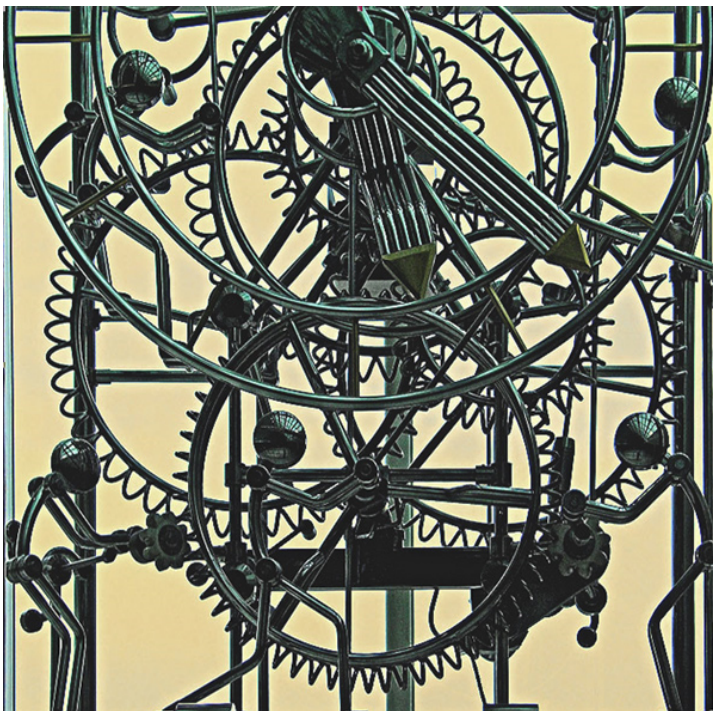


## **Business Essentials: Managing Complexity**

*Is it time to get rid of unprofitable product lines? How do you decide?*

*by Fred Heintz, CPIM CIRM*

Almost everyone in business is familiar with the Pareto Principle, which states that 20 percent of a company's items will account for 80 percent of its revenue. At Sixth Floor Consulting Group, we firmly believe that this is true. We've seen the results in many different industries. When you look at your own organization, this principle will help guide you on how different items should be treated.



First, those top 20 percent items need to be protected like gold, because they are the foundation of staying in business for your company. Just "protecting" them (e.g., making sure there are no out of stocks) is not enough. The key is to determine why your customers are choosing those products over your competitor's products. What is the differentiator? You need to leverage

that difference to keep those products ahead of the competition. Failure to recognize what makes your "A" items special can have disastrous consequences. (Did someone say, "New Coke"?)

The next 30 percent of the items in a company's portfolio will normally represent 10 percent of its revenue. These items usually fall into three categories:

- Items growing in their product life cycle, which hopefully will soon be "A" items.
- Items on the downward curve of their life cycle that need to be monitored before they become a drag on resources.
- Niche products that will never obtain large volumes, but which command a premium that keeps them profitable for the company.

The big question: What do you do with the bottom 50 percent? These normally represent 10 percent of your business. The glib answer would be to discontinue all of them, but that might not be possible. It should be explored,

*cont. on page 2*

## **A Time for Celebrating, Coming Together, and Being Thankful**

*by Tom Dzialo, CPIM CIRM*

This is the time of year to give thanks for what we have. After the type of year 2009 has been, it is especially important to look at what we do have to be thankful for. While most people will look back on this as a year of hardships, it is important to also look at what is good and important in our lives.

With the December holidays coming, be it Christmas, Hanukkah, or Kwanzaa, it is time to reflect on what has gone well this year. Your business might have had a tough time or experienced some financial setbacks, but think about what has gone right. Where did you find success among the challenges? What lessons have you learned? Who are the people who have been able to enrich your life either professionally or personally?

This is the time to try and gather friends and family together to celebrate. What's to celebrate? Just being able to be with the people you care about and enjoying their companionship. Take this time to surround yourself with those people who mean the most to you.

As part of any holiday gathering, food is a way to show affection for those you're with. Here is one of our favorite recipes that is always a hit at any party. This cheesy bread is easy to make, and it can be made assembled of time and then popped in the oven when your guests arrive.

*cont. on page 3*

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though. These are the items that are adding the most complexity to your business.

There are three justifications for keeping items in the lower 50 percent. If these items provide support for your "A" items, if they represent a growth opportunity for the company, or if they make a profit, they might be worth keeping. But unless you can truly justify keeping low volume items, they should be discontinued. Let's look at each justification separately.

