Waging War on Complexity Costs

Reshape your cost structure, free up cash flows, and boost productivity by attacking process, product, and organizational complexity

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The Imperative for Waging This War

(And the Need for Better Battle Strategies)

We're surrounded. That simplifies the problem.
— *General Lewis B. "Chesty" Puller,*
U.S. Marine Corps

A few years ago, Procter & Gamble reduced product cost by more than $2/case over a three-year period as a result of a program of simplification and standardization, accounting for nearly $3 billion in savings. An additional $1 billion was generated through the closure of 10 plants as a result of the simplification. Its margins over that period increased from 6.4% to 9.5%.

Similarly, Motorola generated savings of $2.6 billion in operating and material costs in two years of a "War on Complexity," at the same time reducing inventory by $1.4 billion and capacity by 40% as fewer factories and distribution centers were needed.

These cost reductions were all made before the current economic downturn savaged revenues. The implication is even in boom times there was opportunity. But now that "*the list of bad news is almost endless*" (as *The Economist Intelligence Unit* put it), the opportunity, and challenge, has been magnified manyfold.

Early in 2009, *The Economist* forecasted the worst global GDP performance since the end of the Second World War. Global in nature, pan-industry, and to all indications sustained, this contraction is not only putting immediate cost pressures on companies, but also threatening to reshape the economic landscape in ways that may last a decade or more. To what exactly, no one knows. But as the landscape changes, so too must companies.

The contraction marks a sharp divide between the last decade and the next. Companies over the past decade were part of a rising tide that floated all boats, growing and expanding in sync with the consumer. They rushed to market with new products and line extensions, expanded into adjacent markets and services, and grew rapidly into new geographies driven by steadily growing consumer demand.

Consider, for example, the trajectory of many food retailers in the past decade and the demands of growth, as they…

- Expanded into new formats, from the traditional grocery store format to variants including city center stores and the out-of-town megastores

- Stretched their processes and supply chain to handle an explosion in new ranges, both inside existing grocery categories and beyond—into hardware, clothing, and electronics (in fact, many stores now carry more than 100,000 SKUs in diverse categories)

- Grew their organizations to expand into new geographies, from home base countries to high-growth markets in China, India, and elsewhere

The consumer packaged goods companies, as suppliers to these retailers, have kept apace, launching a volley of new products: new versions of Oreo cookies, an aisle of potato chips, hundreds of types of toothpaste. The retailers, the consumer goods companies, and *their* suppliers have all rightly rushed to meet consumer demand, but not without considerable adjustment.

Think about the impact of all that change on the supply chain that "grew up" over many years getting cans of soups from the supplier to the shelf edge. That same supply chain now has to also support flat-screen TVs… now extend across multiple countries… now support different format stores, and on and on.

You may not be in the business of retailing soup or flat-screen TVs, but chances are your business has gone through similar changes. You have seen your range of products and services expand to meet the growing diversity of customer demands. Your internal processes, organizational structures, and technology have likewise grown in complexity. Your business has stretched and rapidly grown to meet a decade of growth but has left in its wake an enormous burden of complexity costs.

A "product" by any other name

A core principle of this book is to simplify things as much as possible. Therefore, we use the term "product" and "product complexity" to represent the complexity in the portfolio of offerings that you put before your customers, whether these offerings are products or services. Clearly there are some differences between service complexity and product complexity. A prime difference is the fact that service complexity is often rife because of its ability to lurk unnoticed. A warehouse full of spare parts because of product proliferation is a very visible manifestation of complexity. But a bulging portfolio of banking products may go unnoticed under the radar. We will continue to spell out some of those nuances in the book. But to keep things simple, we will refer to customer-facing complexity as product complexity, as shorthand.

An Island of Profit in a Sea of Cost

As the P&G and Motorola stories illustrate, the prize for cutting complexity costs can be substantial. At a general level, we've found that it's **possible for companies to reduce costs by 15% to 30% in significant portions of their business by waging war on complexity costs.**

How is this possible? Consider how profit is usually concentrated within a company. A so-called Whale Curve (Figure 1) demonstrates this effect, plotting a company's cumulative profit as a function of products ranked by their profitability. (There are a variety of Whale Curves, each showing cumulative profits against various drivers, such as products, customers, and revenue.)

