Simplify to Grow

Building
Scale, Speed & profitability
in a Complex World
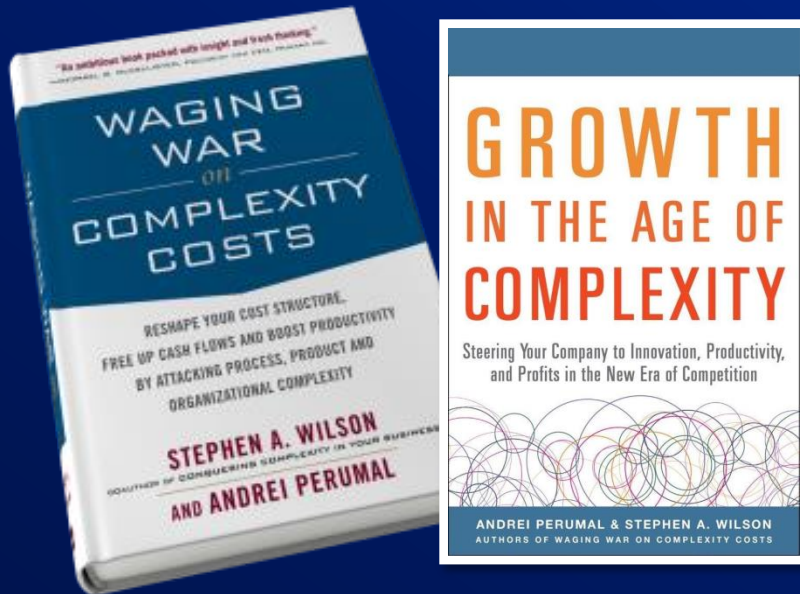
Wilson Perumal & Company, Inc.

London CSO Conference

April 29, 2014

Wilson Perumal & Company

> "…an ambitious book packed with insight and fresh thinking. Separating good from bad complexity is a critical task facing companies today, and the authors provide a compelling roadmap"
>
> – Michael B. McCallister
> President & CEO, Humana Inc.

- Management consultancy, with clients in NA & EU

- Strategy, complexity, operations

- *We help our clients compete in a complex world*

Our POV on Complexity

Complexity has impacts across the business:

Cost & Operations

Efficiency

Complexity costs

Whale Curve & Profit concentration

Business & Operational Risk

Increasing opportunities for catastrophic risk

High-reliability organizations

Growth & Innovation

Simplify to grow:

- ✓ **Simpler for customers**
- ✓ **Easier for sales force**
- ✓ **Improved KPIs**
- ✓ **Scale vs. fragmentation**
- ✓ **Margins to fuel growth**

Our discussion today

Complexity & Growth		Ways to Simplify		Overcoming Barriers
	▶		▶	

"Simplicity does not precede complexity,
but follows it."

--Alan Perlis, Mathematician and Computer Scientist

Our discussion today

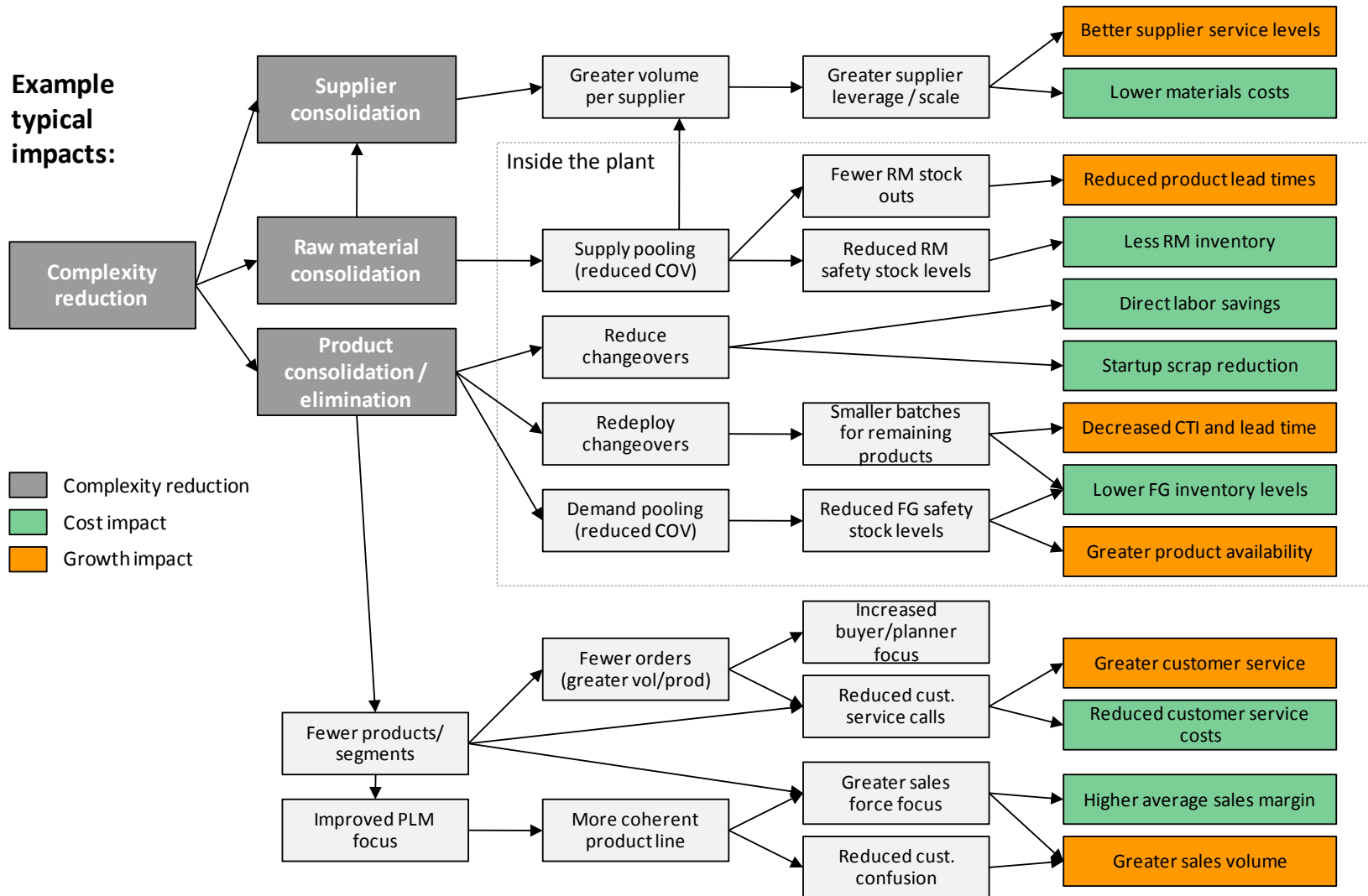**Complexity & Growth** ▸ **Ways to Simplify** ▸ **Overcoming Barriers**

