SIMPLY'S THE BEST

Complexity could be costing your company more than 10% of its profits, warn Simon Collinson and Melvin Jay

Treasurers have a vital role to play in the battle against corporate complexity. With a major responsibility for the capital structure of the firm, including financial risk management, their work is at the heart of efforts to manage sources of external complexity and uncertainty, such as new forms of regulation and compliance, or fluctuating FX rates. But they also have a duty to fight the growing complexity inside their own organisations, which poses an equally significant threat to profitability.

The Global Simplicity Index (GSI), conducted jointly by Warwick Business School and the Simplicity Partnership, analysed the largest 200 firms out of the Forbes Global 500 to better understand the relationship between complexity and performance. It found that the 200 biggest companies in the world are losing 10.2% of their profits on average each year due to complexity. This equates to $1.2bn each in lost EBITDA.

Ranking these companies according to complexity and performance (EBITDA) reveals a distinctive trend line – an inverted U-shaped curve. Initially, as new products, divisions, subsidiaries, employees and so on are added, complexity increases and so does performance. But there is a critical tipping point after which performance declines as complexity grows. As companies grow their product and service portfolios, expand internationally, engage in more M&A activity or increase the number of organisational divisions and layers of management, 'good complexity' adds value – but only up to a point, after which additional (bad) complexity overwhelms the organisation and has a negative effect on performance.

In addition to the GSI analysis, 600 executives across 300 European firms were surveyed to find out which kinds of complexity had the greatest impact on their personal productivity and performance. Large capital investment projects, such as launching new products and services, rank high for complexity and risk for obvious reasons. But the over-complexity inherent in more mundane processes, including customer order processing and operational expenditure decision-making, were also highlighted in the survey as having a significant negative effect on performance.

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In addition to the general cost of complexity for firms, treasurers should be specifically concerned that excess complexity adds particular kinds of financial risk and uncertainty. Just as systemic instabilities have increased with the growing complexity of the global financial markets (particularly due to the interdependencies across multiple portfolios), internal corporate instability, greater uncertainty and risk can result from greater levels of organisational complexity. As a result, financial shocks are both more likely and harder to predict, at both the macro level and within individual organisations.

Treasurers should encourage complexity reduction within their own company, but also within companies with which they interact. Interdependencies between financially linked firms (suppliers, buyers, contractors and related banks) create the same kinds of systemic complexity and uncertainty. Any portfolio of banking assets relies on links to other portfolios for its value, across a network of interdependent assets. The combination of both internal and external complexity exacerbates the levels of risk that a company faces. The role of treasury is central to complexity reduction and management for both profit maximisation and risk reduction.

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