What does the Whale Curve tell us? Often the most profitable 20% to 30% of products generate **more than 300% of the profits** in a company.[1] Because actual profits can't exceed 100% of the total, the **remaining 70% to 80% *lose* 200% of the profits:** they are tied to assets, processes, products, and customer groups that are disproportionate drivers of cost in your organization.

Figure 1: The Whale Curve
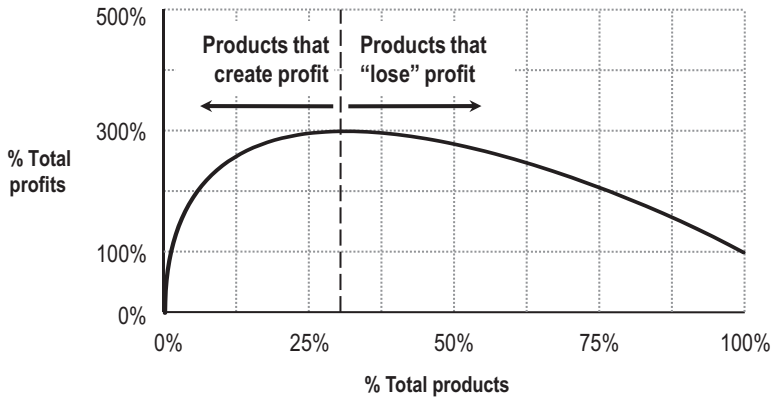
The Whale Curve is a provocative representation of profit concentration, and it provides a tantalizing reflection of the possibilities. What would your organization look like if you could somehow shed the 80% of products that were sapping profit? (We will later discuss how process and organizational complexity affect the Whale Curve.) A prerequisite to shed that excess baggage is to understand how your product line creates or "loses" profits by undertaking a profitability study. However, the results often jar with commonly held assumptions. In his book *The 80/20 Principle*, Richard Koch reports, "*Routinely, executives who commission product-line profitability exercises often do refuse to believe the results when first presented with them.*" And even if they believe that 80% of their products are "profit losers," they often shy away from dealing with that portion of the product line. The executives' rationale, Koch maintains, is that it is impossible to remove the 80% of corresponding overhead in any sensible time

frame. Therefore, only the most horribly unprofitable business is removed. Koch further says,

> *Yet all this is a dreadful compromise.… The truth is that the unprofitable business is so unprofitable because it requires the overheads and because having so many different chunks of business makes the organization horrendously complicated. It is equally true that the very profitable business does not require the overheads, or only a very small portion of them.*

It is difficult for many—despite the data—to accept the impact of complexity on the overall health of the organization, particularly given the fact that complexity does not announce itself with fanfare. Rather, it creeps in decision by decision, each choice adding costs that are hidden from traditional accounting methods. Worse still, its effects are geometric: a small expansion in a product or service line affects not just the offering of the delivery process but also everything else that goes into creating and supporting that process—inventory, instructions, overhead, and more.

Consider a familiar business strategy of the past decade: consumer goods companies proliferating line extensions as a way to secure customer niche segments, steal share, or in response to customer requests. What has been the impact on revenue and costs? The first thing to understand with line extensions is that they rarely increase demand. As a study pointed out, "People do not eat or drink more, wash their hair more, or brush their teeth more frequently simply because they have more products from which to choose."[2] What happens frequently is a cannibalization of one product by another.

On the cost side, the news is rarely better: Line extensions require increases in marketing expenditure, product development, production, and packaging as new manufacturing lines are required. New warehouses and sometimes new factories are needed. Transportation costs increase, not only with increased volumes going to stores but also with fewer and fewer full pallets being loaded onto trucks. Administration and overhead costs increase as new product managers are brought in to manage the expanding portfolio. The result as cited in the above study: **the unit costs for multi-item lines can be 25% to 45% higher than the theoretical cost of producing only the most popular item in the line**. (We will reveal the math behind the proliferation costs in Part II.)