If the items support your "A" items, they may need to be retained. This would be a situation where a complete line of a product is needed to be competitive. For example, Sixth Floor Consulting has worked with many Alcoholic Beverage companies. To successfully sell cordials (brandies, schnapps, liqueurs, etc.), the distributors wanted to carry a complete line. So, in order to get someone to carry high-volume Peppermint Schnapps, the company also needed to offer Blue Curacao.

Support items like this might be a necessity. To see if they are, you need to review the whole business line. In the above example, does the complete line of cordials make money? In our client's situation, analysis indicated that the complete line was not profitable. While it hurt to eliminate the few high volume stock-keeping units, it

was not worth the added complexity of carrying the whole line.

Items with the potential for growth need time and nurturing. These should be closely watched by management to see if they reach the expected potential that was forecast when they were launched. A tricky category on these is line extensions. While these are easy, and therefore less complex, they also can add greatly to complexity without giving the payback needed to justify them.

The other area to be watchful of is items which have growth potential outside their original intentions. For instance, the cell phone no longer just makes calls. It also needs to take pictures, play music, surf the web, and more. Can any of your current "C" items have uses outside your company's original intent? See our article on the book *The Innovator's Guide to Growth* in this newsletter.

The last situation seems a given. If the items are making money, keep them. This, however, is not as simple as it seems. Normally a company would just compare the standard cost to the selling price. If the cost is less, we win! Traditional standard costing does not do a very good job of allocating overhead in determining the true cost of items. Most overhead and indirect labor is allocated to items based on volume; however, most low volume items consume a disproportionate amount of these support services.

For example, a production planner spends as much time looking at "C" items as at "A" items. Costs for direct materials, procuring, receiving, and inventorying are actually very similar, independent of volume, so lower volume items are responsible for more than their share of costs.

We've had companies tell us that the cost for their products are almost the same across the board, because they all go through similar processes and use similar materials. Nothing could be further from the truth! Unless they all have the same volume throughput, the low volume items must be consuming *proportionally* more resources than the high volume items. While some overhead can be volume sensitive (e.g., electricity to run equipment), most overhead is totally independent of the number of pieces produced. Back in the early 19th century, basing overhead absorption on volume or labor dollars might have made sense, but this allocation method is worse than worthless today.

In the book *Conquering Complexity in Your Business*, by Michael George and Stephen Wilson, the authors recommend using Economic Profit to determine whether items are truly making money. Economic profit is a comparison of the Return on Invested Capital vs. the company's Average Cost of Capital. Every item either adds value or it doesn't. If the return doesn't meet the cost of capital, the company is better off just investing that money in some other instrument.

A company needs to remember these key facts about complexity:

- Eliminate complexity that customers will not pay for.
- Exploit the complexity customers will pay for.
- Minimize the costs of complexity you offer.

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**The goal of Sixth Floor Consulting Group is to create best-in-class processes, allowing each of our clients to take their businesses to a higher level of quality, profitability, and Lean operation.**

**Contact us today to put us to work on your team.**



*Complexity, cont. from page 2*

Your customers will not complain about being given too many options; however, if they are not willing to pay for these options, it makes no sense for you to increase the complexity of your business. Everyone needs to realize any option offered on a product will add to the overall complexity of the organization.

While complexity can add to the value of your product in the eyes of the customer, a business needs to make sure it is a differentiator the customer will pay for. For help on this or any business process, please contact Sixth Floor Consulting Group, Inc. We can help you review and evaluate complexity in your organization. Click [here](#) to get started. ■

*Celebrating, cont. from page 1*

### **Cheese & Herb Bread**

French bread loaf

10 oz. Fontina Cheese, grated

¼ cup Olive Oil

3 Tbs Dry White Wine

2 Tbs fresh Basil, chopped

2 Tbs chopped Green Onion

2 Tbs chopped Arugula

2 large Garlic  
cloves, crushed



Cut bread in half horizontally, and scoop bread out of the crust of the bottom half. Mix all remaining ingredients together, and season with salt and pepper. Pack mixture into bottom crust. Place top on bread and press firmly. Wrap tightly in foil (bread can be prepared 8 hours ahead and refrigerated until ready to cook).

Preheat oven to 350°. Bake bread for 30 minutes (45 if bread was refrigerated). Let bread stand 10 minutes before slicing.

