VIEWPOINTS ON **COMPLEXITY REDUCTION**

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Complexity Reduction: Governance Sets the Foundation for Success

by Mick Broekhof

De-cluttering the business frees up staff to focus on growth, and in many cases, the process of doing so generates enough cost savings to fund growth initiatives.

Typically, companies can generate from 0.5% to 5% of additional profit through a stock keeping unit (SKU) complexity reduction initiative, while at the same time positioning the business for accelerated growth. Knowing where to reduce or eliminate SKUs is critical, but where do organizations begin?

This series of viewpoints will feature practical examples, common tips and tricks, and details on the financial impact of reducing SKU portfolio complexity. This first viewpoint focuses on laying the groundwork for a complexity reduction initiative with a strategic governance process.

The Right Governance Sets the Foundation for Success

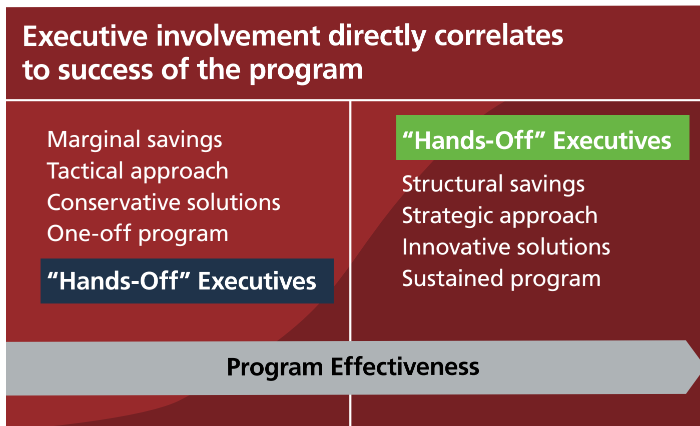
Complexity reduction is critical to healthy business growth. However, rationalizing products or SKUs may seem counterintuitive because eliminating SKUs from the product line directly reduces the revenue and variable margin of the business. Think in terms of the tree analogy: just as we may cut a limb that still bears some fruit, reducing complexity may rationalize some SKUs that still generate incremental revenues and margins. Establishing the right governance for complexity reduction initiatives will make these difficult rationalization decisions easier.

A Tale of Two Companies

The following example illustrates two common approaches to governance and the degree of success derived from committing to the right approach.

Hands-Off Executives: At a hands-off company, the CEO typically charges the head of supply chain with complete responsibility for executing the SKU portfolio optimization process. Complexity reduction decisions are the product of the deliberations of peers from sales, category, operations and R&D. The result is a typical committee outcome. There is no aggressive goal setting, no pushing the envelope when it comes to difficult decisions, and no aggressive execution of agreed-upon plans. As a result, complexity savings are marginalized.

Hands-On Executives: When the C-suite has a hands-on approach, complexity reduction exercises are run bi-annually by a small team of industry experts. These exercises result in a short list of recommendations that is presented to a team of leaders from sales, operations and supply chain, and chaired by the CEO. The process is embedded in the routine of decision making activities of the C-suite. Cost structure is removed. In this scenario, the C-suite often sees opportunities for complexity reduction in other areas of the business and can initiate swift and decisive action.



Organizations whose executives take a hands-on approach to complexity reduction are more likely to have effective programs.

Role of the Process Owner in Governance

To ensure success of the governance process, successful companies appoint a process owner. The process owner ensures that the score card is updated, business rules are adhered to, the metrics are maintained, the process is kept current, and the roles and responsibilities of the various team members are clear to the members and well-understood by the organization.

Typical responsibilities of the process owner

- Maintains and updates documentation including:
  - Clear definition and scope of SKU portfolio process
  - High-level SKU portfolio optimization activities
  - Roles and responsibilities of portfolio team members
  - Business rules the team will adhere to
  - Metrics used to measure success and progress
- Maintains a list of "do's and don'ts"
- Owns the format of the scorecard
- Owns the schedule of meetings
- Embeds the portfolio optimization process into existing business processes
- Owns communication from the team to the wider organization

In general, the role of process owner is never 100% dedicated. Depending on the frequency with which complexity reduction exercises are done, the role can be as little as 5% of someone's time. Defining a role with clear responsibilities will help sustain the process.

How to Sustain Success

Failure to manage complexity can paralyze an organization's ability to drive innovation and growth. Real gains come as a result of implementing a strategic complexity reduction initiative that begins with a strong governance process. Sustaining the involvement of the C-suite and establishing a process owner have proven to be two critical elements for portfolio optimization. Successful organizations are those that have implemented these critical factors, and have a stronger portfolio and improved profitability as a result.

The next article in this series will look at the specific role of the CFO in complexity reduction: expectations, key success factors, and types of savings.

Complexity Reduction Part 2: The CFO's Imperative to Drive Growth

by Mick Broekhof

A previous Viewpoint, Complexity Reduction Part 1: Governance Sets the Foundation for Success, discussed two critical elements for laying the groundwork for a complexity reduction initiative - sustaining the involvement of the C-suite and establishing a process owner. This second piece of the series focuses on the specific role of the CFO in complexity reduction: expectations, key success factors, and types of savings.