Decomplexity Case Study

Let's consider a concrete example of complexity creep and what one company did to address it. Toblerone is the iconic candy bar with the distinctive triangular shape (meant to echo the Matterhorn in the Swiss Alps). As often happens, complexity within the brand line occurred as the result of many incremental

decisions, all made with the best of intentions. Since its creation 100 years ago, the Toblerone bar has grown in popularity and availability. Slightly different versions were launched in neighboring geographies, requiring the support of additional processes and organizations.

In short, the growth created a web of complexity. To turn this around, Kraft (which now owns the brand) launched a "decomplexity" effort, which promoted three strategic goals for the company: help drive growth, improve consumer satisfaction, and drive out costs and assets. The Toblerone effort is summarized in Table A.

Kraft saw benefits in two types of cost:

1) **Reduced material costs**, from savings in raw materials, ingredients, packaging, formats, and SKUs

2) **Reduced process costs**, including savings in R&D, procurement, conversion, logistics, marketing, sales, and administration.

Table A: Kraft's Toblerone Decomplexity Initiative

From...	To...
9 plants in 9 countries	1 plant
Multiple dimensions	Unified dimensions*
Numerous recipes	Common recipe
One language per package	Language clusters
Seasonal packaging	Standard w/ promotional sleeve
Country-specific or regional sourcing	Global sourcing

While all Toblerone bars were a similar triangular shape, there were slight variations in the dimensions of the bar.

Kraft estimated that the result was an ongoing pre-tax cost benefit of $400 million per year.[3] With a focus on sustainable productivity improvements, Kraft used decomplexity as an enabler to efficiently attain global scale and develop functional excellence. The company understood that a focus on eliminating the bad complexity costs was good for the shareholder and good for the customer.

Why Companies Lose the War or Avoid It Altogether

We've now seen three examples—P&G, Motorola, and Kraft—of companies that have made significant progress in cutting costs via complexity reduction. And we're now in a climate that demands meaningful action on costs. So the question arises as to why more companies have not taken action.

Clearly companies everywhere are looking at costs. But traditional corporate approaches inspire little confidence. A recent study reported that fewer than half of all the companies launching cost-reduction programs actually realized benefits, and even then the benefits were short lived.[4] Only 10% of the companies were able to sustain the cost reductions through year 3. Executives have their own opinions as to why things go awry; we have heard the following:

> *"The cost program focused on the wrong areas."*
> *"It sacrificed long-term value for short-term benefits."*
> *"It didn't go beyond the low-hanging fruit."*

Part of the trouble is that companies are not in business to cut costs, nor should they be. For the consumer products company, the source of competitive strength lies in getting compelling new products to market fast; for the retailer, it is keeping shelves stocked with customers' favorites; for the industrial goods manufacturer, it is keeping quality high and lead times short. In short, cost-reduction efforts for most companies are not a core competence. Such tactics are one-time events, forced by external circumstances, focused on short-term results. This may be why so few cost-reduction initiatives deliver what's required of them or help truly transform the cost position of the company. (See "Deep Dive #2: Assessing Your Company's Cost-Cutting IQ" for further discussion of this topic.)

But all that said, our takeaway is the following: **Cost-reduction approaches that didn't work before won't work any better now just because the need is greater.**

It is our assertion that the best path to restructuring your costs is by attacking product, process, and organizational complexity. But although the issue of complexity costs is increasingly transparent, many shy away from attacking the issue as a more strategic and effective path to cost reduction. Why does such a large and attainable prize go unclaimed?

1) **No one has quantified the size of the prize—so attacking complexity as a root cause has not been made a priority.** Financial systems and processes are ill equipped to quantify, or even flag, the costs of complexity, which is why many of these costs stay hidden from executive line of sight. But even when leadership recognizes the symptoms, they have difficulty placing a dollar value on what it's worth to address complexity. This is a major hurdle when it comes to deploying real resources and investment to wage the war on complexity costs. Thus, such initiatives often fail to get traction, overshadowed by alternative initiatives that are less profitable but more easily quantified. (The ineffectiveness of GAAP in capturing complexity costs has been widely explored elsewhere[5]; we won't belabor the point here.)

