Think:Act

navigating complexity

March 2019

Detox your business

A hands-on approach to succeed in complex markets

Roland Berger

THE BIG 3

THE DETOX MATRIX
A recipe for remaining relevant
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Desperately seeking simplicity. Why companies must step up to the challenge.

Our work at Roland Berger brings us into close contact with markets around the globe – and the biggest players in those markets. You might think that different industries in different corners of the world would vary widely, with distinct factors driving and molding them. But you'd be wrong. The closer we look, the clearer we see that markets in widely varying geographical regions are in fact shaped by very similar tendencies. Markets, like people, have more commonalities than differences.

Three major trends are shaping today's markets. The first is that markets are experiencing increasing turbulence and volatility. There are many symptoms of this underlying upheaval: a growing rate of innovation, the commoditization of technologies, tumbling entry hurdles and increasing numbers of mergers and acquisitions (M&A). In the past, companies could go decades without receiving a takeover bid or feeling the need to swallow up a competitor. Today, M&A is an almost daily occurrence. Take the travel industry, for example. TripAdvisor, Booking.com and Expedia – three relatively new players in the industry – carried out M&A activities worth an astonishing USD 12.8 billion between 2013 and 2017, a figure far in excess of the combined market capitalization of incumbent travel companies such as TUI and Thomas Cook. Market landscapes are also changing with unprecedented speed, driven to a large extent by digitalization. In 2017 alone, for instance, USD 25 billion of venture capital was invested in startups in the travel and mobility sector, with 55 percent of that going to China.

Second, customer expectations are growing with regards to service and prices. Across sectors, industry leaders are raising the bar when it comes to customer experience. Market transparency is increasing and the range of products and services available expanding. As a result, customers have come to expect broader product and service options, combined with simpler, personalized choices. To take the example of the travel industry again, a survey by Google found that more than half of all travelers felt that they had to check too many sources of information before making travel decisions. Around 60 percent of respondents went even further still, adding that what they would really like is for brands to tailor the information they present based on customers' personal preferences and past behavior.

The third overarching tendency we observe around the world is a transition from value chains to value networks. The "network economy" is breaking down traditional barriers between industries and competitors. This enables more players to compete for direct access to customers, for example. Again, digitalization is a key factor here. It is changing the cost structure of firms as the cost of transactions –

Cover photo: David Crockett/Getty Images

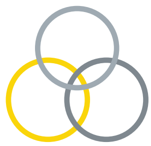
both within organizations and between organizations – is declining dramatically. Many of the benefits associated with integrated firms with fixed hierarchies, such as lower transaction costs, are evaporating. The fragmentation of traditional value chains is taking place right across industries, from banking to automotive. And this is a trend that will only increase as new technologies such as cloud platforms and blockchain mature, making connectivity secure and seamless.

In the following chapters we show how these three trends make simplification the number-one imperative for companies. We present our understanding of what underlies the global trends outlined above and their impact on companies' offerings, operations and organizations. We specify the nature of the "simplicity challenge" – and why it seems just so hard to master. And we suggest a hands-on framework that enables players to remain relevant in today's complex markets.

Three trends shape today's markets and make simplification imperative for companies

Markets are experiencing increasing turbulence and volatility

Customer expectations are growing, market transparency is increasing and the range of products and services expanding



Value networks are replacing value chains, breaking down traditional barriers between industries and competitors

A double-faceted challenge. Companies must offer maximum simplicity to customers, and at the same time keep their own operations as simple as possible.

The global trends outlined above give rise to undeniable opportunities for companies. The blurring of lines between industries means that the traditional barriers to market entry are disappearing. As a result, mass markets are increasingly easy to access. Cooperating with partners allows firms to combine their strengths, adapting the network – rather than the company itself – in pursuit of agility. Companies can expand in all directions. As tech capabilities become commodities, they can add new services and do more.

But there are risks, too. Firms are in danger of losing customer access and becoming irrelevant. The complexity of large, amorphous networks can be confusing to stakeholders, with staff unsure of their role within the network, customers unsure who to turn to for a specific product or solution, suppliers unsure about who to contact, and investors unsure which entity to invest in. All too often, companies find themselves in a tug-of-war between two strategic objectives.

On the one hand, they want to make their offering as simple as possible for customers. This means combining different products and services, and acting as a one-stop shop for consumers. Inevitably, this leads to operational complexity for the company. To its customers, companies present a simple face. But lift the curtain and a hugely complex machine is revealed behind the scenes.