Three Steps to Fueling Growth through Complexity Reduction

To implement an effective complexity reduction initiative that delivers optimum results and fuels growth, CFOs need to take a three-step approach:

1. Communicate the "reason-why" to galvanize the organization at the start of the complexity reduction initiative
2. Craft and communicate the financial expectations
3. Develop a strawman to set aggressive but achievable targets for reducing complexity at the start of the project

1. Communicate the Reason-Why

Crafting the reason-why and communicating it to the organization is the CFO's first step of a successful and sustainable initiative. Typically, 20 percent of products generate 80 percent of the profit. The other 80 percent of the product portfolio often requires a disproportionate amount of resources and effort to maintain. If that oversized group of products can be reduced, the corporation has the option to add the savings directly to the bottom line — or to reallocate the resources to grow the top line.

An initiative where savings are only added to the bottom line is implicitly positioned as "cost-cutting" and is typically viewed by internal and external stakeholders as short-term, tactical, and with a negative impact on existing resources.

Leading CFOs build more positive support by positioning complexity reduction exercises as a way to boost top line growth and create room to innovate.

2. Set Financial Expectations

The organization has to be equally clear about the financial expectations of the CFO and how he or she wants to have them expressed.

In our experience, clients typically achieve one to five points (on a return-on-sales basis) of hard financial impact through effective complexity reduction initiatives. This requires rationalizing products and sales to certain customer segments or large accounts. Client teams must be ready to justify the need to cut near-term revenue. CFOs must insist on these hard savings and position them as growth drivers.

Hard savings, like increased cash flow and net profit, are easy for CFOs and leadership teams to measure and articulate.

To capture hard profits, companies must plan and take deliberate and interdependent actions to restructure their cost base to effectively monetize complexity reductions. Hard savings become real when unnecessary assets are disposed of, labor costs are reduced, or material costs are eliminated. A good example of how to achieve this is through smart merging of finished products and/or semi-finished products.

Soft savings are harder to measure but are just as strategic. Examples include:

- Strengthened brands
- Better portfolio transparency
- Increased business agility and nimbleness
- More effective resource alignment
- Improved organizational focus
- Faster time-to-market

Soft savings cannot be measured in assets or people. One example a soft saving cited by a leading CFO is "better portfolio transparency, allowing faster decision-making regarding product portfolio mix and brand strategy optimization." Regardless of the actual savings, CFOs must be clear about measuring and communicating both hard and soft benefits.

3. Develop a Strawman

Smart CFOs will insist a strawman is built at the start of a complexity reduction program. A strawman is a simplified projection intended to generate discussion around the number of SKUs that can be reduced and the impact on margin, revenue and cost base of the business. To be most effective, the strawman should be prepared prior to kicking off a complexity reduction project. This way, the team can jumpstart their discussion with the leadership team in terms of specific goals for hard and soft savings. The strawman should also drive the discussion on when and how the cost structure of the business will be changed to reflect the new state of the company based on the complexity reduction initiative. The strawman is ultimately owned by the CFO.

Three Approaches to Monetizing Complexity Cost

There are three typical approaches companies take on when to recalibrate their cost base.

Proactive Approach: These companies set goals for cost reduction before the complexity reduction initiative starts, forcing the team to push the envelope and come up with aggressive action programs to reconcile the cost-to-serve with the new resource budget. This proactive approach carries the risk of destabilizing the performance of the company by driving cost reduction programs too fast and deep.

Reactive Approach: These companies recalibrate cost after complexity is reduced. They run the risk of structural accommodation to complexity—i.e., complexity is eliminated but the organization never really redeploys its effort in a manner which drives growth and profits.

Concurrent Approach: These companies re-calibrate costs concurrent to complexity reduction initiatives. This approach is still aggressive but it can help align structure to the complexity imperative, at medium risk.

Sustain Growth for the Long Haul

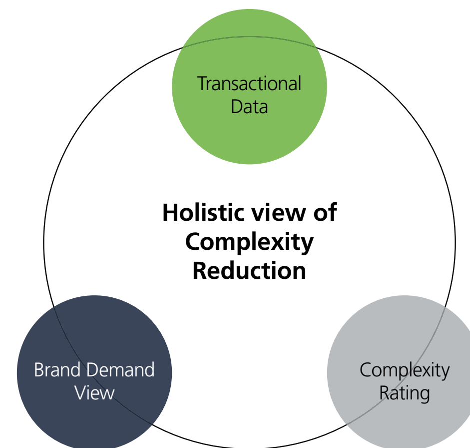
Leading organizations drive complexity reduction to create room for strategic growth — literally and figuratively. Stripping out unnecessary complexity generates new funds and resources to attack strategic growth opportunities. But complexity reduction also has direct and immediate financial impact that appeals to CFOs and stakeholders, especially when cost reduction is part of the Annual Operating Plan (AOP). To ensure short-term and long-term success of these programs, successful CFOs and leaders position complexity reduction initiatives to the organization and external stakeholders as opportunities to fuel growth rather than just cut costs.