Complexity: the enemy of growth?

- Customers like variety
  - But good vs. bad complexity
  - Complexity frontier
- The impact on growth
  - Indirect effects (service levels, focus, sales force)
  - Direct effects (over-choice)
- **Opportunity: simplify to grow**
  - & improve profitability

Benefits across the business

Example typical impacts:

Complexity reduction → Supplier consolidation → Greater volume per supplier → Greater supplier leverage / scale → Better supplier service levels / Lower materials costs

Inside the plant

Complexity reduction → Raw material consolidation → Supply pooling (reduced COV) → Fewer RM stock outs → Reduced product lead times; Reduced RM safety stock levels → Less RM inventory

Complexity reduction → Product consolidation / elimination → Reduce changeovers → Direct labor savings / Startup scrap reduction

Redeploy changeovers → Smaller batches for remaining products → Decreased CTI and lead time / Lower FG inventory levels

Demand pooling (reduced COV) → Reduced FG safety stock levels → Lower FG inventory levels / Greater product availability

Legend:
- Complexity reduction
- Cost impact
- Growth impact

Fewer products/ segments → Fewer orders (greater vol/prod) → Increased buyer/planner focus; Reduced cust. service calls → Greater customer service / Reduced customer service costs

Improved PLM focus → More coherent product line → Greater sales force focus → Higher average sales margin; Reduced cust. confusion → Greater sales volume

Simplification example

Case: $1B tech company

| Select Metrics	Y1	Y2	Y3
Portfolio (#)	3500	2079	499
New products (#)	0	8	14
On-time delivery	70%	78%	90%
Cust. Satisfaction	27%	55%	90%
Mfg. productivity	1x	2.2x	3.1x
Operating Earnings	-6%	3%	7%
Sales	1x	1.6x	3.4x

- *86% reduction in portfolio!*
- *57% increase in cust. satisfaction!*
- *13% pt increase in op. earnings!*
- *3x growth in sales!*

Defining complexity

Type of complexity	Description	Impact of too much
Product	The **variety** of products (and services) you offer	• *Bloated portfolio* • *Customer confusion* • *Strained processes*
Process	The **number** of processes, steps, handoffs, etc.	• *Duplication* • *Rework* • *Work-arounds*
Organization	The **number** of facilities, assets, functional entities, organizational units, systems, policies, etc.	• *Bloated organization* • *Functional silos* • *Disarray* • *No clear picture*

The impact is in the interactions

Product   **Process**

NVA

VA

Organisation
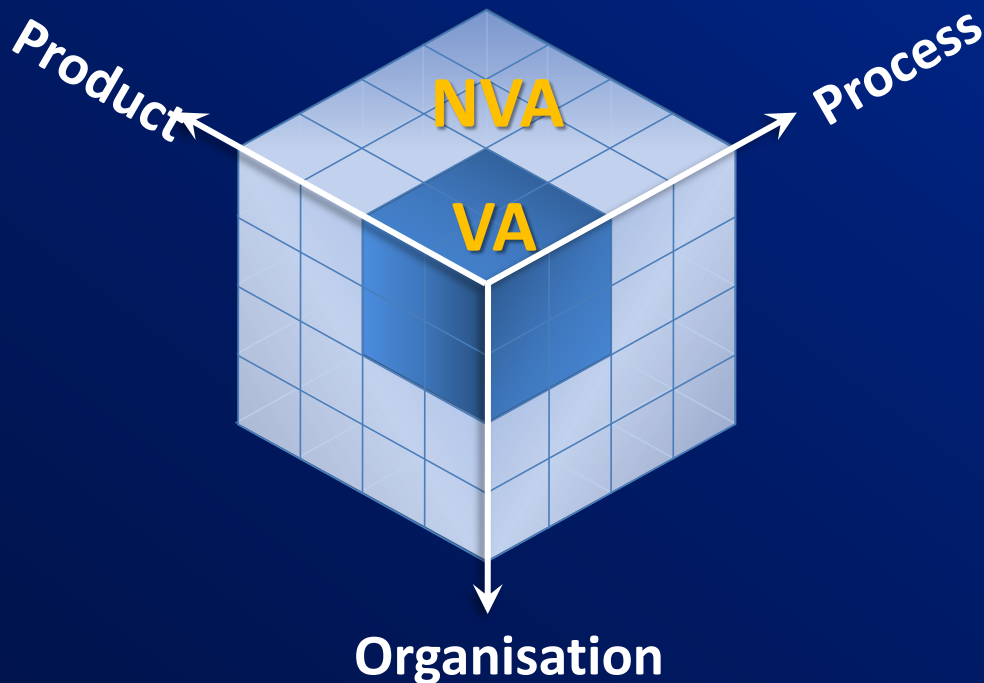
- Complexity resides on the **axis** of the cube

- But complexity costs or impacts reside on the **faces** of the cube

"Complexity… is a 'cube' function. If I have 10 applications, I may be able to manage them all. If I have 100 applications, **managing them is not simply 10 times the complexity—it's more like 30 times the complexity**."

