



How to achieve a value-driven SG&A organization

Applied Value Knowledge
Cost Efficiency

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Introducing Sustainable Lean Growth

The evolving and fluctuating business environment in 2020 poses significant existential challenges for companies in the coming years. On top of economic turmoil, new technology, shifting client demands, low-cost competition, and stress from shareholders force companies' business models to become more flexible and responsive to change. In times of crisis, insecurity, and economic uncertainty, this becomes even more important.

Management teams that fail to recognize a strategic and/or economic crisis early on often overcompensate in their response (e.g. cut more costs than necessary or focus on the wrong areas), which will ultimately lead to longer and costlier recoveries.

In our experience, companies whose management offensively recognizes a downturn, investigates business drivers, and models out improvement scenarios are much more likely to successfully safeguard short term impacts, while also preparing for the long term.

Applied Value's Sustainable Lean Growth framework guides executives in how to successfully react to a downturn, build financial sustainability and gain a competitive advantage:

1. Re-visit the company strategy to secure appropriate business focus and financial targets
2. Optimize the company's cost structure (COGS, SG&A, and R&D) to secure improved profitability
3. Re-invest cash into new organic and non-organic growth pockets and areas
4. Achieve sustainable business productivity, competitive advantage, and profitable growth



Figure 1: Sustainable Lean Growth framework: From Cost to Innovation



A fundamental part for achieving sustainable Lean Growth

Selling, General and Administrative expenses (SG&A) is an essential part of a company’s P&L. SG&A expenses typically cover up to 15-20% of total revenue. SG&A is the single cost item that is not directly affected by revenue, making it highly ambition driven. Therefore, companies can decide themselves on how small or how large of SG&A costs to have.

Organizational functions generally associated with SG&A are Sales, Business Development, Marketing, Finance, HR, IT, and Legal. Costs are mainly fixed but also variable. Having more variable costs increases a company’s flexibility and responsiveness to change.

Addressing SG&A is considered a quick fix as it is less impeding on the core business compared to other cost items i.e. COGS and R&D.

The consequence is that every organization can decide on how high SG&A costs should be. In the past, Applied Value has helped clients secure SG&A cost reductions by up to 50-60% during a given year.

Company performance, as related to SG&A, is typically measured by comparing the SG&A over Sales ratio. In positive business cycles, companies tend to add too much SG&A compared to the revenue increase, resulting in shrinking profit margins. Instead, a financially healthy company should be able to show a decreasing SG&A over Sales ratio by 1% per year.

SG&A Business Drivers

SG&A improvements can be done by addressing four business drivers. Not addressing all performance drivers when improving SG&A typically leads to sub-optimal outputs, resulting in short term gains at best. The objective should be to create an environment where a company can gain short-term wins, while at the same time seizing long-term opportunities.

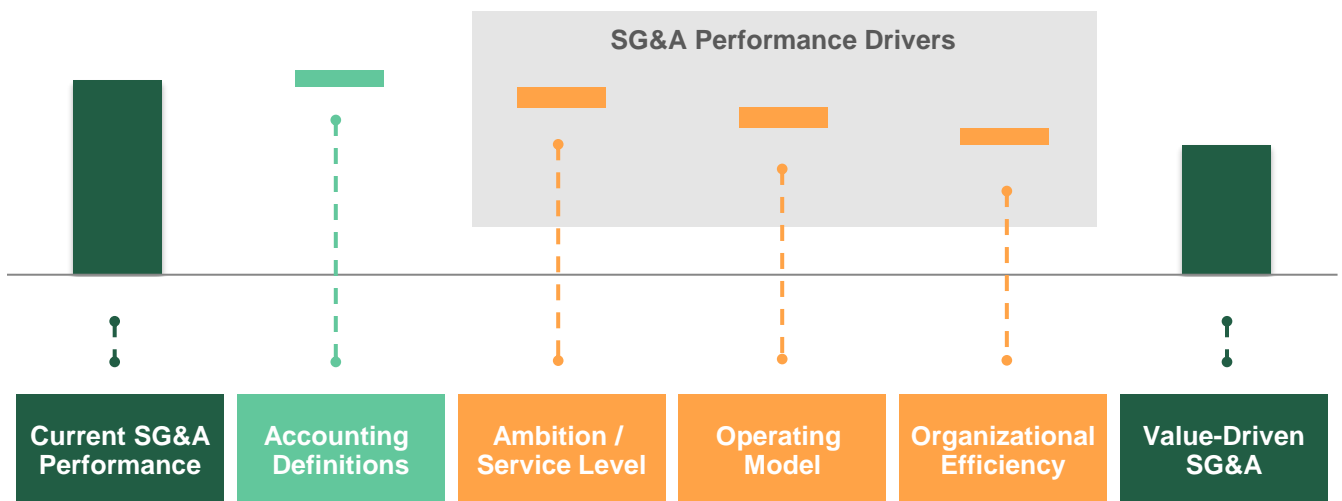


Figure 2: Typical Drivers for SG&A Performance Differences



During crises, organizations often rush into cost-cutting decisions without having a clear picture and properly understanding the true resource- and cost drivers that affect SG&A productivity. Common malpractice include:

- › **Too broad cost cuts**, where many to all supporting functions are targeted to distribute the downsizing while trying to meet ambitious targets
- › **Cutting too deep in the wrong areas** as managers lack insight into true staff productivity, cost- and resource drivers, resulting in value-destroying instead of value-creating
- › **Not creating a well thought out cost-cutting plan** and structured governance typically fails to see savings in the corporate Profit & Loss statement

SG&A Improvement Process

Applied Value's improvement process builds on our Sustainable Lean Growth framework and focuses on achieving operational excellence by increasing our clients' SG&A productivity. Leveraging Applied Value's SG&A improvement approach has helped clients reap significant benefits over the last 20 years. Including:

- 1 ***A new SG&A strategy, ambition and focus***
- 2 ***An improved resource productivity***
- 3 ***A right-sized, lean and flexible cost structure***



Size, Seize and Sustain SG&A improvement opportunities

1. Size the Improvement Opportunity

In any company, it's important to have a clear strategy, business focus, and level of ambition. The same goes for any business area or support function. To achieve proper clarity into the SG&A opportunity, a thorough evaluation of the existing SG&A resource and cost structure will ensure a proper understanding of the true drivers and inefficiency levers. Together the two will enable business leaders to make fact-based improvement decisions. At the end of the day, management teams want to move the focus from non-value adding towards a value-adding / ROI driven approach.

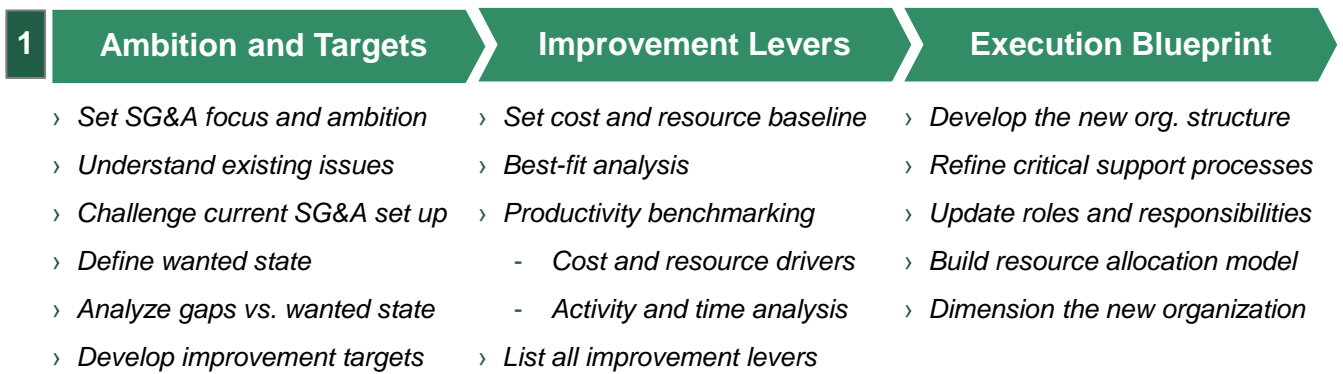


Figure 3 Key process steps in the “Size the Opportunity” phase

Ambition and Strategy

Reviewing the strategy, business focus and ambition by the function will enable a company to challenge the existing business needs for SG&A function. The strategy for a function should be closely aligned with the company strategy. Focus and ambition should be determined by conducting a current vs. wanted state gap analysis i.e. identify currently redundant (no-value-adding) or missing activities (value-adding).



Figure 4: Example of current state vs. wanted state analysis



Review focus, ambition and targets individually for each SG&A function i.e. Sales, Business Development, Marketing, Finance, HR, IT, and Legal. Conduct cross-functional interviews and workshops to ensure holistic business coverage.

