MEMO TO THE CEO

Winning in Turbulence

Streamline G&A

By

Hernan Saenz and Darrell Rigby

Previews the forthcoming book

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By

Darrell Rigby

Bain & Company, Inc.

Harvard Business Press
Boston, Massachusetts

ISBN-13: 978-1-4221-4043-7
4044BC

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Streamline G&A

WHEN COST REDUCTION is an urgent priority, one of the first places executives look for savings is general and administrative (G&A) expenses—the cost centers that provide support and back-office functions such as finance, marketing, information technology, and human resources.

There are good reasons that G&A represents such an attractive target. When business is growing, companies tend to add support services. The cost of those services usually doesn't set off alarm bells because profits are healthy and marginal investments are easy to approve. Cost centers may even show apparent correlations between their expanding investments and the improving results of the business. It's like a sailboat that accumulates barnacles: as long as the wind is steady, nobody notices the drag from below the waterline. But when the wind dies, the drag from below threatens to stall the boat. In a downturn, it becomes painfully apparent that incremental support services don't contribute enough to sales or earnings, and many executives react with across-the-board cuts in G&A.

This slash-and-burn approach doubtless eliminates some unnecessary expense. But it often destroys value as well. To make their numbers, managers may eliminate activities that really do drive sales and profits. Later, the company realizes it needs at least some of the services those teams were providing. Bit by bit, resources get added back—often just in time to be slashed again in the next downturn.

A Better Way to Streamline

There's a better approach. It's almost as quick as the slash-and-burn method, and in our experience it produces cost savings that are sustainable, typically in the range of 10 percent to 30 percent. It also improves the productivity and effectiveness of support functions, which in turn helps boost the performance of a company's front line—a powerful advantage in a downturn. We'll describe the steps involved and then look at some examples of how the approach works in practice.

Invert the Pyramid

The approach begins with what we call inverting the pyramid. The usual organizational pyramid shows front-line managers and employees—the people who deal with customers and perform mission-critical operations such as sales or service—at the base. Support functions are somewhere in the middle, and senior management is at the top. Tipping the pyramid upside down emphasizes the importance of the people who actually provide the products and services that customers value. Below them are the support and back-office functions that help the front line deliver the goods. At the bottom is senior management, whose fundamental job is to help the rest of the organization do its work effectively.

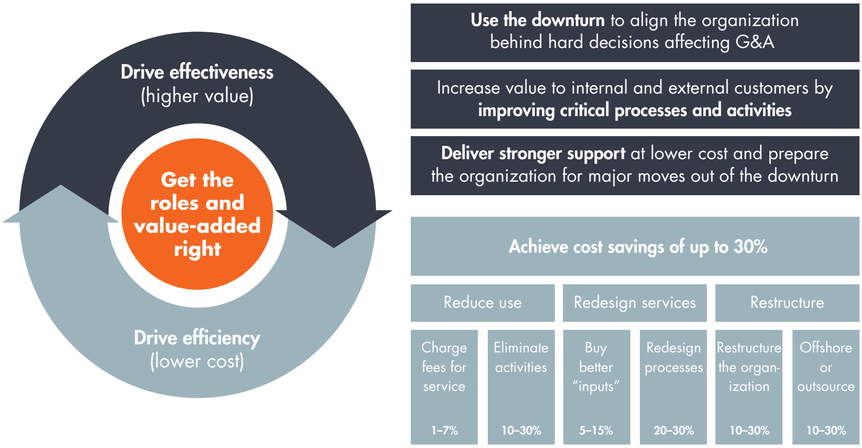
The inverted pyramid provides a kind of acid test for support services: Which of HR's many activities, for example, help put talented, well-trained people in a company's critical positions? Which of IT's activities solve the problems that are getting in the way of delivering value to the customer? Using the inverted pyramid, executives can determine which support services are essential to the front line, where the company makes its money each day.

Reduce, Redesign, and Restructure

There are three ways to maximize front-line benefits while eliminating unnecessary expense. The key is to understand which services should be reduced, which should be redesigned, and which should be restructured (see figure 1).

FIGURE 3-1

Streamline G&A: The potential to save up to 30% in costs



To *reduce*, companies can clarify what support functions are expected to deliver and eliminate nonessential activities. Some companies use internal pricing mechanisms to help executives see which services front-line managers really want, based on what they're willing to pay for. *Redesign* requires companies to scrutinize the processes that deliver support services. They can streamline some—often by automating certain steps—and purchase better or lower-cost inputs for others. *Restructuring* usually involves consolidation or outsourcing. The goal is to ensure that support services are located and organized in such a way that they can perform most effectively at lowest cost.

Run Support Functions Based on Productivity and Output, Not Only Costs

Minimizing costs is rarely a business's sole objective, because some costs create value that customers are willing to pay for. It's the same with G&A: minimizing costs for every function is seldom the right answer, because companies need to invest in support functions that make their front lines more productive. When management teams focus on effectiveness as well as efficiency, they usually get the best results.

What can you expect from this approach? Typically, a combination of reduction, redesign, and restructuring can save about 20 percent of G&A

costs, although some companies save more and some less, depending on their starting point. In our experience, reduction of use usually accounts for about 25 percent of total savings; redesign, 35 percent; and restructuring, about 40 percent. And by focusing on effectiveness and efficiency together, these cost savings can be sustained.

Let's move on to the examples.

Tailoring Support to the Product

Inflexible back-office cuts can impose one-size-fits-all procedures on a company's production and marketing activities. That's unlikely to help a company adapt to an ever more competitive marketplace.