Lee Coulter, former SVP, Kraft Global Shared Services Group

"The greatest challenge to any thinker is stating the problem in a way that will allow a solution."
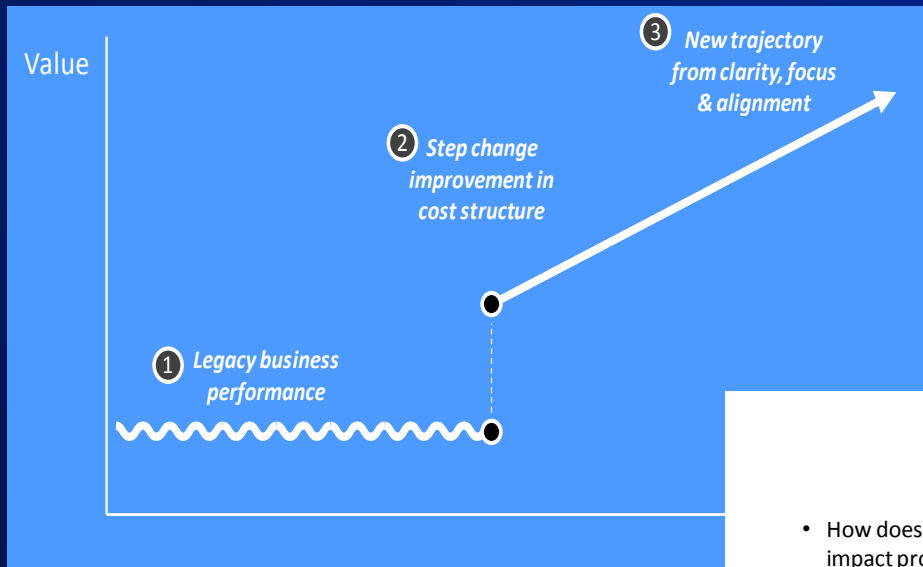
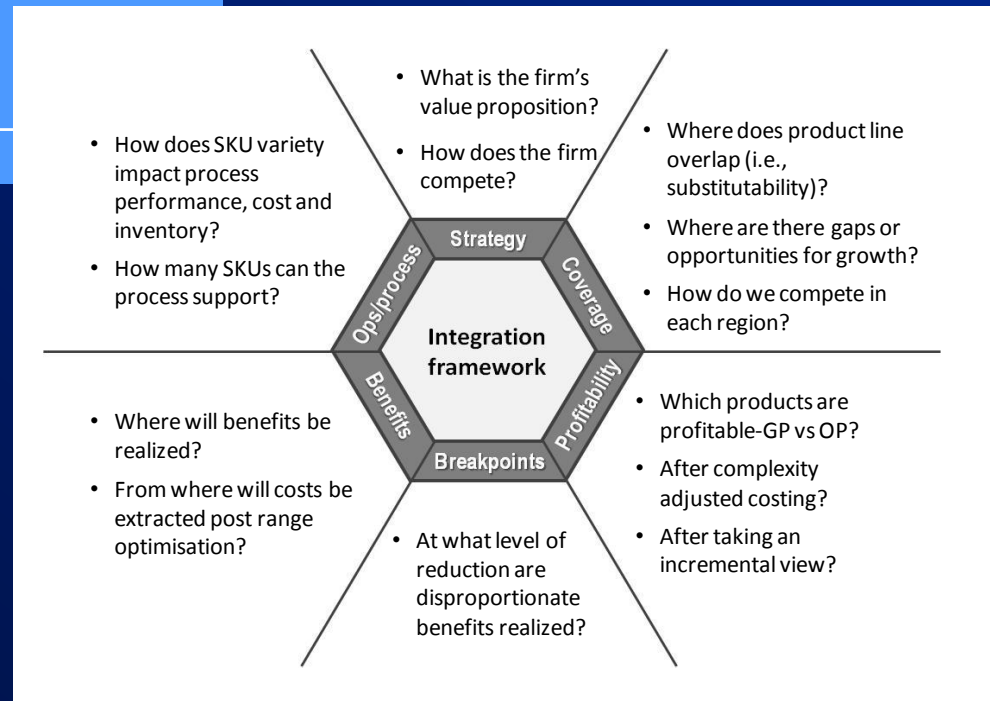*— Bertrand Russell*

