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.

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What's your view? Add your question or comment
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