AGENDA

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Why Boards Need to Combat Complexity

by Tony Chapelle

One way that 21st-century corporations are seeking to grow is by giving customers ever-wider choices. Yet that has also led to overly complex organizations and processes.

Boards can help managers reduce unnecessary complexity — and improve profits — by asking them to prove that operational issues such as scale, product offerings and processes are in line with the current strategy.

That idea of current strategy is key.

“Complexity is often the accidental strategy,” says Stephen Wilson, a managing director of management consultancy Wilson Perumal & Co. “If companies aren’t focused, they try to be all things to all people.”

Wilson and his business partner Andrei Perumal recently released a book, *Waging War on Complexity Costs*, which lays out ways to fight this unintentional outcome.

Cutting complexity doesn’t rank high on most boards’ lists of challenges. Yet it’s the flip side of a topic that every board must tackle: how to maximize shareholder value. Complexity costs can be the single biggest factor in why a company’s cost structure is not competitive with its peers’, say Wilson and Perumal. Cutting organizational entanglement can reduce a corporation’s costs by 15% to 30%, they say, based on studies and their clients’ experiences.

Directors should compare benchmarks and operating ratios across the industry, Wilson says, to check that an organization isn’t being overly complex. “Rigorously debate the strategy with your fellow directors,” he adds.

Automation has made it easier for companies to become more complex, says David Bodde, a director and engineering professor. Meanwhile, he says, increasing government regulation is piling on the complexity for corporations, especially those that benefit from federal largesse. Both trends create a Gordian knot for directors.

“The difficulty comes from a fundamental limitation: the bandwidth between the human ears,” explains Bodde, who is on the board of Great Plains Energy and teaches engineering students at Clemson University how to be entrepreneurs.

“Our data systems can accommodate complexity at a faster rate than our minds. And this is a difficult problem for boards to address.”

Yet complexity isn’t necessarily always bad.

“I don’t believe complexity needs to drain profitability, and [it] may help build effective barriers to entry,” says Ron Rittenmeyer, former chairman and CEO at Electronic Data Systems.

"But complexity that creeps into a business is not good," continues Rittenmeyer, who was also chief operating officer at EDS as well as at Burlington Northern and Merisel.

"Inefficiency and ineffectiveness drain corporate profitability. It comes down to solid leadership that looks into the reasons for complexity and determines whether it has real merit to the outcome."

Several Fortune 500 companies, particularly in the packaged goods industry, are knee-deep in complexity reduction projects right now.

For example, Johnson & Johnson announced a restructuring last November that J&J executives claim will not only set up sustainable growth in the future, but also save the company at least $800 million before taxes this year, and at least $1.4 billion in 2011. (As a result, the company took an $852 million restructuring charge in the fourth quarter of 2009.)

According to a Nov. 3 press release, Johnson & Johnson is simplifying business processes at the operating company level across the globe.

In addition, the company is laying off about 7% of its workforce while increasing the responsibility of the remaining managers. A company spokesman declined to give details. The savings are supposed to ensure the successful launching of new products and continuing growth in J&J's core businesses.

Reducing Unnecessary Complexity

Here are some suggestions for reducing unnecessary complexity across organizations from author Stephen Wilson and Sean Kracklauer, president of the advisory services unit at the Hackett Group, an operations consulting firm.

Put an opportunity cost on complexity. If you take out the costs associated with inefficient, manually intensive processes, those hundreds of thousands or millions of dollars might represent the biggest opportunity costs for the year.

Think about the impact of complexity. In some organizations, 20% of the products drive 200% of the profits. That means that some other products are actually destroying profitability. So identify them. If you can liberate the overhead and processes that aren't pulling their weight, you could transform your cost basis.

Standardize globally and benchmark the best. Hackett Group analyzes how leading companies rank in cycle times, supplier leverage and some 10,000 other data points. The best in the business typically have just one fourth of the number of customer databases as other companies, which allows them to compare analyses better. They operate with a third fewer business performance reports. They use half of the number of suppliers per billion dollars spent, and they've automated twice the number of travel and entertainment transactions.

"The board director has to know there's a new global or regional service delivery model to achieve sustainable performance," says Kracklauer.

"You have to provide more support — processes, technology and infrastructures — to internal businesses and customers where it makes sense, and eliminate the complexity for those that don't make sense given your strategy."