Our discussion today

Complexity & Growth ▸ **Ways to Simplify** ▸ **Overcoming Barriers**

4 ways to simplify to grow

1. **Optimize your portfolio**

2. **Unburden your sales force**

3. **Hit service-level breakpoints**

4. **Restructure for speed and customer-centricity**

1. Optimize your portfolio

Value

③ New trajectory from clarity, focus & alignment

② Step change improvement in cost structure

① Legacy business performance

- *Portfolio optimization can reduce costs, but also can rebalance mix to higher growth areas, returning business to better trajectory*
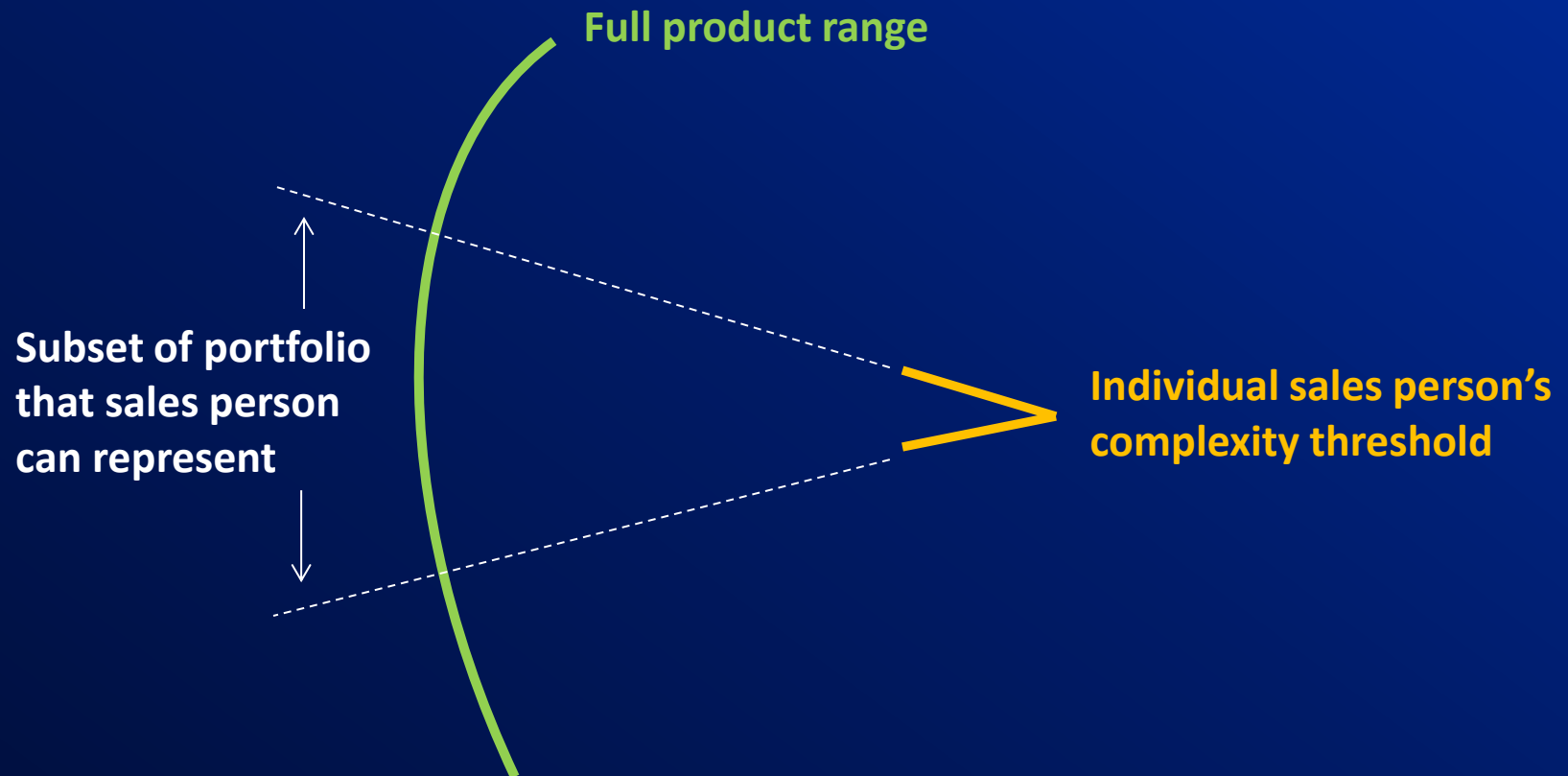
- *Better an 80% view across 6 facets than a 100% view of just 1 facet*

Integration framework

Strategy
- What is the firm's value proposition?
- How does the firm compete?

Coverage
- Where does product line overlap (i.e., substitutability)?
- Where are there gaps or opportunities for growth?
- How do we compete in each region?

Ops/process
- How does SKU variety impact process performance, cost and inventory?
- How many SKUs can the process support?

Profitability
- Which products are profitable-GP vs OP?
- After complexity adjusted costing?
- After taking an incremental view?

Benefits
- Where will benefits be realized?
- From where will costs be extracted post range optimisation?

