

The CEO's Guide to Managing Complexity

Four keys to navigating new frontiers



COMPLEXITY IS A FACT OF BUSINESS

From the earliest days of commerce, successful corporate leaders intent on growth have encountered challenges intertwined with markets, regulatory demands, consumer trends, and their own organizations.

Today's environment brings an even higher level of complexity, with the constant motion of global trade and instantaneous communication adding to the mix.

Companies have few options as they face the full range of complexities: they can scramble to change strategy based on every new development, or they can accept that some complexity is unavoidable and uncontrollable – and some is even desirable. Indeed, complexity that is managed with skill and foresight creates tangible competitive advantage. Making smart decisions about what to attack and what to embrace “as is” can be the difference between taking a lead position and losing a handle on long term success.

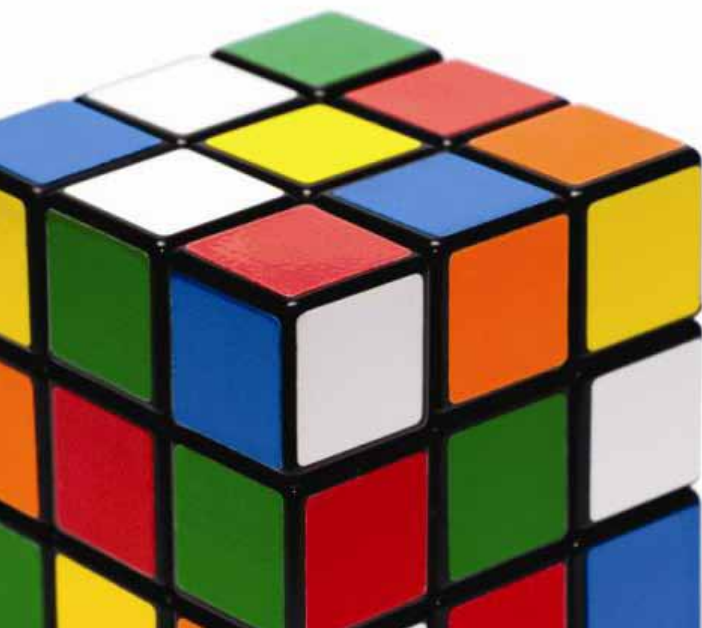
Consider, for example, Honda's investigation into putting alternative fuel to use in a power plant scheduled to come online in the UK. Factoring in predictions of country-wide electricity shortages that could limit industrial power, regulatory pressure on carbon emissions, and an auto industry

turned completely on its head, the company carefully chose which elements of complexity to roll with and which to tackle head on.

According to a Wall Street Journal report, the company's most innovative move is an effort to supplement traditional power sources with a specific grass, miscanthus. “The company has offered farmers 15-year growing contracts and could eventually require between 5,000 and 15,000 hectares of farmland,” the article notes. “Honda officials say a miscanthus-fueled power station, along with wind turbines and the use of solar panels could, in theory, satisfy all its factory's electricity needs.”ⁱ

This leading global auto manufacturer, then, is embarking on negotiations with the local agricultural community in order to nail down its power generation plans. The initiative accepts the complexity brought on by carbon and electricity concerns, but attempts to shorten supply chain by growing the grass locally while tapping a renewable source that can keep its new plant running reliably at lower costs.

ⁱ *Honda Looks to Grass to Resolve Its Power Needs*, Michael Weir, *Wall Street Journal*, November 8, 2010



CREATING TANGIBLE COMPETITIVE ADVANTAGE

Now that's managing complexity with an eye on competitive advantage.

Honda is not alone, as forward-thinking leaders worldwide recognize that complexity gives them an opportunity to excel. By reducing operational complexity to maximize existing strengths, they can create a company agile enough to navigate externally propelled market developments.

Food sellers are seeing such difficulties by the barrel, as they dodge crises left and right while trying to maintain quality product, brand strength, and fiscal viability. Kraft is no stranger to this, especially given its position as an industry leader. The company has high visibility due to its dominating presence in so many markets, but along with that comes exposure to cross-border complexities.

