



Sustainable SG&A Cost Cutting – a Measure with Significant Effects but Little Recognition

By Christian Schlenker

**“Only when the tide goes out do you discover
who’s been swimming naked.”**

Warren Buffet

Although economic upturns and downturns are nothing new in principle, many businesses have failed to adapt themselves satisfactorily to this cycle. Caught in a vicious circle, they rejoice over the rising turnover during boom times, only to be surprised by the next recession and forced to introduce immediate cost-cutting measures in order to survive. Once the economy recovers, they return to their old habit of pushing cost management to one side. Around 60 % of companies do not pursue long-term cost reduction programs. In these times of rapid change and increasing volatility, driven by the media and internet, fired by the rapidly depleted natural oil resources and pressure on salaries from low-cost countries, this attitude to cost management bears considerable risks.

Despite the crash of Lehman Brothers on September 15th 2008 and the subsequent recess-

sion, many firms still stick to short-term measures for reducing the cost of personnel, travel, marketing etc. The urgency of the situation often prevents businesses from thinking these measures through diligently and the results frequently leave much to be desired. Once the crisis has passed, the mistakes made need to be ironed out, once again increasing the cost factor.

However, there are some positive examples, such as the German automotive corporation BMW, who use the times of economic prosperity to introduce suitable cost-cutting measures, to prepare for the next crisis. Although this Munich company sold around 7 % more vehicles throughout the EU during 2007, they enforced a strict program of savings: by 2012, BMW aims to have saved costs of around 6 billion Euros. The operative turnover is expected to rise from 8 to 10 %.

This article examines in detail how businesses can best reduce their costs over the long term and in a sustainable manner. The focus is placed on so-called SG&A costs (Selling, General and Administrative Expenses), as these (in addition to material costs) not only form the largest cost block but also appear in all corporate areas, as illustrated by the following brief example: if one of the 50 largest US corporations managed to reduce its SG&A costs by only 0.5 %, it would be able to save around 250 million dollars per annum. Typical SG&A topics include a shared service center, travel & entertainment, communication & IT, budgeting & controlling or energy & carbon footprint.

Tefen has developed a systematic approach in order to raise the awareness of its customers towards SG&A cost-cutting programs and to thereby equip them for forthcoming challenges. This approach covers four individual steps:

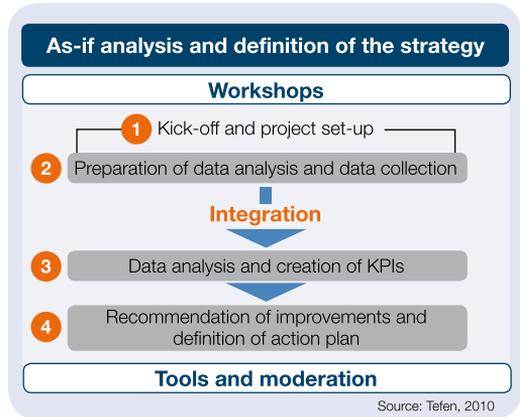
- 1. As-if analysis and definition of the strategy**
- 2. Reorganization of tasks**
- 3. Reduction of controllable expenses**
- 4. Change management**

As-if Analysis and Definition of the Strategy

The analysis of the current state not only forms the underlying basis but also the core of our SG&A cost reduction program. We work closely with the customer to establish the individual cost-cutting potential and to define the most suitable measures to be taken. Initially, we begin with a setup meeting, in which the members of the overall project team are appointed and individual tasks are allocated. This overall team is then subdivided into subordinate project teams, each of which is responsible for one of the functions, divisions or costing areas (e.g. travel costs, energy costs, shared services etc.) in which savings are to be achieved. After these

clear responsibilities have been assigned and the targets defined, step two involves the collection of all data relevant to the cost-reducing process by the subordinate project teams in that specific corporate area. The data collected is then analyzed and evaluated by the overall project team (step three), before the best cost-reducing measures can be ascertained and a plan of action compiled in step four. Cost-cutting measures generally fall into one of the following types:

- Improvement of organization and processes
- Reduction of controllable expenses



Reorganization of Tasks

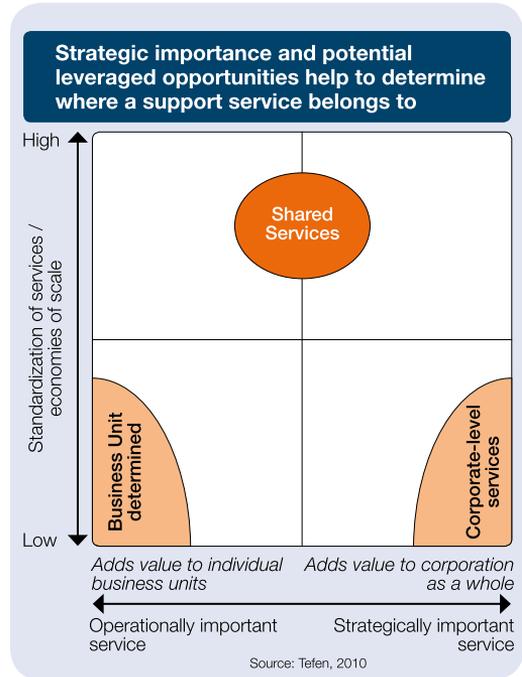
After the “cost drivers” in the company have been determined and measures for reduction defined, we usually advise our customers to first attack the organizational and procedural cost-reducing measures, before they attend to the controllable expenses. This approach has the following benefits:

- A basis for further cost reductions is laid from the start, enabling the corporation to align itself accordingly to the coming measures.
- The subsequent cost-reducing measures are implemented at the right points in the company from the very start.

- The advanced centralization of certain tasks prevents duplicate implementation of individual measures and also leads to greater economies of scale during the following reduction of controllable expenses, e.g. in travel management.

When reorganizing tasks, the key question is: "Which tasks can we centralize in order to operate more efficiently and streamlined, while also profiting from the resulting synergy effects?" The answer to this is not always easy to find and depends on various corporate factors, such as the company culture, structure and organization. In traditional "holding companies", the SG&A tasks are applied to the respective business units. An "operating company", in contrast, is highly centralized, as is the application and management of most classic SG&A tasks. The individual organization of a company depends greatly on its corporate structure. If the corporation serves different markets with a range of products, it is more likely to have a decentral organization than businesses which provide the same product to one market, for which the majority of SG&A tasks is already centralized. So we see that the models used to apply SG&A

activities, vary according to the structure and organization of a company. Tefen has developed a model which is suited to these differing circumstances, while also enabling a structured approach to the reorganization of tasks:



Option	Description	Pros & Cons
Decentralize to Business Units	Business units should be responsible for all services which are critical to their success in the market place.	<ul style="list-style-type: none"> + Increased responsiveness to client needs + Local knowledge + Quicker decision making / little bureaucracy - Duplications/costs - Inability to exploit best practice transfer - Limited economy of scale and standardization
Centralize at Corporate	Services which are required in order to define and control business units' performance and the overall strategy of the organization should be viewed as corporate.	<ul style="list-style-type: none"> + Control + Coordination + If resources are limited (e.g. small BUs, lack of critical mass) - Difficult overhead allocation - Lack of sensitivity on business needs
Shared Services	Services which are not critical for the business units and generate significant advantages of centralization (economies of scale, synergies) should be grouped together, but not necessarily at HQ.	<ul style="list-style-type: none"> + Run as a "profit centre" + Users as "customers" + KPIs/ SLAs (service level agreement) + Centers of excellence + Best practice transfer + Removal of duplication + Economy of scale - May lack critical mass - Risk of over-standardization - Investments in systems/technology

In our model, tasks are evaluated for their ability to be standardized (Y axis) against their strategic significance to the overall corporation or individual business units (X axis). If a certain task is directly critical for the success of a specific business unit but is not suitable for standardization, this should be implemented on a decentral basis, in the respective unit. Tasks which relate to the control and management of business units and divisions to the definition and realization of corporate strategy, but which are not suitable for standardization, should be run as corporate level services, a tier above the individual business units. Tasks which are not critical to the success of individual business units but which bring significant synergy effects during centralization should be consolidated in the shared service centers, on a centralized level.