Breakpoints
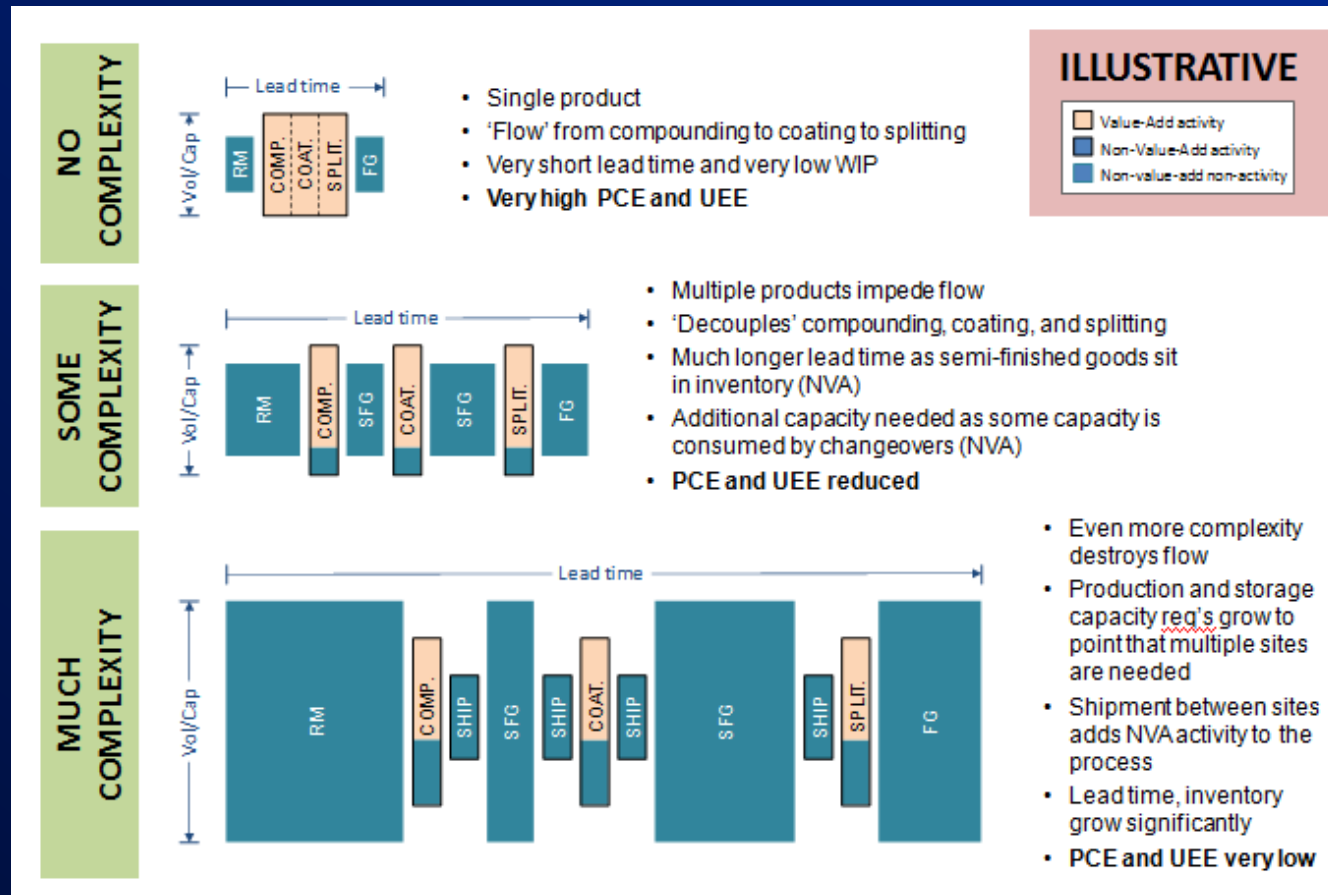- At what level of reduction are disproportionate benefits realized?

2. Unburden the sales force

"No one in sales can possibly support all our products."
- Managing Director, French multinational Business Unit Leader

Full product range

Subset of portfolio that sales person can represent

Individual sales person's complexity threshold

3. Hit service-level breakpoints

Combine simplification with process improvement to step-change improve key "breakpoint" KPIs, such as lead time

NO COMPLEXITY

- Single product
- 'Flow' from compounding to coating to splitting
- Very short lead time and very low WIP
- **Very high PCE and UEE**

ILLUSTRATIVE
- Value-Add activity
- Non-Value-Add activity
- Non-value-add non-activity

SOME COMPLEXITY

- Multiple products impede flow
- 'Decouples' compounding, coating, and splitting
- Much longer lead time as semi-finished goods sit in inventory (NVA)
- Additional capacity needed as some capacity is consumed by changeovers (NVA)
- **PCE and UEE reduced**

MUCH COMPLEXITY

- Even more complexity destroys flow
- Production and storage capacity req's grow to point that multiple sites are needed
- Shipment between sites adds NVA activity to the process
- Lead time, inventory grow significantly
- **PCE and UEE very low**

4. Restructure for speed & customer-centricity

- Launched My Macy's initiative to simplify and align the organization
- Eliminated regional operating companies
- Consolidated buying to national level
- Pushed inventory planning and merchandizing down to more local level
- Eliminated 1600 positions, redeployed 500 of them (where they matter most)
- *$500MM net annual savings*
- *Launched sustained period of industry beating same store sales growth*
- *Despite harsh retail environment, Macy's just enjoyed their best year ever!*

★macy's

"The retail landscape has deteriorated, not strengthened. But our outlook is going the other way."

--Terry Lundgren, CEO, Macy's

Process-Organizational Alignment

PREVIOUS REGIONAL STRUCTURE

National level
- Smaller, coordinating role
- National initiatives on "opt-in" basis
- Less ability to leverage national scale

National

Regional level
- *Buying, planning centralized at regional level (~100 stores)*
- Command & control relationship over stores
- Operate largely independently from national level and other regions

Regional

Local level
- Less resources at local level
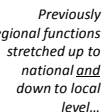- Not empowered to respond to local tastes and preferences

Local

Simple operating structure but less responsive to local preferences and little national scale

HYBRID LOCAL-NATIONAL STRUCTURE

National level
- *Buying pulled up to national level, with aggregate local input*
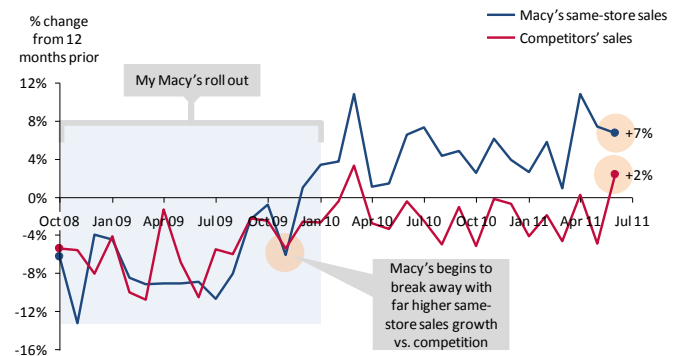- Greater strength with suppliers, leading to greater ability to tailor offerings