"We're concerned about potential new government regulations that may expand the use of corn ethanol...there are proposals being considered that could increase corn ethanol's use even further," Kraft CEO Irene Rosenthal told Forbes magazine. "These proposals may displace a small amount of foreign oil,

but create unintended consequences, including higher food prices, both for consumers and manufacturers."ⁱⁱ

The Wall Street Journal also touched on outside factors that are impacting food prices, writing that: "Costs are being driven by growing demand for meat in China, India and other emerging markets. That's driven up grain prices, which in turn boost the cost of chicken, steak, bread and pasta. Grain prices also have been nudged higher by drought in Russia, planting problems around the world and speculative trading."ⁱⁱⁱ

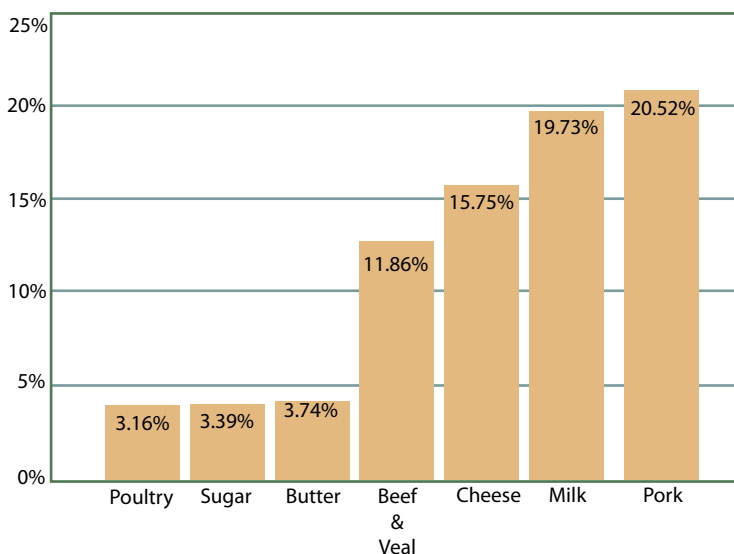
This far-reaching blend of difficulties hits every point in the supply chain, and begs the question for the food industry: where can complexity throughout the organization and supply chain be managed to yield an advantage instead of a pain point?

ii Kraft's CEO Clears The Air About Cadbury And Buffett, Alexandra Zendrian, *Forbes.com*, October 28, 2010

iii Food Sellers Grit Teeth, Raise Prices, Julie Jargon and Ilan Brat, *Wall Street Journal*, November 4, 2010

Increase in US Food Prices, 2009-2011

Figure 1: OECD-FAO Agricultural Outlook 2009-2018



Four keys to managing complexity



EXECUTIVES SHOULD GUIDE THEIR OPERATIONAL STRATEGY USING THE FOUR KEYS

Knowing where to focus energy and where to let the market play its hand takes discipline, foresight, and a keen grasp on how to steer an adaptable organization. Executives should guide their operational strategy using four keys to complexity:

1. ACCEPT UNMANAGEABLE COMPLEXITY

Not everything is part of the business plan, a point driven home by the obstacles encountered by the above companies and industries. The question for CEOs is when to bear down and challenge the market on its own terms, and when to look inward to determine how to best adapt. Leaders have to choose which course of action will lead to the most sizable competitive advantage.

To stay ahead of the storm, businesses must align their internal systems and processes to meet the demands of external complexities while remaining profitable. At the same time,

these processes must be designed to assist executives in making one decision over another, and then to gauge the success of that decision after the fact.

This is one of the most critical elements of managing complexity – without a clear view that aids decision making, there is no way to make a real determination of which path leads to the desired result. When considering external developments or internal strategy, leaders should develop a full understanding of their business' end-to-end processes, which will provide a picture of where complexity can be simplified or even eliminated. Yielding is never easy, but with a snapshot in hand it becomes clear which forms of complexity must be accepted, challenged, or effectively managed “as is.”