- › Are our SG&A functions generating value to the organization? Challenge strategic vs. transactional activities.
- › Do we have the right operating model by function incl. footprint, outsourcing, shared-service?
- › Are our functions aligned with business needs i.e. having the right ambition level and offering?
- › What are our top-down financial targets that we want to achieve?

Improvement Levers

A strategic and financial bottom-up analysis of each SG&A function should be conducted after having defined the ambition and targets. The analysis will help a company gather insight into how efficient and effective the current organization is versus the new ambition and targets.

Applied Value leverages three types of analyses to evaluate current productivity levels.

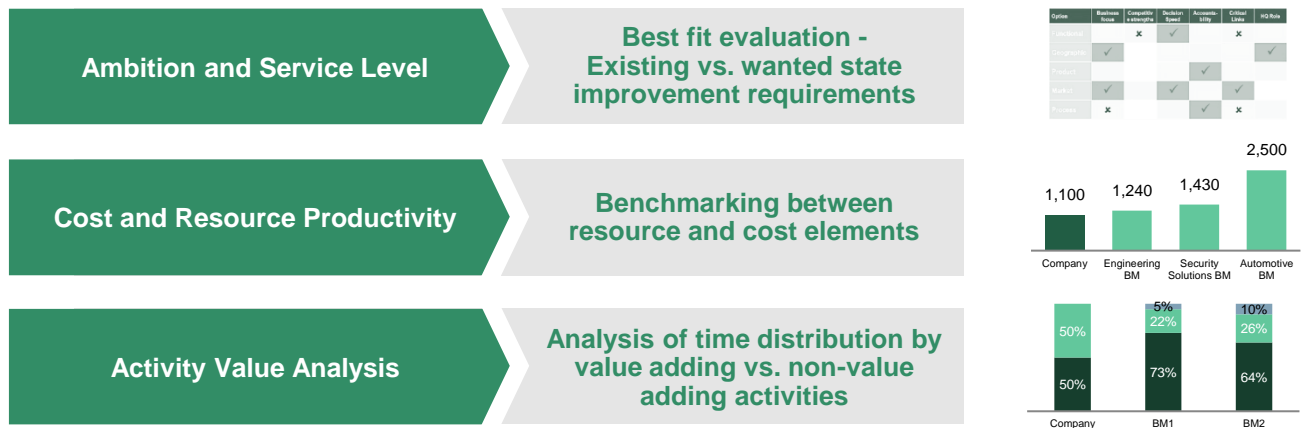


Figure 5: Examples of three core benchmark analyses

The three analyses enable business leaders to get insight into the proper business drivers and then start developing improvement hypotheses and determine levers. Levers may be centralized around:

- › How can we improve value-add / output?
- › What non-value activities should be removed?
- › How can we minimize fixed costs?
- › What fixed costs can be converted into variable cost?
- › What are the bottlenecks in our organization?
- › How do we address low performers?



A company needs to ensure that value is generated from a given input (resources and cost), for every function. By focusing on the right value-drivers, a company will maximize output, thus improving SG&A productivity. All improvement levers should be prioritized according to their Strategic Impact, Financial Impact, and Time-to-Impact.

Execution Blueprint

Improvement levers will be detailed and translated into a comprehensive execution blueprint. This will help the company to secure short-term gains and long-term wins. The blueprint will outline how to successfully improve each SG&A function, and typically includes:

- | | |
|---|---|
| 1. Development of new org. structure | 5. Resource allocation model |
| 2. Refining of critical support processes | 6. Systems for agile resource planning |
| 3. Updating of roles & responsibilities | 7. Dimensioning of the new organization |
| 4. Staff based on planned goals | 8. Anchoring levels with org. owners |

The final blueprint will force the organization to focus on core and value-adding activities. This improvement is a result of allocating time and resources towards the right activities, customers and projects while making sure under- or overstaffed activities are balanced, eliminated or automated.

2. Seize and Sustain the Opportunity

Operationalize the improvements levers into an actionable implementation plan, while also establishing an agile program management team that secures project delivery and ROI.