National

Previously regional functions stretched up to national and down to local level…

…requiring greater, richer and asymmetrical information flow between local and national levels

Local level
- *Inventory planning pushed down to local level (~ 10 stores)*
- More responsive/ customized stores with greater employee ownership

Local

Restructured operating model with richer information flow allows stronger national scale and greater responsiveness to local customers

Same Store Sales vs. Competitors

% change from 12 months prior

— Macy's same-store sales
— Competitors' sales

My Macy's roll out

+7%
+2%

12%
8%
4%
0%
-4%
-8%
-12%
-16%

Oct 08 Jan 09 Apr 09 Jul 09 Oct 09 Jan 10 Apr 10 Jul 10 Oct 10 Jan 11 Apr 11 Jul 11

Macy's begins to break away with far higher same-store sales growth vs. competition

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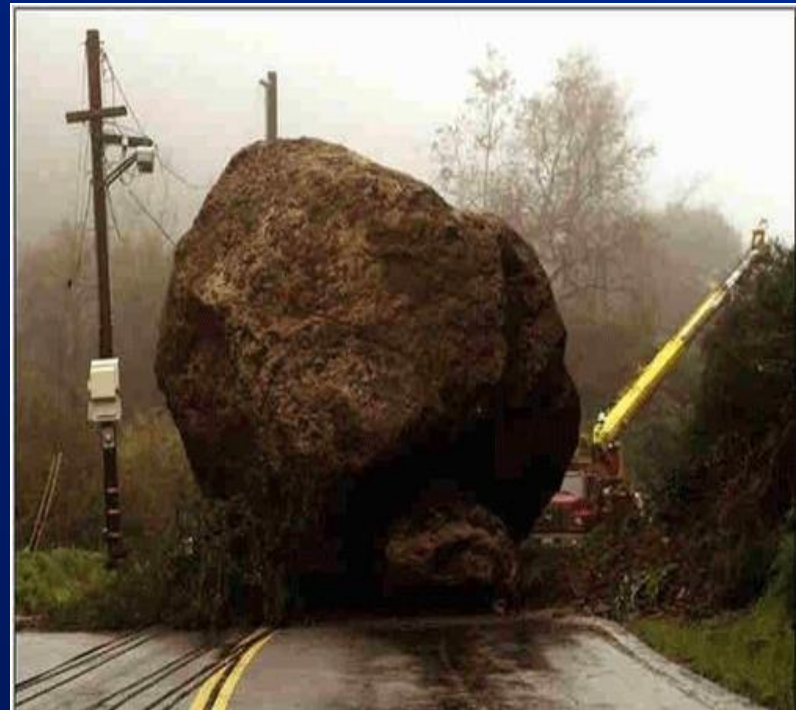
Common barriers to simplification