2. CREATE A NIMBLE ORGANIZATION TO MANAGE INTERNAL COMPLEXITY

With visibility in place, choosing which organizational complexities to focus on becomes an exciting exercise. Leaders can combine their understanding of outward facing

issues with internal capabilities, allowing them to position people, processes and systems in such a way as to capture the benefits and avoid the pitfalls.

For example, CEOs and their teams will see when market movements are changing customer preferences. The organization may not be able to impact that change, but it can make a firm stand on which segment it sells to. Making an adjustment means tweaking operations throughout the supply chain, product development, and marketing channels.

Not an easy task, unless the organization is already primed to make quick adjustments. That means being tuned into suppliers, vendors, and of course each area of internal operations. For some enterprises, managing these elements can feel like maneuvering 15 companies at once; structuring the organization so that there are fewer – and more dependable – levers to throw at any given time will create opportunities to capitalize on market conditions instead of falling prey to them.

3. GETTING THE MOST VALUE OUT OF OPERATIONS

Navigating through this complexity requires a different way of thinking, acting, and organizing than the typical “control” mentality. Passion and emotion should be removed from the equation, and each choice should be guided by what the data indicates is the best option. Choosing several key performance indicators as metrics is absolutely necessary, and care should be taken that enough KPIs are leading, and not lagging, indicators. An executive should be focused on looking through the windshield – not in the rear view mirror.

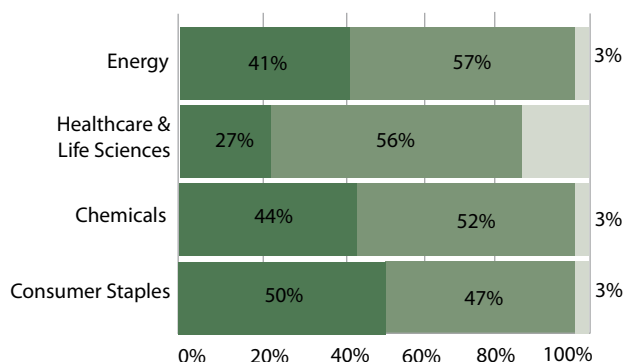
One key metric is the amount of time employees spend on activities that add value to the final product or service. A recent Celerant study^{iv} found that across most major industries, as much as half of the time employees are at work is spent on non-value-adding activities (NVA). Much of this NVA time is impactable, and it should be redirected towards activities that have a positive impact on the bottom line.

Large businesses often operate in silos and this, combined with the complexity inherent in an organization of size, means a CEO’s left hand often does not know what his right is doing. Promoting a greater end-to-end understanding across the entire company will help reduce costly errors that can often halt production in other facilities and divisions.

^{iv} Saved Time, Saved Value: Impacting Employee Contributions Across the Organization, Celerant Consulting, 2010

Value Assessment by Major Industry

Figure 2: All industries struggle with non-value add activities



4. CHANGES IN BEHAVIOR FROM PEOPLE, PROCESSES, AND SYSTEMS BRING LASTING RESULTS

A culture of creativity, innovation, and data-based decision making must be fostered all the way down through the management ranks.

A crucial element in managing complexity is ensuring that those ranks are well organized and working towards the same goal. Each employee should have at most a few items of concern, and each with supervisory duties should have only a few direct reports beneath him. Every employee should also know where they fit in the structure and how their actions affect the company as a whole.

Embedded in this organizational framework must be a clearly distributed system of responsibilities and accountability that is understood by all. When variance occurs, a CEO should be able to easily follow the path – to the individual operator if necessary – to find the cause. When the pain point is identified, the responsible employee should be held accountable in a manner that both improves the future work of that employee and advances the company.

The ultimate objective is a team that, through repeated action and sheer muscle memory, is constantly driving towards the same end. Executives should be able to gauge how well their teams are doing by setting, communicating, and monitoring clear and sustainable metrics. Whether they are financial, operational, or a combination of the two, each metric should be tied directly to the performance of the company.