Complexity Reduction Part 3: SKU Portfolio Optimization & Brand Strategy

by Mick Broekhof and Scott Gamble

The first article of this series, Complexity Reduction Part 1: Governance Sets the Foundation for Success discussed two critical elements for laying the groundwork for a complexity reduction initiative — sustaining the involvement of the C-suite and establishing a process owner. The second part of the series, Complexity Reduction Part 2: The CFO's Imperative to Drive Growth focused on the specific role of the CFO in complexity reduction: expectations, key success factors, and types of savings.

This third viewpoint focuses on the need for a more holistic approach to complexity reduction to achieve the strongest competitive advantage. For most companies, complexity or SKU reduction initiatives still start and stop with transactional data, focusing on turnover, profit, and volume by customer and channel. For a more balanced outcome, consumer product companies should create a holistic view of complexity reduction that includes brand demand view and complexity rating.



Brand Demand View

Brand demand view is an external view of the ideal product portfolio from a consumer, customer and competition perspective. To create the demand view, companies must gather information from consumers and shoppers about how they perceive the brand and ideal product portfolio. Consumer products companies should also ask their retailer customers about the ideal portfolio from a category and shelf perspective. An analysis of what the competition offers (and why) completes the brand demand view.

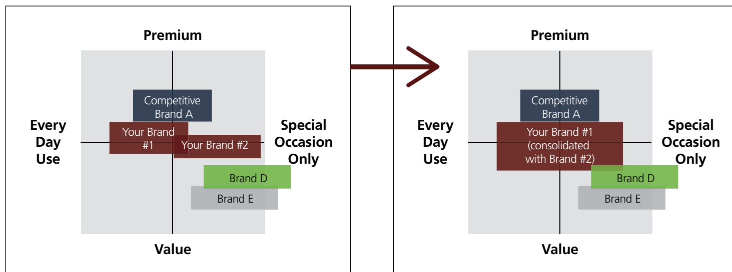
During a recent SKU portfolio rationalization at a confectionery company, several actions were taken to create their brand demand view.

Consumer insights experts canvassed shoppers in a supermarket and asked them about the ideal portfolio, category managers met with their peers at retailers to gain an understanding of key buying drivers, and the company's researchers checked the shelves to gain competitive insights. Insights from the three sources helped the company create an ideal profile of the product portfolio that was easily measured against the existing portfolio.

The brand demand view includes the extent to which a SKU delivers on the brand positioning and strategy. The confectionary company further broke down brand fit into brand differentiation strategy, brand personality, and even brand expansion strategy. A SKU has high brand fit when it fully supports the brand on all of these aspects.

Brand fit also applies to retailer 'Own Brands.' Leading retailers develop a quality/sensorial profile for each product category and price point in order to differentiate themselves from the competition.

Brand Consolidation Example



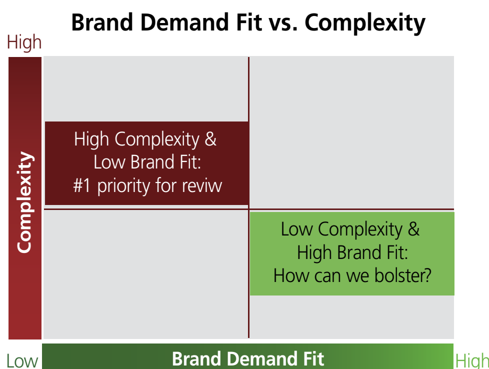
To position the brand portfolio for future growth, companies should optimize the brand portfolio through a deep understanding of emerging consumer needs, customer category expectations and competition.

In most cases, brand consolidation – resulting in fewer, stronger brands in the marketplace – results in improved margins and stronger overall market share. After optimizing the brand portfolio, it's easier to evaluate the optimal SKU assortment.

Complexity Rating

Complexity rating profiles the internal and external complexity of a SKU. Internal complexity factors include recipe, process, batch size, equipment utilization, filling, packing, inventory and logistics. This information comes from supply chain, R&D and operations groups.

Brand Demand Fit vs. Complexity



External complexity includes commercial complexity and risk, and is typically provided by sales and distribution teams. Ideally, activity-based costing (ABC) provides information about all the costs allocated to a product. But in reality, it's too complex to extract the real cost of a SKU from the total cost of a company.

Companies that want to understand how complexity affects cost without using ABC can use the complexity rating as a proxy. By rating each SKU on its internal and external complexity, the confectionery company found a large group of products with hidden cost of complexity.

If a SKU has high complexity and low brand fit, it is a greater candidate for review than a SKU with low complexity and high brand fit. Plotting complexity and brand fit is especially interesting when there are multiple brands with a similar profile, as would happen when merging two companies with similar product lines. In addition to transactional data, consumer products companies should consider brand fit, demand view and complexity rating when rationalizing the SKU portfolio. This provides management with a macro view of brands within the portfolio, a view of SKUs within the portfolio/brand, and a micro view of SKUs within the organization. As with our confectionery company example, these additional dimensions have proven to deliver a more balanced and profitable outcome.

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