2) **Companies are put off by the scale and nature of the problem itself.** Even for those executives who recognize the issue and the opportunity, it can seem at the outset an intimidating mountain to climb. There are many interactions between products, processes, and organizational structures that extend beyond the normal functional structures in corporations for "getting things done." Cross-functional efforts, by definition, require coordination across functions to work. Given the nature of complexity, it is not surprising that many efforts that start out with ambitious goals are reduced to piecemeal solutions.

3) **Companies need better battle strategies.** Even companies that understand the financial prize on the table, and are looking to take this on, need battle plans that account for the nature of complexity, which can extract meaningful benefits quickly without quagmiring them in endless analyses and frustrating sets of interdependencies. (In Parts II and III, we will explain the nature of unlocking complexity costs and provide specific battle strategies you can use.)

To close these gaps, we are writing this book. We will explain how to size the prize, scope your efforts, and extract the benefits to successfully take cost out of your organization.

The Art of Complexity Warfare

We recently met with the CEO of a Midwest industrial equipment manufacturer. The company had correctly diagnosed complexity as an issue and formed an internal team to reduce product variations by 40%. The team had worked diligently toward this goal and eventually achieved this reduction. But the CEO was puzzled: Despite the efforts and investment in the team, there was no improvement in the bottom line. How could they cut the product offerings like this without seeing a reduction in costs?

Unfortunately, this scenario is not uncommon. For while few companies can stick with the "do nothing" strategy, the "just do something" strategy can be just as ineffective, absent an understanding of what it takes to extract the full benefits of complexity reduction.

To meet the task before us, then, we need a different approach—different, and better, battle strategies that can help companies like this manufacturer better quantify, locate, and purge complexity costs. We need to *think* differently about how we approach the challenge.

There are six key principles that inform the art of complexity warfare:

- **Principle 1:** There is good complexity and bad complexity (reduce the bad and make the good less expensive to deliver)

- **Principle 2:** Complexity is a multi-dimensional issue (and must be viewed as such to be understood in its fullness)

- **Principle 3**: Piecemeal approaches will not move the needle on cost reduction (don't nibble at the edges of the issue)

- **Principle 4**: Unlocking the benefits requires "concurrent actions"

- **Principle 5:** Complexity costs "creep in" incrementally, but you need to remove them in chunks

- **Principle 6:** This need not be a long, academic exercise

Principle 1: There is good and bad complexity

Companies are reacting to new levels of demand and assessing what the future may hold. In a *Wall Street Journal* article from April 2009, executives discussed concerns that "shrunken nest eggs—along with an overhang of home foreclosures, personal bankruptcies and credit card debt—may cause shoppers to tighten the purse strings indefinitely."[6]

Mike McCallister, CEO of Humana, one of the United States' largest publicly traded health benefits providers, said,

> The real trick there is to separate the good complexity from the bad complexity.
>
> If you're going to respond to consumers and try to meet them where they are, it will generate some complexity, but try to stay away from what's not important and what consumers won't pay for.
>
> I think we in the industry allow our complexity to be the wrong kind at the wrong place.... We're early in figuring out exactly what complexity we're going to be able to manage and put in front of consumers directly.... We'll have to see how that plays out. I think the complexity that we manage, tolerate, and make good at the consumer level has big potential. Ongoing complexity in the back office from an old model is absolutely non-value-add.

Customer demand is part of the equation, and companies will have to adjust to new levels of demand. But as Humana CEO McCallister points out, we also need to establish a much deeper understanding of how complexity is impacting our organization and what it is costing us, both from a financial perspective and in terms of productivity.