At the same time, companies want to keep their operations as simple as possible. Simple operations mean low costs and short times to market. So, their goal is to focus on a single area and become masters of that field. The more they try to offer, and the broader the scope of their services, the more they risk becoming jacks of all trades and masters of none – fragmented, average and irrelevant.

Simplicity, it turns out, is a complex matter. The traditional advice to simply "adopt a simplicity mindset" does not go far enough. Companies need a hands-on framework for achieving simplicity on all fronts – in their offering, in their operations and in their organization.

This is the nature of the simplicity challenge: the need to offer customers simplicity while keeping your own operations simple. It combines with a number of other factors that make achieving simplicity even more difficult for companies. For example, there is the ever-present problem of people's egos. We often find within organizations that the more important individuals feel, the more status symbols they gather around them. Unfortunately, those status symbols often take the form of unnecessary meetings, special administrative processes, for instance to arrange appointments, or privileged office space, all of which add to complexity, draining resources and detracting from the real focus of the business.

Another factor is what is known as the "endowment effect". Sometimes decisions within organizations are irrational. It has been demonstrated that once you own something – a factory, say, or a large and expensive piece of industrial machinery – you are willing to pay more to retain it than you would be to obtain it in the first place. In other words, the mere fact of ownership makes you value a thing more highly. This makes it difficult for companies to make the sort of changes that logically might be required, such as divesting certain parts of the business or giving control of a product to another member of the value network.

Simplicity, it turns out, is a complex matter. The multilayered challenges involved and the hurdles presented by the nature of human beings – and by extension organizations – help explain why the traditional advice to simply "adopt a simplicity mindset" does not go far enough. What companies need is a robust framework for achieving simplicity on all fronts. We turn to this in the following chapter.

Define, detox, declutter. A framework for mastering the simplicity challenge.

So, what can companies do to overcome the double-faceted simplicity challenge with its many complicating factors? How can they harness the opportunities and manage the risks associated with the increasing turbulence of markets, growing customer expectations and the shift from value chains to value networks? As mentioned above, we believe that companies need more than change of mindset: They need a hands-on framework for detoxing their business and achieving simplicity on all fronts – in their offering, in their operations and in their organization. We present such a framework below. → A

STEP 1:

DEFINE YOUR OFFERING

The first step toward mastering simplicity may appear straightforward, but it is fundamental to the framework. The task here is to review your value proposition for customers and clarify how it generates profits for your business. While carrying out this process of self-examination, it is important to remain open to expanding your offering – potentially by leveraging the partners in your value network, as we see later on.

Companies should ask themselves the following questions, tailoring them to their specific business as appropriate:

> How can we improve our existing offering?
> What additional services can we offer?
> How can we increase our customers' willingness to pay?

A number of levers are available for continuously improving your value proposition. These levers operate by eliminating any sticking points in your products or services, taking the entire customer experience into account – both the products or services themselves and your communication with the customer.

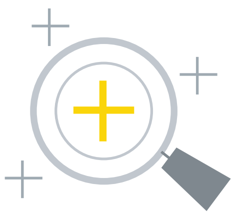
One increasingly common strategy for improving the value proposition is to offer "X as a service" (XaaS). This means providing services to customers on a subscription basis. In this model, prices are transparent and simple. For example, you offer flat rates for services that could be offered as individual components – and often were in the past – but are now provided instead as complete solutions. This approach mirrors the way customers perceive services, be they mobility offers, software or telecommunication services.

Another option for improving your offering is to sell products through the simplest, most direct channel possible. For example, hospitality company Marriott International recently partnered with Alibaba Group to create a new distribution channel that can potentially reach half a billion Chinese customers. Marriott can now market directly to Alibaba's clients. It can also link

A

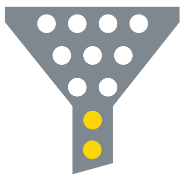
DEFINE, DETOX, DECLUTTER

A framework for mastering the simplicity challenge



DEFINE
YOUR OFFERING

Review and continuously improve your value proposition



DETOX
YOUR OPERATIONS

Restrict your business to your core activities and cleanse yourself of everything else

DECLUTTER
YOUR ORGANIZATION

Create a structure that focuses on your core and allows you to adapt without changing the structure each time

Source: Roland Berger

the two companies' loyalty programs and promote its hotels with offers tailored to Chinese consumers.

Marriott and Alibaba illustrate one possible partnership strategy – teaming up with a large platform. Others follow different paths. For example, French hospitality company Accor is pursuing a "community hub strategy". The mobile app that the company provides enables users to access services not just from Accor but from other services providers in its "community", too. The idea is that people then interact with the brand daily or weekly, rather than just on the few occasions a year when they might actually stay in one of the company's hotels.