This bread will go perfectly with sparkling wine, whether it's a French Champagne, Spanish Cava, or Italian Prosecco. ■

## *Sixth Floor* BOOK REVIEW

by Fred Heintz, CPIM CIRM

***The Innovator's Guide to Growth*** by Scott D. Anthony, Mark W. Johnson, Joseph V. Sinfield, and Elizabeth J. Altman (Hardcover 2008, Harvard Business Press)

This is a very interesting book. It builds on Clayton Christensen's book "The Innovator's Dilemma." The original book used "disruptive innovation" to create new products. Disruptive innovation, as opposed to sustaining innovation, introduces companies into new markets as they fill customer needs not met by current products.

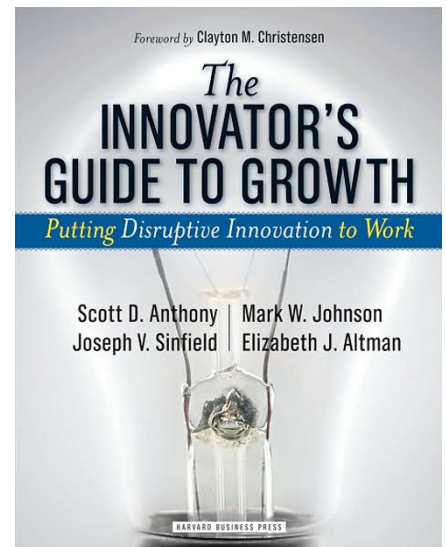
This book is meant to guide companies in their efforts to create and implement systems that support innovative ideas or products. While many of us think of innovation as Archimedes shouting "Eureka" as a brilliant idea flashes into his consciousness, putting a process in place to foster innovation makes sense. Only by properly encouraging and promoting disruptive innovation can a company expect to grow the business.

The book outlines three steps in the innovation process:

1. Identifying Opportunities
2. Formulating and Shaping Ideas
3. Building the Business

One of the key factors the book returns to constantly is the need to understand what the customer truly needs. It uses the theory that customers (whether individuals or businesses) don't buy an item, but rather they "hire" a product to get a job done. The question becomes, "What fundamental problem is the customer trying to solve?" This emphasis on customer needs, while seemingly obvious, is often missed in business today.

We recommend this book to everyone looking to expand their businesses into new profitable areas. Like Lean Manufacturing, it emphasizes quick, good-enough solutions as opposed to long "perfect" projects. Standing still will never lead to improvements in either business processes or innovations. ■



# Technology Tips and Tricks: Keyboard Shortcuts

Print this page and post it near your computer for easy reference.

**"We are what we repeatedly do. Excellence,  
then, is not an act, but a habit."**

- Aristotle



Below is a selection of "Keyboard Shortcuts" that speed your work by eliminating wasted movement and time switching back and forth from keyboard to mouse. It reduces the need to use the mouse for some actions, allowing you to keep your hands on your keyboard. Used together with the mouse, they give you the best of both worlds.

Consider this an introduction to the fundamentals of "Keyboard Shortcuts." As you might expect, Microsoft has built in so many features, a book could be written to explain them all.

Keyboard Shortcut	Action
F1	Help: Don't waste your time struggling to remember how to do specific Windows tasks. Extensive help exists to assist you when you simply press the F1 key.
ALT + TAB	This command allows you to switch among the different windows of all open programs. Some call it the "Task Switcher". <ul style="list-style-type: none"><li>• First press and hold down the ALT key, then press the TAB key once to open a task selection window showing the icons for all open applications and positions the selector to the application last open.</li><li>• Release the ALT key to move to the next application.</li><li>• Press the TAB key to move to the previous application.</li><li>• Press and hold down the SHIFT key before the TAB key to advance backward through the list of open applications.</li><li>• Press the ESC key to abort the switch.</li></ul>
CTRL + A	All: Select All the items (text, images, etc.) in the current window.
CTRL + C	Copy: This command will Copy the selection to the Windows clipboard so it can be pasted elsewhere.
CTRL + S	Save: Use this command to quickly save your work. Remember to save your work early and often to minimize the risk of losing it.
CTRL + V	Paste: Use this option to quickly paste the selection cut or copied from elsewhere.
CTRL + X	Cut: Better than using the "Delete" key. This command cuts or removes the selected item and places it on the clipboard for placement elsewhere.
CTRL + Z	Undo: Undo the last command. This is a great command in case you change your mind and want to return changes back to the way they were.
WIN + D	Desktop: Minimizes all open windows and displays Windows Desktop.
WIN + E	Explorer: Opens Windows Explorer Window defaulting to "My Computer."

*"WIN" refers to the Windows key. It is the key, usually on the bottom row of your keyboard, that contains the Windows logo icon (which looks like a flag made of four small squares).*