AlignAlytics

Value Through Data

Variety drives revenue; complexity kills profitability

9 practical tips to help finance leaders across manufacturing to break the destructive hold of complexity and to prevent a long-term spiral of declining profitability

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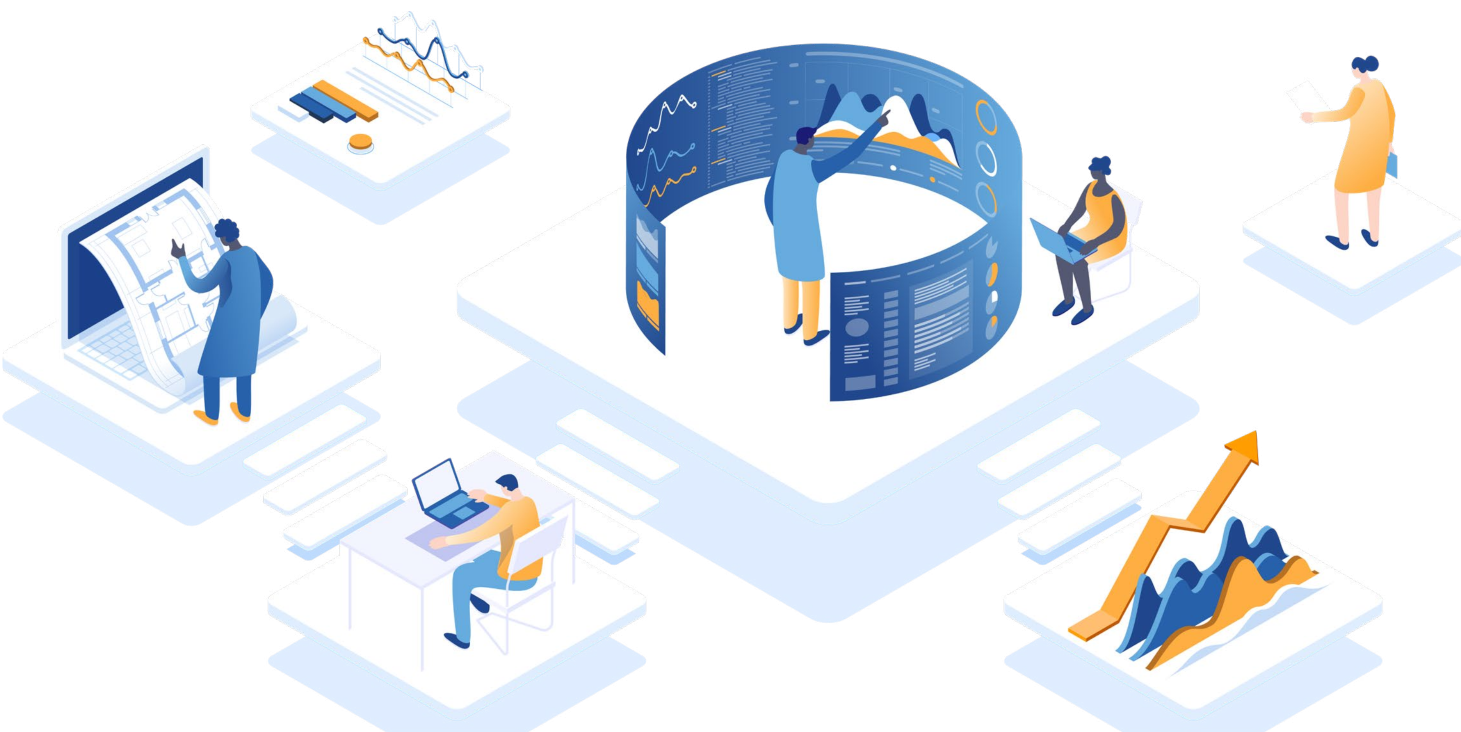
As manufacturing businesses face intense pressure from all directions, it is essential to take decisive action to defend margins. Whilst 'doing more' may provide a short-term revenue gain, we find that this normally comes at the expense of profitability. Overlooking the implications can lead to a dangerous spiral of increasing effort and decreasing margin.

No doubt variety helps you sell to and serve your customers, and without variety you risk becoming commoditized. However variety generates complexity, which if left unchecked, drives unnecessary increases in overheads and waste, to the detriment of performance.

Most businesses are aware that lack of focus and excessive complexity is unhealthy, but few are truly able to identify, measure or manage complexity. Our work on the frontline of advanced commercial and operational analytics with multiple manufacturers provides insights and a proven approach to address this challenge.

You can discover those insights in the checklist below, which shares nine mistakes that can lead to a long-term spiral of declining margin. Breaking the destructive hold of complexity across your organization will ensure that you are not continuously leaking margin, so you can protect your bottom line.

Using this document as a checklist, review the nine mistakes to reflect on whether any of these mirror what is happening in your business. If several of the mistakes resonate, then it is probably time to take action.



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9 insights to help you become a master of complexity and to boost manufacturing margins

1 **Product choice.** Variety is a reliable selling tool, but it is also the primary response to demand fragmentation.

A slight growth of the long tail induces an extraordinary amount of complexity cost under the surface. The problem is exceptionally hard for manufacturers, considering the logistical and operational challenges to design, produce, and support so many products.

2 **Portfolio Performance.** The vast majority of items in any portfolio generate only a small amount of profit and sales dollars.

However, these products are also responsible for creating most of the overhead. The long tail items carry a significant amount of complexity cost.

3 **Decision support.** Monthly income statements deliver consolidated business financials, but they do not help to make decisions related to individual products or customers.

General accounting focuses on production and distribution costs. But it does not give you the ability to manage complexity or recognize the portion of complexity costs created by each product or service.

4 **Granularity.** A gross margin led view is not sufficient to manage complexity and optimise customer/product portfolio profitability.

Its critical for a business to recognise and understand that all business is not good business and growth at any cost will drive too much complexity and a negative margin backlash.

5 **Overhead Impact.** The true cost of complexity is hidden within a business's indirect and overheads costs.

All kinds of challenges and hidden burdens are usually not recognised nor measured because there is no obvious approach to allocate indirect costs. Neither volume or value "butter smearing" nor activity based costing is accurate or practical.

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6 **Kneejerk responses.** Mistakes often occur when for example earnings decline and managers typically focus on expense reduction first.

While that helps, it does not align with the fact that profits only come from customers and products, and not from cost-cutting alone.

7 **Gut feel & assumptions.** When assessing portfolio performance, managers take too long to correct problems, inhibited by biases and personal incentives.

In general managers rely too much on dubious assumptions and too little on portfolio analytics and complexity modelling.

8 **Functional alignment.** It is human nature to address business challenges from a narrow perspective – Sales want to keep all customers, Operations want simplicity, Commercial want flexibility and Procurement want to minimise options and cost.

Sustainable improvement is cross-functional, when addressing complexity you need a common language and single version of the truth to bring alignment and agreement.

9 **Cost of Complexity.** Experience shows that complexity costs are directly proportional to activity and inversely proportional to economic value.

High-value products and services tend to evolve fast and get optimized over time, with more efficient resources, fewer suppliers, better manufacturing lines, and less complexity in general.

Are you taking advantage of every chance to address complexity and to boost your profitability? Explore the best ways to focus your business profitably, effectively align your functions whilst mastering complexity.

Visit www.true-profitability.com or contact info@align-alytics.com to learn more