Companies can also potentially enhance their value proposition by enabling their products to be accessed by other companies that provide solutions in related areas. In 2014, for example, ride-hailing service Uber allowed third parties to incorporate their "request a ride" functionality into their applications. As a result, users of local sightseeing apps can now commute from one landmark to another without switching apps. Another example of companies opening up is Microsoft allowing third parties to develop applications for their Windows Office programs. Developer events are now among the most important occasions for the likes of Microsoft, Facebook and even Apple. Open source is becoming increasingly popular, even for multi-billion-dollar businesses.

STEP 2:

DETOX YOUR OPERATIONS

Having clarified your value proposition and made your product even more relevant to customers, you're now ready to move on to the second step. This is to "detox" your operations, restricting your business to those activities that are necessary for your value proposition and that you are able to master yourself. All other activities are actually toxic to your attempts to achieve simplicity: Like toxins in the human body, they need to be removed in order to ensure good health. In the past, companies were often advised to ask themselves the "make or buy" question: Should they offer a particular product or service themselves or should they buy it in from a third party? This is a classic "value chain" question, reflecting the old way that companies operated and cooperated. But in today's "value network" world, the question is different. Rather than deciding whether to make or buy, companies must master and partner.

What do we mean by that? First, having defined their true value proposition, companies should focus exclusively on activities within their own sphere of competency that fulfill this promise to customers, and that they are in a position not just to "make" but to "master". But providing the end-to-end service that today's customers expect means that there will be other areas that also represent part of the company's value proposition but that fall outside the company's core. Here, the company should then partner or team up with other members of its value network.

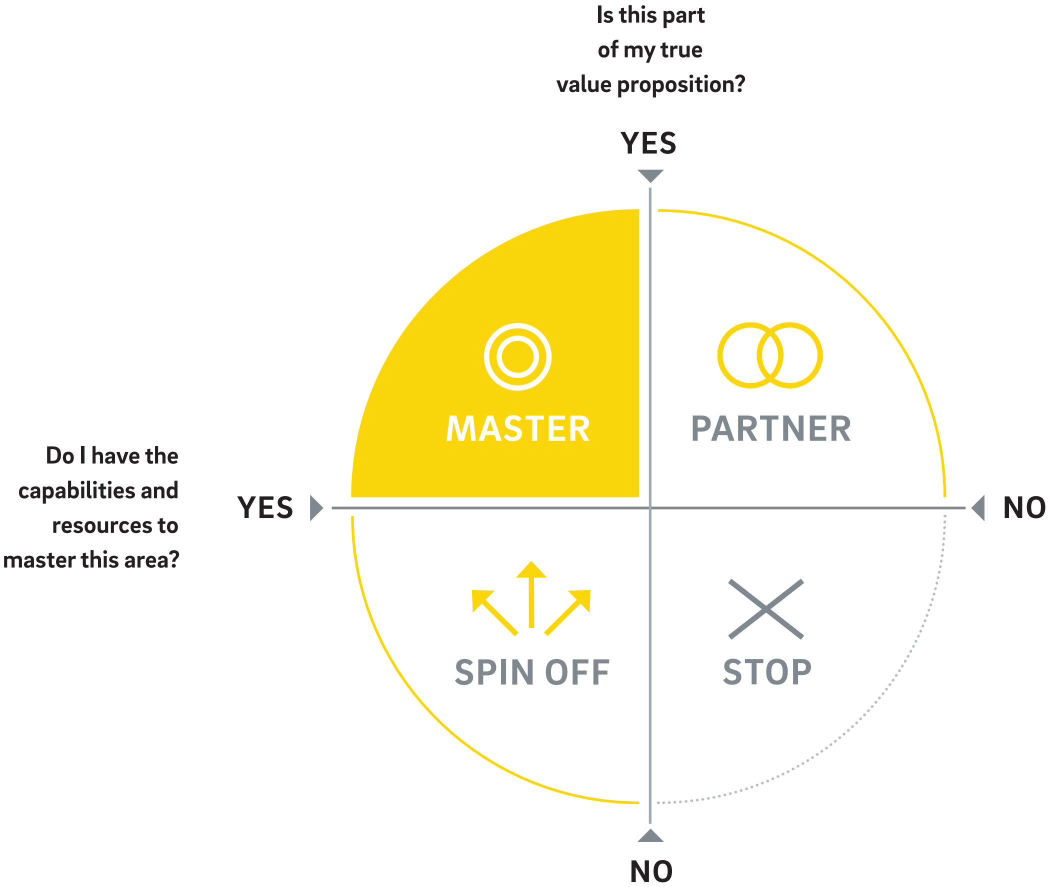
Make or buy? – That's a classic "value chain" question, reflecting the old way that companies operated and cooperated. But in today's "value network" world, the question is different. Rather than deciding whether to make or buy, companies must master and partner.