The fact that some complexity is good means you can't just focus on eliminating SKUs, parts, vendors, dealers, and so on. While this is an important component of controlling costs, it is only half the answer. Reducing complexity

costs is not just about *reducing the amount of complexity* in your business. It is also about reducing the cost of delivering complexity—**making complexity less expensive.** This means a two-pronged approach:

  1st Prong: Reduce the overall amount of complexity in the business by removing complexity that adds disproportionately large costs to the business

  2nd Prong: Reduce the cost impact of each "unit" of complexity on the business by becoming much better at managing and delivering it

Figure 2: A Two-Pronged Assault on Cost
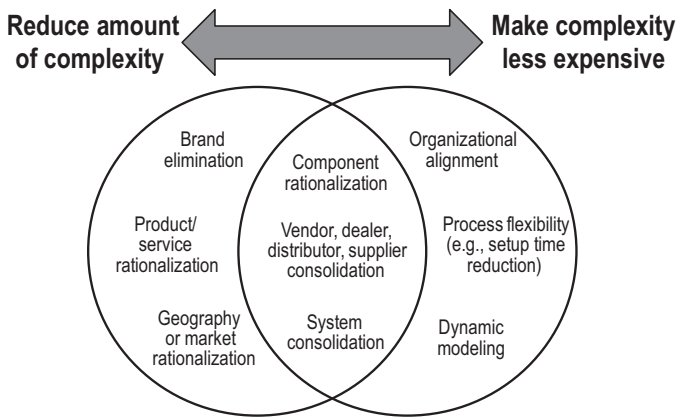
Waging the war on complexity costs requires a two-pronged attack to reduce the amount of complexity in the business while also making complexity less expensive. You achieve the latter by improving how the company manages and delivers complexity. Cost-reduction actions, examples of which are shown in the Venn diagram above, tend to fall across the spectrum between these two approaches.

The mix of the two prongs in the approaches will vary according to your business and to the opportunity. But it is usually a mix of both, rarely one or the other. Why? Because in many if not most business sectors, cutting product complexity is necessary but insufficient to remain competitive. For one thing, customers are demanding more products and services—at a lower cost but with improved service levels. To keep up requires becoming much better at delivering complexity—and better translates to lower cost. And if you can't do it, your competitors will. For another, a lot of slack has crept into processes over time, which imposes its own costs. So even in situations where the customer values the variety and is willing to pay for it, there are often opportunities in the supporting processes.

Principle 2: Complexity is a multi-dimensional issue

Complexity is a systemic problem, one that is dispersed in origin and affects everything inside the system. It is the result of the interactions of many different parties—and to compound the problem, like pollution, the effects are hard to see and track. Therefore, the approach to tackle this also needs to have a systemic—or integrated—perspective.

For example, suppose you make what seems to be a rational choice to add new varieties to a product line or add new options to a service. Consider first just the more **visible costs** of complexity:

- Variable costs increase as more staff is required to handle new products and services, more production time is needed, and inventories rise owing to increased material goods or the IT applications become more complicated to support additional options.

- Increased complexity brings step-change increases in brand management costs and marketing support. New fixed costs are required.

- Product complexity bequeaths what we term process complexity—new administrative processes and production processes needed to provide the increased variety—which in turn engenders increased organizational complexity, as functions flex to cope with new levels of variety and variation.

This all amounts to a leap in costs that can destroy profitability. Further, consider the more **hidden costs** of complexity:

- Production and delivery lines see diminished capacity and increases in waste and yield problems as a result of complexity.

- New functions sprout simply to work around the complexity; expeditors are dispatched to track down orders lost in the noise.

- Worst of all, at some point, complexity creates "a fog." At this point, there is no standard process: Every order is treated as a one-off; scale economies are destroyed; and costs rise further. Consider the industrial giant with 2 million parts in its database. "We have so many parts, all with different numbers, while in fact many are the same," said a VP associated with the company, "but we just don't know which is which. It's easier to create a new part than track down an existing one through the system."