- **Cannot quantify the business case**

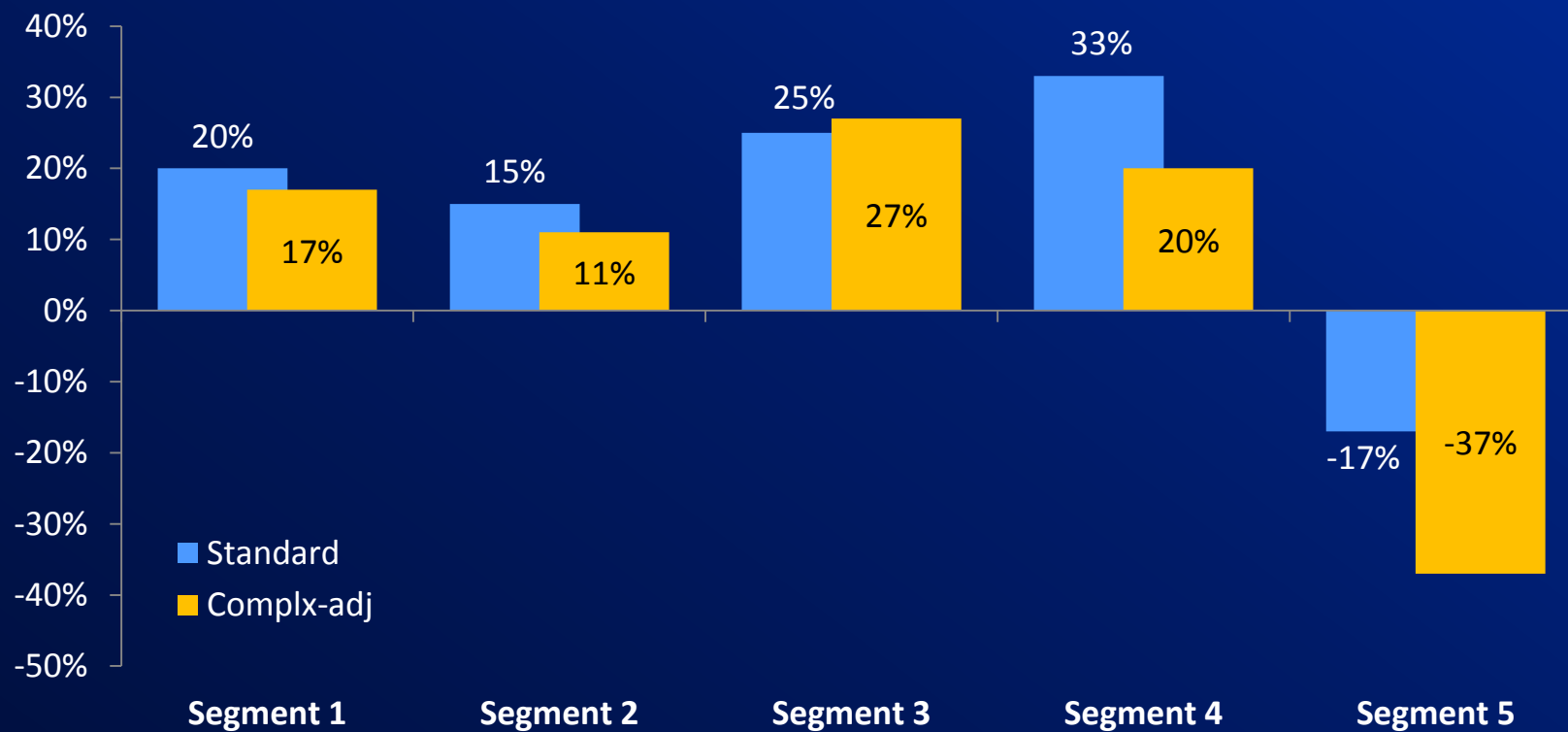- **Fear of revenue loss**

- **Functional perspective**

Barrier: Cannot quantify the business case

Mitigation: Account for complexity costs

EXAMPLE:

High-complexity [segment 4] was actually less profitable than lower-complexity [segment 3]

OP by Product Segment

Chart: OP by Product Segment

- Standard
- Complx-adj

	Segment 1	Segment 2	Segment 3	Segment 4	Segment 5
Standard	20%	15%	25%	33%	-17%
Complx-adj	17%	11%	27%	20%	-37%

Mitigation: Understand substitutability

- The **opposite of cannibalization**

- Simplify, while remaining **revenue-neutral**

- Approach eliminates products that do not generate incremental revenue
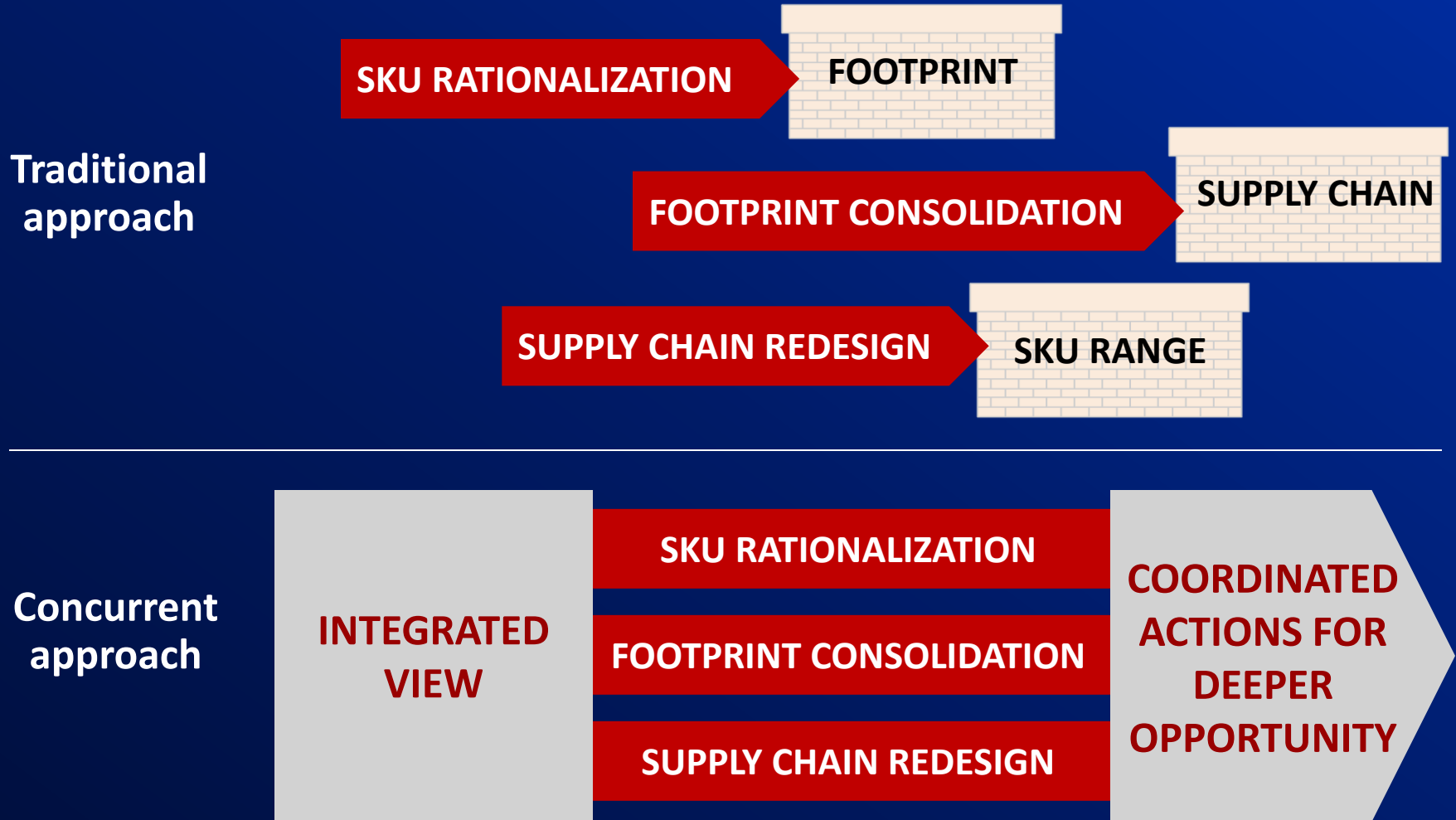
Substitutability: a client example