Consider the case of an office products company. Faced with fierce competition from overseas suppliers and big-box stores hawking private-label goods, this company knew it needed to improve its performance. Part of the answer lay in cutting costs dramatically to allow for more competitive pricing. So the company centralized support functions, eliminating what had been a high level of duplication across its business units.

But while lowering costs was essential to greater efficiency, the company also saw a big opportunity to improve its performance through more effective marketing and R&D. Some of its customers bought primarily on price. So in certain product categories, *reduce* was a key lever as the company slashed support spending to compete with very low-cost, private-label goods. But other customers valued innovation and sought out some of the company's brand-name products. In these high-value categories, the company actually increased its investments in R&D and marketing to bring innovation to the customers who cared most about it.

In most cost-cutting campaigns, R&D and marketing would be in the crosshairs. But for this company, an across-the-board cut would have been a mistake. By segmenting its customers and product categories, it was able to cut costs judiciously, which resulted in an overall boost in productivity and sales in its core product lines. That led to an improved cost structure and some of the strongest economics in the industry.

Eliminating Bottlenecks

Speed is paramount in turbulent times. But ineffective support services can create bottlenecks that slow organizations down. Consider the experience of one international entertainment company. The company was hoping to capitalize on its popularity by adding shows on its global tours. But to its dismay, it found that costs were rising faster than revenues. Adding more shows threatened to flatten margins instead of generating the profits that might be expected from spreading costs across more output.

The problem turned out to be twofold. First, the company had a tangle of back-office services like finance and HR that were duplicated for each show. In effect, a mini-back office, including a financial controller, a dedicated HR staffer, and so on, hit the road with the performers for every show. The back office provided services, but the incremental cost was debilitating. Second, many crucial support services, from costume making to casting, were world class and were treated as such—quality always came first. This was hardly surprising: the company's core asset was its ability to put on unique, high-quality events that drew rave reviews and commanded a premium ticket price. But nobody was paying attention to the effectiveness of the back-office systems.

Creating a back-office structure more amenable to profitable, sustainable growth meant *redesigning* much of what was already in place. As a creative enterprise, however, the company had to examine closely which processes could be redesigned without disrupting the artistry that so appealed to customers. It also had to respect what needed to remain inviolate—costly but essential parts of the high-quality production process such as expensive props or staging installations.

Some of the solutions were obvious, such as centralizing and streamlining the finance and HR functions. Despite the distributed nature of the finance function, transactions for as little as $20 had had to be signed off centrally. Simply processing the transaction could cost more than the amount being processed. To resolve this issue, the company provided its staff with credit cards for small purchases.

Other solutions were less obvious. HR, for instance, had invested heavily in creating a database of candidates for the most skilled and versatile positions in its shows. It spent less time collecting names of less-skilled players. When the company looked more closely at absentee rates and backup depth, however, it realized that the greatest need for replacements due to injuries or illness was among the rank-and-file performers, while the most-skilled roles had more backups than were necessary. That meant there was room to invest less in recruiting for starring-role understudies while still ensuring that backups were always available. HR could focus more where it was most needed, while spending less overall.

Costume making was another area of opportunity. At first, the costume shop was off limits to the efficiency drive. The craftsman ethic was strong, and costume makers proudly sewed their garments from hand-dyed fabric. Creating and repairing costumes was labor intensive, however, and skilled artisans were in short supply. Processing twice the volume—the expectation in the growth strategy—was out of the question. So the company analyzed which costume elements were commodity items and which were truly unique. Eventually it was able to outsource production of several commodity items without compromising overall quality, thereby eliminating another bottleneck. The show could go on—more often than before and with higher profitability.

Improving the Productivity of the Front Line

Sometimes back-office processes actively interfere with mission-critical, customer-facing activities. No company can afford that when times are hard. It's one reason why inverting the pyramid and listening closely to the front line are so important. Consider the approach taken by Kyobo Life, a Korean financial services company that took quick, practical steps to *restructure* its customer support operation and to *redesign* some of its processes to make the salesforce more productive.

Kyobo was an early adopter of the Internet sales channel in Korea. It began selling automobile insurance policies on the Web in 1999. It also operated branch offices where salespeople could meet directly with customers. Bringing a higher level of efficiency and effectiveness to the branches required more finesse. Each branch had thirty to fifty sales agents advising clients on investment options and insurance products. But the same agents were also responsible for customer support, and the company's incentives actually encouraged them to divide their time between sales and support. Sales productivity lagged. When Kyobo studied the situation, it discovered that the average agent spent 60 percent of his or her time on support—a back-office function—and only 40 percent on selling.

One way out of this box might have been to change the incentive system, so that expensive, specialized sales agents earned more for selling than for customer support. But Kyobo's business would suffer if it simply reduced support. The solution instead began with inverting the pyramid to understand what support services the front-line agents required to boost productivity. With that perspective in mind, Kyobo's sales managers proposed investing in a customer call center that would handle both customer support and lead generation. Call-center staff would pass along the leads to the sales agents, splitting the commissions. To be sure, Kyobo had to invest in training the call-center staff. But the restructuring plan energized the salesforce and made it more productive.

G&A clearly offers companies many opportunities for lowering costs and improving performance quickly. The current downturn is likely to be lengthy, and a focus on G&A effectiveness as well as efficiency can help companies survive. But the downturn won't last forever. When it ends, companies will need to take their foot off the brake and step on the gas. Wholesale G&A cuts are likely to slow results now and get in the way of rapid acceleration later. Smart strategic measures, the kind that boost effectiveness while increasing efficiency, will help a company both survive the turbulence and accelerate out of it.