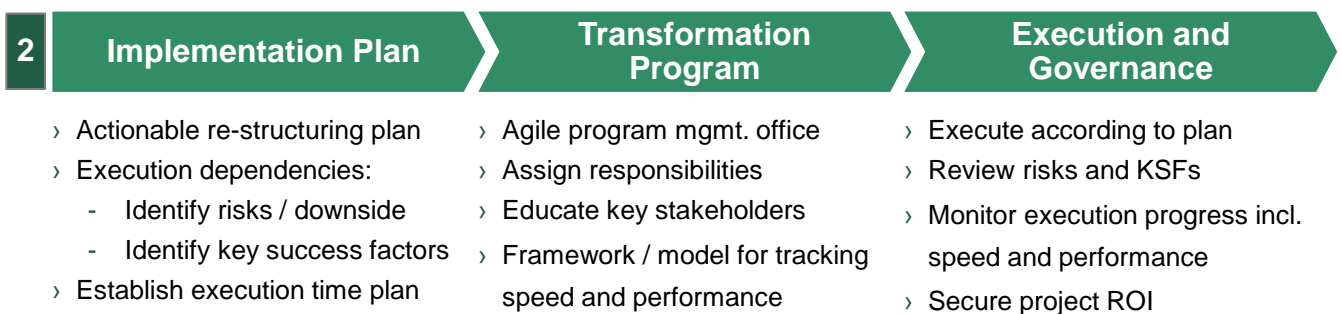


Figure 6: Key process steps in the “Seize and Sustain the Opportunity” phase



Implementation Plan

Besides being operationalized and actionable, several other aspects and implementation dependencies need to be considered when creating the implementation plan.

- | | |
|---|-------------------------------------|
| 1. Core vs. non-core activities | 1. Quick win opportunities |
| 2. Relevant risks & key success factors | 2. Implementation time requirements |
| 3. Business case re-structuring costs | 3. Organizational dependencies |

Each function is unique; which is why action items should not only be process-specific but also org-specific; the implementation plan should be customized. Risks and re-structuring implications should be weighed against the improvement potentials to understand how to best maximize the return on investment.

Transformation Program

Unstructured leadership and engagement is a common pitfall for any re-structuring initiative. It is key to ensure executive commitment and accountability during transformation programs. Therefore an agile program management team to drive implementation should be appointed. The team should be equipped with the right tools and processes to drive implementation, communicate the plan, tracking targets and institutionalizing the new model. Transformation teams are recommended to follow a six-step checklist to ensure seize and sustaining improvements.

- | | |
|-------------------------------|--|
| 1. Create an aggressive plan | 4. Re-evaluate targets and prioritize initiative |
| 2. Communicate the plan | 5. Get the low-hanging fruits |
| 3. Establish sense of urgency | 6. Invest in long term improvement areas |

5.2.3 Execution and Governance

Most importantly, monitor risks, key success factors and performance metrics, and take actions that help you to secure delivery speed and meet financial targets / ROI.



Example cases completed during the last year

1 Supported an industrial equipment manufacturer to set up a new SG&A org, cost structure, and operating model

Project Approach



Outcome / Result:

- › Established new SG&A strategy, focus, and ambition by S&M and G&A functions
- › Developed new organizations, cost structures and operating model for all functions
- › The client was able to improve their SG&A over Sales ratio by 3 percentage points

2 Supported a high-tech company to reduce org. complexity and set up a new G&A cost structure

Project Approach



Outcome / Result:

- › Improved business leader understanding of resource and cost inefficiency drivers
- › Detailed product plan per function with strategic- and financial targets and timing
- › Suggested list of ~60 improvement activities that yielded \$44M in savings

3 Supported a global airline to reduce SG&A cost by 46%

Project Approach



Outcome / Result:

- › Created productivity evaluation model to test different SG&A scenarios
- › Developed lean SG&A function that was built on org. and operational principles
- › Accelerated implementation speed and realized all savings within three months

4 Supported an industrial equipment manufacturer that was close to bankruptcy in a turnaround where SG&A costs were reduced by 25%

Project Approach



Outcome / Result:

- › Increased sales per employee by more than 35%
- › Headcount and fixed costs reductions by more than 25% in less than one year
- › Stock price up 321% during AV's involvement



Concluding remarks – Value Driven SG&A

In 2020, companies in all industries are currently facing increasing pressure from an evolving business environment, with competition getting more aggressive and customers becoming more pragmatic in their choice of supplier. To respond to this development, companies must become more flexible and lean as well as deploy capabilities to secure their competitiveness in both the short- and long term. Addressing SG&A costs as a lever to increase productivity and secure improved cash flow is a battle-tested measure to deploy. Be lean and maximize financial and strategic value creation. Applied Value's Sustainable Lean Growth framework is a powerful tool that should be used to Size, Seize and Sustain SG&A improvement opportunities.

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Applied Value Group is a premier boutique management consulting, investment, and social impact firm with a global presence. We focus heavily on ROI and tangible bottom-line results for our clients. We service both global conglomerates as well as small and medium-size companies on improving their cost and capital productivity from our offices in New York, Stockholm, and Shanghai.

