In Time inventory control systems, meant that the suppliers had to meet 24 hour delivery schedules. Though Homecolour could meet the technical demands of the market, it was unclear as to the level of technical support that it would need to provide, and what shape this should take.

Powder coating. A growth sector in metal manufacture was powder coating to protect metal work, especially furniture. The market had an estimated worth of £3 million in the current year, and there were currently 65 outlets that were active in the production of powder coated products. The current price for powder coated product was £7.50 a litre, which would provide Homecolour with a 60 per cent gross margin. All the large companies bought direct from the two manufacturers that currently supplied paint to this market. Generally, each company would carry out powder coating in batch production and concentrate output in 3 or 4 days in a 2 week period. The powder coating companies were able to forecast their production requirements several weeks in advance. Most of the paint requirements were in four colours which made up 85 per cent of total demand. Customers tended to prefer to purchase product in large containers, which would be fitted into existing powder coating equipment. As the market was demanding on quality, companies operating in the sector had to provide detailed guarantees on quality.

Structural paint. There was a large existing market for the supply of structural paint, the specialist product used to coat buildings and steel frameworks. Most of the work was carried out by small independent contractors buying from builders merchants - there were an estimated 2500 of these in the country selling significant volumes of structural paint. Some structural paint was sold through DIY wholesalers who were already Homecolour customers, but this was much the smaller part of the market. The market was worth around £15 million, as much of the demand for structural paint was met by paints that were available from the consumer sector. Price competition was in consequence, extremely severe - the average price was below that obtainable in the consumer sector, and there was substantial import substitution. Homecolour estimated that the company would be able to enter the market but that the potential margins per litre for the basic products were unlikely to be better than 10-15 per cent.

Homecolour management was convinced that over time they would be able to develop a premium sector in the market, based on current product experience in the consumer sector, in external paints. One of the directors felt that it was possible to gain up to 30 per cent of the market, and improve margins to 30-40 per cent, by marketing a product that would provide longer term protection to steel structures than the current products. The product would have to be provided in far larger containers - often in excess of 10 litres. The packaging would also need to include contact points for spray equipment.

Action

How should Homecolour build on its existing segment and product benefit?

What information do the management need to control the business?

What changes in the product will improve the position of the company in the market?

What changes will be necessary if Homecolour changes its area of activity?