Mastering core activities and partnering for non-core activities is the key to the simplification challenge, the recipe that enables companies to realize profitable growth while focusing their activities. These two actions represent the two upper sections of the Detox Matrix below. → B

B

THE DETOX MATRIX

Master, partner, spin off or stop



Source: Roland Berger

We like to call this strategy of concentrating on the core of your business **"core-centration"**. Companies often feel that they are being pulled between poles: should they concentrate or should they diversify? We would argue that this is not the right question. In fact, they can do both, concentrating on what they can master themselves, and at the same time diversifying toward the customer by teaming up with other members of their value network.

"Core-centration" is driven by a simple fact of life. With customer demands for simplicity growing and barriers to entry falling, the chances are that if you try to master two or more areas, someone will come in and focus on one area – and do it better than you. By mastering your core area and teaming up with other players in other areas of your value proposition, you strengthen your overall position. Partners are not a weakness: They are a fundamental strength.

> **"Core-centration" is the strategy of concentrating on what you can master and diversifying by teaming up with partners. It stops companies from being pulled between strategic poles.**

Some examples from industry will illustrate the point. Rather than trying to master all areas internally, IBM is partnering with startup Loyyal to develop blockchain infrastructure for loyalty and rewards programs. Similarly, IBS Software, a leading IT solutions provider to the air transportation industry, is working with London-based incubator Traveltech Lab to enhance innovation in its technology offerings to travel, transportation and logistics customers. Another example is the alliance between Uber and the music-streaming platform Spotify. The two have entered into a partnership to allow Uber customers to choose the soundtrack for their Uber ride, giving the company an edge over their competitors.

The two lower sections of the Detox Matrix are "spin off" and "stop". These are the options for activities that are not necessary for your value proposition. If you have the capabilities and resources within your organization to master these areas, you should consider spinning off these non-core activities into different companies. Different business areas can then focus on their individual business models under one holding company. This way each entity remains completely focused but interfaces and collaboration become easier due to the existence of a common parent company. Spinning off may also be the first step toward complete divestment.

This approach is exemplified by E.ON. In 2014 the German electric utility service provider decided to withdraw from fossil fuel over the course of the following years. In 2016 they transferred almost their entire fossil energy business to a new spin-off company named Uniper. They then sold a 53 percent stake in the company through an IPO, and in 2018 sold the remaining 47 percent to the Finnish power company Fortum. Fiat Chrysler Automobiles accomplished something similar with its 2015 spin-off of luxury brand Ferrari from its core business; since October 2015, Ferrari has traded as an independent brand on stock exchanges.

Finally, the Detox Matrix indicates that you should stop any activities that do not form part of your newly defined value proposition and that you do not have the capabilities or resources to master. Companies must be rigorous here. Between 2012 and 2015, for example, the world's biggest retailer Walmart rolled out 102 Walmart Express stores in a pilot project. But one year later they began to shut them down again, following a strategic decision to focus on their core businesses of Supercenters, Neighborhood Markets, e-commerce and in-store pickup services for customers.

STEP 3:

DECLUTTER YOUR ORGANIZATION

The third and final step in mastering the simplicity challenge is to make sure that your structure and governance are 100-percent geared toward the purpose of your business – in other words, that they are fit for purpose. Here, again, companies may find it useful to ask themselves a number of key questions, in particular:

> How can we gear our organization toward partnerships?
> How can we make our organization resilient?
> Can we shorten critical path lengths for decisions and operations?

Questions of governance can involve a major trade-off between synergies and simplicity. Booking.com, for example, considers complexity the key threat. The company maintains three business units that function quite separately from each other. It consciously chooses not to exploit many of the synergies that would be possible between the different businesses. Rather, it ensures that each business unit is able to act

THE BIGGER PICTURE

Trends, questions and solutions

CURRENT TRENDS

Markets are increasingly turbulent

Customer expectations are growing

Value networks are replacing value chains

OLD QUESTIONS

Concentrate	Diversify
Centralize	Decentralize
Make	Buy

NEW SOLUTIONS

Define your offering

Detox your operations

Declutter your organization

Source: Roland Berger

independently, adapting to its specific market. Keeping the purpose, targets and ambitions of the different business units separate also ensures strategic flexibility: If necessary, each business unit could be divested without spending months unbundling intertwined activities.