The model we've found most useful for understanding the "complexity of complexity" is to think about the impact in three dimensions:

1) **Product complexity:** the variety of products and services you offer

2) **Process complexity:** the non-value-add activity required to deliver product complexity, including duplication, coordination, rework, and complexity-related work-arounds

3) **Organizational complexity:** the demands placed on your organizational structures (staffing, assets, policies, metrics, etc.) to support the delivery of the complexity to the customer

Understanding these dimensions—and, more importantly, how they interact with each other—is key to developing appropriate battle strategies. For now, suffice it to say that **it's the multi-dimensional nature of complexity that has thwarted many traditional cost-cutting approaches**. Trying to cut product complexity (eliminating product or service options or brands, for example) without *also* tackling the associated process or organizational complexity will have a limited effect.

Principle 3: Piecemeal approaches will not move the needle on cost reduction

In "peacetime," it is not uncommon to see a large and diverse set of cost-reduction programs across an organization. In our experience, most of these nibble at the edges of cost management and do not address some of the core structural issues.

In "wartime," we cannot afford that approach; in fact the need for step-change cost reductions represents an opportunity. As the Whale Curve and the 80/20 principle showed, "Big results require big ambitions" using the words of Greek philosopher Heraclitus. It is as true today as it was in 500 BCE (see sidebar "Cut by half," next page). As the saying goes, if nothing changes… nothing changes! For a company to find and sustain significant improvements in its cost structure, it needs to make some big changes in the way things are done. A cost-reduction strategy that focuses on doing the same things the same way but cheaper is likely to lead to disappointing results.

Consider a lesson from Toyota, as described in *The Toyota Product Development System*:

> *During its global CCC21 initiative, for example, Toyota asked its suppliers to reduce the price charged Toyota by 30% for the next new model. This sounds like an impossible goal, especially given suppliers' tight profit margins. But Toyota never just dumps a demand on suppliers; it makes a request and then works with the supplier to achieve what is needed….*
>
> *As Darrel Sterzinger, general manager of engineering design chassis at Toyota Technical Center, explained:*
>
> *"A true North American supplier cannot imagine 30 percent—it boggles the mind. But when I sit down with them and explain Toyota's thinking, they can understand the purpose of it. It is not the 30 percent we are thinking about. It is a new way of doing business."*

> **Cut by half**
>
> In his book *Cost Half*,[7] author Toshio Suzue describes how he recommends companies push past existing paradigms to uncover opportunities through a series of "cut by half" questions:
>
> - How can we cut the number of parts by half?
> - How can we cut the number of production processes by half?
> - How can we shrink development lead time by half?
>
> Why half? Because, Suzue asserts, "when cost-cutting activities are based on a goal such as a mere 10% or 20% reduction in costs, people tend to come up with small, incremental cost-cutting ideas and are always conscious of the constraints involved.

Principle 4: Unlocking the benefits requires "concurrent actions"

Given the systemic nature of complexity, unlocking the benefits requires a coordinated combination of actions. To achieve big savings, you need to understand how the three dimensions of complexity (process, product, and organizational) work to trap costs in the business. And then you need to attack complexity with an integrated campaign targeted at a combination of dimensions.

For example, consider the pharmaceutical company that was looking to reduce its factory footprint and distribution network. As it examined the various factors involved, such as geography, channels, portfolio, and volumes, the focus soon became how to best rationalize the footprint *assuming the same or near same portfolio of products*. This is a decision trap: assuming an element is fixed and designing around it. The fact is—to revert to the Whale Curve for a moment—no company aspires to a long "profit-losing" arc in their curve, and no company would fund a production and distribution footprint to support this portion of the product line. For the pharmaceutical company, this is an opportunity to assess how the product line is defining the footprint and rethink where it wants to be.

A global industrial goods company had a different dilemma: it knew its product range was hopelessly bloated. As the executive considered what it would mean to make big cuts in its offerings, the team quickly got nervous at the prospect of many of its factories sitting idle with lower capacity utilization but the same overhead.