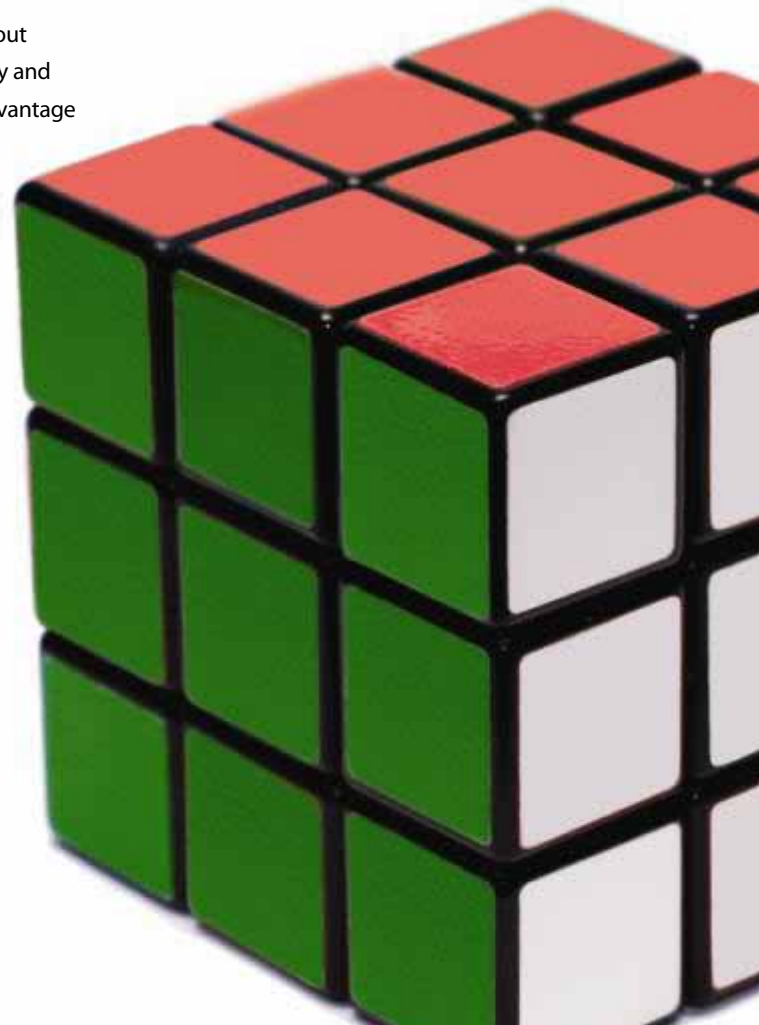
IN CONCLUSION

Maintaining a focus on people, systems, and processes can bring about enduring changes in behavior that vault a business to new levels of productivity. In turn, new revenues and decreases in expenses, combined with measurable successes on the human and operational levels, can yield increased and sustainable profitability.

When complexity is managed effectively and in harmony with the opportunities presented by innovation, distinct and measurable advances are gained. Smart executives can utilize their position to grow both profits and market share and to maintain an advantage that will prevent competitors from leapfrogging their place on the playing field.

Honda's pursuit of alternative fuel taps an inventive solution, but keeps the management of the solution close to home by enlisting farmers near its planned power plant. Creative leaders can take such difficult situations and, by leveraging a nimble organization, generate momentum in a direction that rides the wave of unmanageable complexity, accelerates growth, and enables the company to jump a plateau.

In the end, understanding and managing operational complexity is all about being positioned to adapt, succeed, and lead. CEOs that prioritize visibility and agility will inevitably uncover timely opportunities to turn competitive advantage into tangible results.



ABOUT THE AUTHOR

Doug Newman is a Senior Vice President at Celerant Consulting and leads the consumer products sector. During his two decades in manufacturing and consultancy, Doug has undertaken a wide range of assignments across multiple industries and functional areas. His experience includes extensive work in manufacturing, supply chain, information technology, research & development, sales and innovation. His industry experience includes food, beverage, household and personal care products, as well as, work in multiple other industries including chemicals, automotive, high tech electronics and healthcare. Doug received a Master of Business Administration from Northwestern University's J.L. Kellogg Graduate School of Management and a Bachelor of Science degree in Marketing from Indiana University's Kelley School of Business.

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