The day-to-day business of the company does not necessarily need to be organized along the organizational structure. This is where incumbents often go wrong. Ask them how they run the business and they will show you their organizational chart – often stressing the difficult decisions that they faced in deciding which functions to centralize and which to decentralize. Suggest that they change how they do things and they will make changes to their structures.

The more companies try to offer, and the broader the scope of their services, the more they risk becoming jacks of all trades and masters of none – fragmented, average and irrelevant.

In fact, the primary task of the structure is to develop skills and then allow them to scale up. Successful companies operate via networks within their organization. They often have rather boring org charts based around "centers of excellence" – a way to simply give everyone in the organization a home. But when they operate, they build teams from different functions and adapt them on an ongoing basis. Rather than changing the underlying structure, they change their operating script.

In terms of achieving resilience, companies would be well advised to remember that principles are more important than structures. No one structure exists that will be appropriate for all organizations and businesses. We discuss these issues in our paper "Simple Smarts", in which we suggest five simple rules that can make an organization more resilient.

Decluttering also needs to take place at ground level. Successful companies cut down the number of meetings they have, in some cases even penalizing managers for imposing meetings on their staff. Simplicity must become part of the corporate culture, a guiding principle in all levels and parts of the organization. Steering the organization should be based more on targets than on processes. This makes it all the more important that you translate the purpose of your business into concrete targets.

AN ITERATIVE PROCESS

It is not enough for companies to make these changes just once. They need to work through the framework and apply the levers on an ongoing basis, making continuous improvements. Companies implementing simplicity often ask us "When are we done?" The answer is never. Markets are in flux, customers are changing, industries are volatile, and – however painful the process – you must be prepared to reinvent yourself time and time again. Organizations can learn from startups here. New companies generally have very limited resources, and those that are successful take a strict approach. Once they have found their direction, they are role models for resource efficiency and focus – out of necessity.

Much has been written about the "simplicity mindset". In practice, however, we find that embracing a new mindset is not enough. The natural proclivities of organizations to tend toward complexity – the "villains of the piece", including loss aversion and linear thinking – are so strong that they require more than a reminder of simplicity. They require the application of a stringent how-to framework such as our Detox Matrix.

Finally, it is worth remembering that an army of sheep led by a lion will defeat an army of lions led by a sheep. Mastering the simplicity challenge has changed from a "nice to have" to a "must have". Accordingly, it must be driven by top management. This is a leadership topic, and those at the top of the company must model the approach.

The time to act is now

Companies must get to work right away with the important tasks of defining, detoxing and decluttering. There is no reason to delay: Complexity is growing by the day and market conditions are getting tougher. As digitalization disrupts established business models and removes traditional barriers to entry, the pressure to act is strong.

The sooner you act, the better equipped you will be to avoid risks and exploit opportunities – and the greater your chances of staying relevant. The good news for incumbents is that they now have a way of fighting back against newcomers, by following our Detox Matrix.

But even small firms can benefit from this approach: Simplification does not rely on your business having critical mass or scale. Rather, it is a matter of having the will – and the skill – to simplify. In today's network economy there are many examples of companies forming partnerships and achieving startling levels of growth in very short periods of time. Simplification can help your business, whatever its size, write a similar success story.

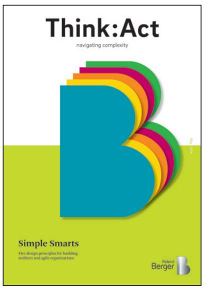
ABOUT US

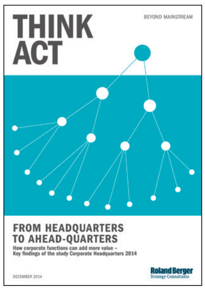
Roland Berger, founded in 1967, is the only leading global consultancy of German heritage and European origin. With 2,400 employees working from 34 countries, we have successful operations in all major international markets. Our 50 offices are located in the key global business hubs. The consultancy is an independent partnership owned exclusively by 230 Partners.

Navigating Complexity

Roland Berger has been helping its clients to manage change for half a century. Looking forward to the next 50 years, we are committed to supporting our clients as they face the next frontier. To us, this means navigating the complexities that define our times. We help our clients devise and implement responsive strategies essential to lasting success.

FURTHER READING





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Insights gained from the world of ants have inspired us in our formulation of guiding principles for the agile and resilient organization of tomorrow.

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