Both teams discovered that looking at the factory footprint *and* product portfolio in concert leads to whole new vistas of opportunity, as they would be putting in play the very factors that tend to limit impact. The big savings come from unlocking these interdependencies, which is why we assess complexity in terms of interactions between products, the processes that deliver those prod-

ucts, and the organizational structures (work practices, capabilities, staffing levels, etc.) needed to operate the process.

Principle 5: Complexity costs "creep in" incrementally, but you need to remove them in chunks

Consider a typical product portfolio. Over a number of years, a portfolio has grown bloated with line extensions, new products, and new brands. These additions pile on top of the existing portfolio. You are left with a sprawling portfolio that is the result of hundreds of isolated decisions. The answer is not to trim the bottom 5% of SKUs. That will do little to free up capacity, cost, and focus. Only when you can cut deep enough to cut a brand, close a warehouse, or cease a productivity-draining process will you see substantive cost savings.

The takeaway is that when addressing complexity costs, recognize that there are **pivot points** at which fixed or semi-fixed costs are released. These points represent the staircase of cost targets that can release substantive costs.

Moreover, *the likelihood that you will reach these pivot points by chance is low*, as it often requires a coordinated combination of actions that stretches across process, product, and organizational dimensions. For example, we have seen successful cases where companies have evaluated their asset base and their portfolio simultaneously in a way that helped release "step-change" costs from the organization in a way that was congruent with their strategy. Elsewhere, companies have avoided the common pitfall in SKU reductions of cutting too shallow because of perceived constraints.

Thinking in these terms will change your focus: Traditionally, most companies focus cost efforts on variable costs; however, the biggest cost opportunities often lie in shedding fixed costs. Thus, when you shift from thinking about short-term gains to finding a cost breakpoint that will provide a bigger and longer-lasting shift in your cost basis, you are more likely to look for fixed costs that can be shed, and *the onus on variable costs is less on cost reduction in its own right and more on productivity enhancement that will help you release chunks of cost.*

Principle 6: This need not be a long, academic exercise

Throughout your efforts, we urge you to focus on leveraging 80/20 thinking (see sidebar, next page). Taking out complexity costs does not and should not be a long, academic exercise. Ensure that you are not embarking on a months-long program that is long on analysis but short on insights. It is important to get a more grounded view of the drivers of complexity cost, but a broader view with less detail is more important than deep-diving into any one area. Do enough to develop a battle strategy, and constantly ask yourself, *What do I need to know to move forward on this?* In our experience, it is possible to quickly

develop hypotheses as to the drivers of complexity cost, which can then be validated, and this is a much faster approach than an exhaustive, bottom-up approach.

80/20 costing

As an example of what we mean by 80/20 thinking, consider how companies approach the issue of accurate costing. For many companies, getting an accurate view of complexity costs often gets lost between two extremes: launching an all-out activity-based costing effort or doing nothing. We'd recommend a different path: make the 20% of adjustments that provide 80% of the answer. Understand where the big chunks of cost are and how they should be allocated to get you to a more accurate view of costing without being bound to a full activity-based costing (ABC) effort. Also leverage key rules of thumb.

For example, consider how, all else being equal, the ratio of inventory costs between two products is proportional to the square root of the ratio of their demand. This rule of thumb is nearly as easy to apply as the peanut butter approach (where inventory costs are spread evenly across products on a per-unit or percentage-of-cost basis) but provides a significantly better estimate of actual cost by product. (We will discuss the analytics behinds this rule in Chapter 10.)

What's behind this? Consider how in calculating standard costs, most companies spread inventory costs (the cost for the warehouse, for example) evenly across the number of units that pass through the warehouse. Each unit is burdened with an equal share of the pie. But this is just as wrong as allocating inventory costs evenly between product lines, regardless of their volume. In a typical supply chain, lower volume products enjoy fewer inventory turns; hence, each low-volume item spends more time in the warehouse. It makes sense then to burden lower-volume products with a greater portion of inventory costs per unit. But how much more? The rule of thumb tells us how much. Not knowing this, most companies continue to use the straightforward but wrong peanut butter approach and miss the opportunity to get quickly to a better grasp of true costs.

