



## **The One Percent Trap**

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One of the most striking things about the value stream mapping that people have been doing lately is their final calculation of value added versus non-value added time. That ratio is consistently less than 1 percent. Yet, when managers work on improving performance, they focus almost all of their attention and effort on the 1 percent of the system that already adds value to the customer, while largely ignoring the 99 percent of the system that adds no value at all. Why do smart people behave in such a seemingly irrational manner?

I believe it's because they are being held hostage by some very powerful assumptions. Since the 1970's, the conventional wisdom has been that the key to higher profitability is higher productivity, and the key to higher productivity is higher machine utilization and lower direct labor costs. As a result, managers have focused on improving the efficiency of the part of the system that uses the most direct labor -- the value-added operations.

It has also been the conventional wisdom that the best way to deal with the growing complexity of the business is to break it up into smaller pieces that are easier to manage, and then to maximize the efficiency of each of those pieces to optimize overall performance. That, too, has led managers to focus on individual operations.

### **New Reality**

This approach worked well enough until recently, mainly because Visteon was sheltered from market competition. The Big 3 monopolized the U.S. auto market and purchased most of their parts from their own internal suppliers. The Master Agreement with the UAW kept everyone on a level playing field in terms of labor costs, and higher costs were passed on to consumers in the form of higher prices.

Investors put their money into the Big 3, because despite ups and downs in the economy, the market for cars steadily expanded and the returns were competitive with other industries.

However, all that has changed. The Big 3 no longer dominate the market, and are steadily losing market share to the transplants. They are no longer able to pass along higher costs to customers, who now expect year-over-year decreases in price, similar to what they've become accustomed to with electronics products. As a result, the Big 3 are aggressively seeking to lower the costs of their purchased parts by sourcing them from lower-cost suppliers here in the U.S. and overseas. And, investors have found better returns outside the auto industry, putting pressure on auto makers to boost their profitability to maintain access to investment capital.

Independence has brought a new reality for Visteon as well. It must compete for new business with other suppliers whose costs are significantly lower, who remain largely non-union, and who have access to the same technology. And Visteon must compete for capital with other auto suppliers and other industries whose returns are much more attractive to investors.

This combination of the need to lower costs to compete for new business and the need to raise profits to compete for investment capital is putting intense pressure on the Visteon plants to dramatically improve performance. In too many cases, however, they are going about this in the same way they always have, trying to wring the additional savings out of their value-added operations – the 1 percent – largely ignoring the rest of the value stream. This is having some perverse results.

## **Vicious Cycle**

By now, most mature operations have been through so many cycles of cost cutting that the remaining opportunities are pretty marginal. As a result, it takes twice as long as before to find an efficiency, and it takes twice as many efficiencies to generate the savings that are needed. It also takes twice as much effort to pacify a workforce that is getting increasingly anxious about what they see going on around them.

Experienced managers know that continuing to cannibalize their operations will lead to chronic instability, and even more headaches for them down the road. So, they are shifting their focus to cutting indirect labor, salaried personnel, and inventory instead. However, there's a limit to what can be cut in these areas, too,

before destabilizing the system, particularly if the cuts are made in a random fashion and the system remains unchanged.

Ultimately, as operations get more unstable, managers will be drawn more and more into fighting fires, and fundamental disciplines will begin to break down. Since these disciplines are already weak to begin with from years of neglect, it won't take much to throw the plant into a crisis. That is what happened at Sheldon Road last year. Many other plants will hit this wall soon, if they haven't already.

In addition, the fragmented way people are organizing their cost reduction efforts is actually making the situation worse. I've counted as many as eight separate streams of cost-reduction activity going on at the same time in the same plant, from ongoing processes like TQCM and CSS to initiatives like Break Away and salaried headcount reduction. Each stream of activity has its own separate reporting structure, its own separate meetings, and its own separate action lists. But all of them seem to involve the same people. As a result, when they aren't dealing with crises on the floor, production managers spend the bulk of their day moving in a herd from meeting to meeting, managing action lists that rarely get implemented because there's no time left over at the end of the day for execution. People are spending so much time trying to manage the complexity of the infrastructure they've set up to reduce costs that they can't find time to work on actually improving performance.

This is the 1 percent trap that many plants are getting stuck in today. Trying to get all of the improvements the need out of their value-added operations, they are spinning their wheels faster and faster, but only sinking deeper and deeper.

### **The Ninety-Nine Percent Solution**

Fortunately, the root of the problem is the way people are thinking about the problem. Old rules about how to improve productivity and profitability are leading people into the 1 percent trap. New rules are needed to tap into the 99 percent solution.

The first rule is "*Simplify the flow and the costs will take care of themselves.*" This is the way Toyota improves productivity. At Toyota, people work directly on the work, focusing on flow, not on the budget. The starting point is on the floor, and the focus is on eliminating anything that keeps the product from flowing smoothly through the system without interruption. Groups from Visteon have gone to

Toyota to study their financial management system and have come away mystified by the absence of the kind of financial and operational controls they are accustomed to. They are convinced that Toyota is hiding something from them. In reality, however, the complex cost-accounting system and the redundant and fragmented cost-reduction infrastructure that are part of the Ford legacy are a form of waste that Toyota eliminated simply by adopting a different mindset.

The second new rule is “*Focus on the highest-leverage opportunities and a lot of the small stuff will go away.*” Ironically, this rule is at odds with the way Toyota does things, but for good reason. Toyota already has a lean system in place and is continually improving it in a thousand different ways. Visteon has an inherently inefficient system in place that it inherited from Ford that is not improvable, except at the margin. The task at Toyota is to continuously improve a system that works, while the task at Visteon is to transform a system that doesn’t. Ignoring this fundamental difference and trying to improve performance at Visteon through thousands of small actions is a prescription for disaster. Transformation requires the sustained application of resources and effort at key points of leverage to achieve a breakthrough. That is impossible if people try to do too many things at once.

### **A Simpler System**

Following these rules could eliminate two-thirds of the activities that fill up people’s time and have no impact on performance, along with all of the infrastructure that’s been put in place over time to support those activities. The result would be a very simple operating system that’s easy to manage and capable of achieving significant breakthroughs in performance.