Reduction of Controllable Expenses

After creating the organizational basis for cost-reducing measures, the next step is to reduce the controllable expenses. This is generally the more simpler of the two processes, as it usually has little effect on the number of staff and therefore does not generate corporate policy discussions. While traditional “holding companies” often have limited scope for cutting costs through the reorganization of tasks, they enjoy the same options for cutting controllable expenses as “operating companies” do. Since controllable expenses tend to form around 50 % of “non-production costs”, there is great potential for savings here!

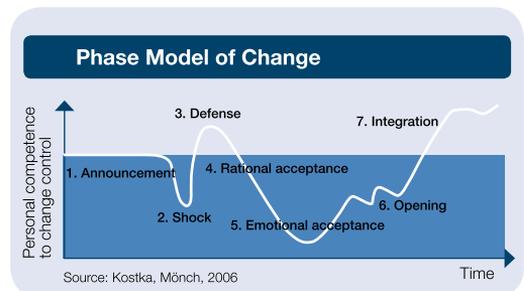
This phase of the project brings us back to the plan of action for implementing the cost reduction measures, as compiled in the first project step. It is now time to turn our attention once again to those topics. In our experience, it is relatively easy to find room for cutting costs in communications & IT, travel or energy consumption. At one of our customers, a leading global life science corporation, we were able to consolidate the

international travel management and standardize processes over a period of 8 months, leading to a fall in direct travel expenses of 6 % or a sum of 5 million Euros. Let us remember that this saving directly improves the corporate result! In comparison, a company with an annual turnover of 500 million Euros and revenue of 5 %, which does not introduce cost-cutting measures, would have to increase its yearly turnover by 100 million Euros, in order to achieve the same result.

Change Management

As mentioned above, many companies try to integrate ad-hoc measures into their organizations, in order to survive times of economic downturn. It therefore remains a challenge to ensure that the cost-reducing approach taken becomes an integral and permanent part of the corporate culture. This must include all business units and operative processes, anchoring itself in the heads of the workforce so that it becomes a way of life for all workflows, from document printing, workplace absence, communication to travel planning etc. This is the only way to ensure the sustainable implementation of cost-saving measures.

In addition to the hard factors “processes and structures”, companies also need to address their soft factors, such as management, staff and the corporate culture as a whole. Employees need to learn to think flexibly and innovatively within a new environment and in a completely new direction. Typically, this type of change management process progresses through seven



phases: announcement, shock, defense, rational acceptance, emotional acceptance, opening and integration. This means that there are a series of hurdles to be overcome before the advantages of this approach are recognized and until each member of staff agrees to apply new approaches, methods and structures. It is of even greater importance that the management tier backs the process to 100%, visibly lives it and continually reminds its staff of it.

Tefen has identified various success factors for the efficient and effective implementation of a change management process:

- Clear vision of need for change and what change will look like
- Senior management commitment to the change
- Clear, regular, ongoing communication with all employees
- Well-defined plan, rigorously adhered to
- Dedicated implementation teams involving all departments
- Visible measurements and ongoing monitoring of progress
- Clear accountability and targets
- Training needs identified and delivered

Project Examples at Tefen

The Tefen Group has already gathered wide experience in the reduction of SG&A costs as part of numerous international projects. Throughout the individual sub-projects, Tefen pursues a systematic approach with the use of various tools (see diagram on page 25).

The following diagram outlines selected sub-projects coordinated by Tefen, for the reduction of SG&A costs:

On October 14th 2010, leading economic researchers announced that the German economy would grow by 3.5 % in 2010 and that growth of 2 % is forecasted for 2011. It therefore seems as if the recession has reached the trough in some regions and that an upturn is to be expected. Many companies will be able to breathe and look with confidence to the future. This is exactly the right time to implement measures to stabilize businesses and avoid nasty shocks when the next downturn comes.

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