Gross Margin

Red = SKU selected for discontinue

The "Tail" →

SKUs Reviewed
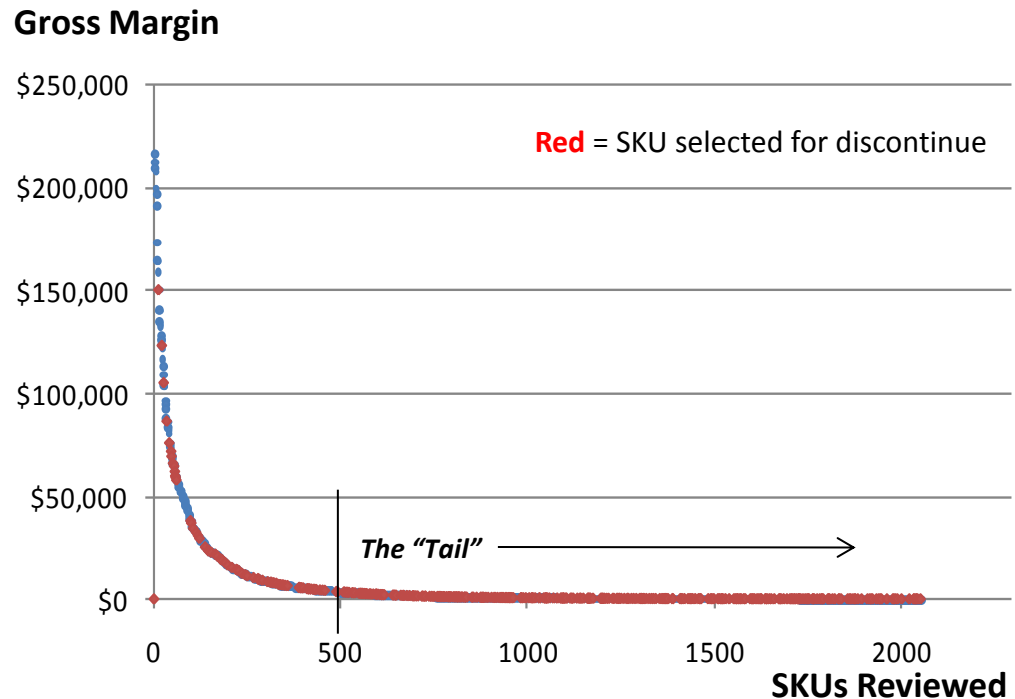
- Did not just chop off the tail
- Smart decisions around "incremental" sales, margin
- Transformed the profitability and trajectory of the business while remaining revenue neutral during the process

Mitigation: Put more in play

Traditional approach

| SKU RATIONALIZATION → | **FOOTPRINT** |

| FOOTPRINT CONSOLIDATION → | **SUPPLY CHAIN** |

| SUPPLY CHAIN REDESIGN → | **SKU RANGE** |

Concurrent approach

INTEGRATED VIEW

SKU RATIONALIZATION

FOOTPRINT CONSOLIDATION

SUPPLY CHAIN REDESIGN

COORDINATED ACTIONS FOR DEEPER OPPORTUNITY

Mitigation: Put more in play (case study)

Make greater portion of product range at each plant

- Shift plant loading to more local production
- ~84% of volume currently made locally

$40M benefit
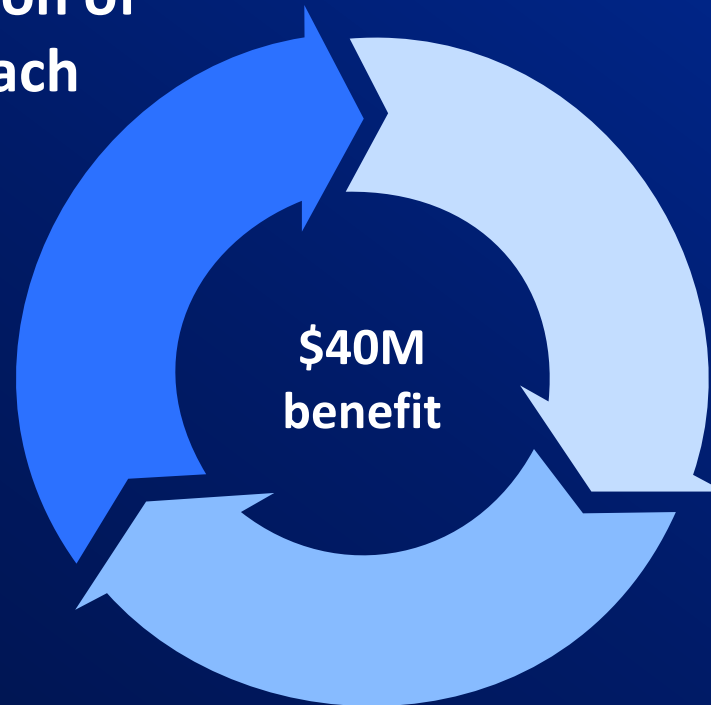
Reduce / eliminate 3-touch distribution moves

- Replace 3-touch with 1-touch

Consolidate product offering

- Reduce number of products in portfolio to allow plants to make greater portion of range *without significantly increasing the number of products made at each plant*
- Leverage substitutability to reduce offering while maintaining sales

Questions to consider

- **Are your competitors more (or less) complex than your organization?**

- **Which KPIs drive revenues in your business? What would it take to radically improve them?**

- **What is the impact of complexity on your sales force, operations, management?**

- **Is your growth strategy creating scale or complexity?**

Recap

Complexity & Growth		Ways to Simplify		Overcoming Barriers

Benefits:
- ✓ Simpler for customers
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- ✓ Scale vs. fragmentation
- ✓ Margins to fuel growth

1. Optimize your portfolio
2. Unburden the sales force
3. Hit service-level breakpoints
4. Restructure for speed & customer-centricity

- Assess complexity costs
- Understand substitutability
- Put more in play

Questions?

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