The Opportunity: Big gains, with speed

Complexity cost is the elephant in the room, and no one is quite sure what to do about it. In this book we tell you what you need to know to be able to confront the issue head-on. We do not suggest that complexity can and should be tackled only through huge, transformation-like efforts. But neither do you want to fritter your time, energy, and resources on attacking individual symptoms.

As you'll discover in the following chapters, it is possible to take targeted actions to achieve both financial and performance benefits and create virtuous cycles of improvement (see sidebar "Forging a new path," p. 18). The key is to structure the effort in a way that will allow you to make substantive improvements at a rapid pace while avoiding the trap of diluting your efforts. Behind

this is the philosophical acknowledgment that winning the war on complexity costs can be difficult but will be ultimately rewarding, and this is vastly superior to a path that is easy but futile. There are no silver bullets, but there are actions of high leverage.

The shift in the competitive landscape—and the threat and opportunity that implies—is strengthening the resolve of many. Our advice is to use the momentum of the crisis! Strong performers will use a downturn to shed poorly performing assets, renew a sense of urgency and purpose in the business, and think about preparing for growth around the corner. A recent article in *The Economist*, "Swinging the Axe," says, "Many bosses admit that the crisis is giving them a chance to restructure their firms in ways that they should have done before, but found a hard sell when things were going well."

The willingness to follow through on major decisions is a prerequisite for success in the war on complexity costs. All the analysis and insight in the world on how to best drive rapid improvements to a company's cost base are fruitless if the will for action is lacking. Now is the time for action, without delay, for we know that…

> *Things may come to those who wait, but only the things left by those who hustle.*[8]

Chapter 1 Endnotes

[1] Cited in Sievanen, Suomala, and Paranko, *Activity-Based Costing and Product Profitability* (Tampere, Finland: Institute of Industrial Management, Tampere University of Technology, Finland).

[2] John A. Quelch and David Kenny, "Extend Profits, Not Product Lines," *Harvard Business Review*, Sep/Oct (1994).

[3] "Kraft: Driving Out Costs and Assets," Investor presentation, Franz-Josef Vogelsang, Executive Vice President, Global Supply Chain, July 19, 2004.

[4] McKinsey & Company.

[5] Michael L, George, Stephen A. Wilson, *Conquering Complexity in Your Business* (New York: McGraw-Hill, 2004).

[6] "Food Firms Cook Up Ways to Combat Rare Sales Slump," *The Wall Street Journal,* April 22 (2009).

[7] Toshio Suzue, *Cost Half: The Method for Radical Cost Reduction* (New York: Productivity Press, 2002).

[8] Abraham Lincoln.

Forging a new path

We have developed a new path for waging war on complexity costs based on the principles outlined here. Each of these pieces will be covered in much more detail in later chapters, and the structure of this book reflects the path you will need to forge. Later chapters of this book will spell out detailed analyses and decisions your management team will need to make to achieve the type of step-change complexity savings we've described in this chapter. At a broad-brush level, the path forward is…

1. **Make the case, and quantify the benefits.** We will show you how to estimate the size of the prize for your company based on the specifics of your business. For many companies, this has been a "holy grail" of sorts: the ability to quantify the cost of complexity. This knowledge enables you to launch your efforts and frame the ambition of the effort. Chapters 4 and 5 will describe the method you can use to accomplish this goal.

2. **Identify the key levers for big gains.** The biggest drivers of complexity cost lie in the interaction between different types of complexity (e.g., how added service options affect the processes used to deliver the service). Part II will identify where some of the biggest costs lie, and will enable you to start identifying your key areas of opportunity.

3. **Extract the big costs quickly.** The focus of this book is to help you find big opportunities and to do so quickly. In Part III we will share some specific battle strategies to incorporate into your campaign.

4. **Keep the bad costs out.** Complexity is insidious because it creeps in under the radar of most business metrics and systems. To avoid the reemergence of complexity costs into your business, you need leverage methods for preventing complexity creep in the first place. We'll cover those strategies in Part IV.