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How to avoid a tangled web

Companies that can't manage their complexity will discover that it will eat into their profits

Carly Chynoweth Published: 13 March 2011

Some companies handle complexity well but added layers of hierarchy, new product lines and geography can hurt income

C omplexity is costing the world's biggest businesses an average of more than $1 billion (£620m) every year, according to the Global Simplicity Index. Published last week, it estimates that the top 200 Fortune global companies lost $237 billion between them in 2010 because of the increasing complexity in their markets and their own organisations.

There is a direct link between profits and complexity, said Simon Collinson, professor of international business and innovation at Warwick Business School and research director of Simplicity, the management consultancy behind the index. "But there is a difference between good and bad complexity," he said.

“It’s not as straightforward as saying simple is more profitable and complex is less so. Some companies are clearly handling complex environments well. For example, Microsoft scores higher than average in complexity but is a much higher performer than others.”

Some complexity comes from outside the business and is unavoidable: new regulations, economic turbulence and so on. A great deal of complexity, however, comes from internal factors such as a business’s processes and structures, its product portfolio and the way in which its managers behave.

Extra internal complexity is generally a good thing at first, Collinson said. It is what happens when businesses grow, move into new markets and add systems that improve performance. The problem comes when so much is added that it slows things down, adds cost and spoils performance.

“The tipping point comes when adding more things to your business hits performance,” he said. “Then those added layers of hierarchy, new product lines and new geographies start to eat away profits.”

The first step in reducing internal complexity is a reassessment of your business’s products, services and markets. “Companies’ product and service portfolios can be a big source of complexity,” Collinson said. “They may be making too many things for too many markets.” Beyond a certain point the intricacy that these new products add outweighs the benefits of economies of scale or larger markets.

The next step is to analyse whether outsourcing some functions would allow the business to focus more clearly on its core operations. “It’s not just price that’s important, it is not having to worry about these things.” This allows it to concentrate on doing the things that add most value to the business.

The third area to assess for unnecessary complexity is management behaviour. “We got a real signal from our survey that this is a big problem,” Collinson said. “Too many emails, too many meetings, too many bureaucratic hoops and too many legacy processes that are no longer needed.”

He cites the example of firms where agreeing even a small budget — say, £5,000 for a new prototype — requires three or four different sign-offs. He came across one business where decisions needed to go through 16 layers of management.

Clearly there are times when multiple filters are called for, but too often all they do is slow things down and waste the time of employees who could and should be doing something more productive. It is entirely possible that signing off a £5,000 budget could use up more than £5,000 of management time, he said.

Complexity isn’t going to go away. If anything, it is likely to increase as organisations get bigger, operate in more places and collaborate more with partners, Collinson said. Business leaders should make every effort to reduce internal complexity where they can and, if possible, to prevent it.

Every new project or process should be assessed against the complexity that it will add to the business before being implemented. In the long run this will mean thinking about success in a different way. For example, it may make sense to divest subsidiaries or divisions, or to exit some markets to focus on the most valuable parts of the business. This may take some getting used to, given that many chief executives view acquisition and expansion as the signs of growth and therefore excellence, Collinson said.

“It will push companies to rethink their business models ... and the companies that don’t will go bust.

ing new markets, that’s what they are

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driving for, but these are the things that add more complexity," said Collinson.

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THE Global Simplicity Index divides companies into four main categories.

- Simplifiers. These tend to operate in stable, predictable markets with simple strategies and structures. They have the opportunity to boost profits by adding "good" complexity — for example, by entering new markets. Examples: Target and Lowe's, the American retailers.

- Performers. They are often state-owned and have a monopoly, but also include companies that balance complex product offerings with efficient organisational structures. They manage complexity well but new acquisitions or products could tip them into "bad" complexity. Examples: Gazprom and Vodafone.

- Complicators. They have complicated business models with wide product portfolios and/or geographical reach. Some perform well overall but are still losing both profits and speed as a result of growing levels of bad complexity. Examples: Nestlé and Novartis.

- Strugglers. They have complex organisational structures and strategies and often operate in turbulent industry sectors or economies. Their profits are heavily affected by complexity. Example: Nokia.

Source: The Global Simplicity Index

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