WHAT CEOs NEED TO KNOW TO ACCURATELY ASSESS & MANAGE OVERHEAD IN AN UNCERTAIN MARKET

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Global growth in advanced economies has shown a gradual increase in 2015 with a marked slowdown in emerging and developing economies, according to the International Monetary Fund. AlixPartners, a leading business firm for turnaround space cites many of Europe's economies still in recession "despite rising sales in growth regions." The significance of this places pressure on businesses trying to emerge in or currently within the global market.

CEOs have an eye out for growth, but when trends lean toward stagnant market activity, reduced margins and profitability, tighter cash flow, and increased competition, it forces initiatives in thinking and doing. As the head of the company, you must make the best possible choice for the best possible outcome. What does this mean? Now is the time to look within the company's selling, general and administrative expenses (SG&A), especially when outside forces are volatile. Companies must begin to re-evaluate opportunities in cost reduction without compromising the business.

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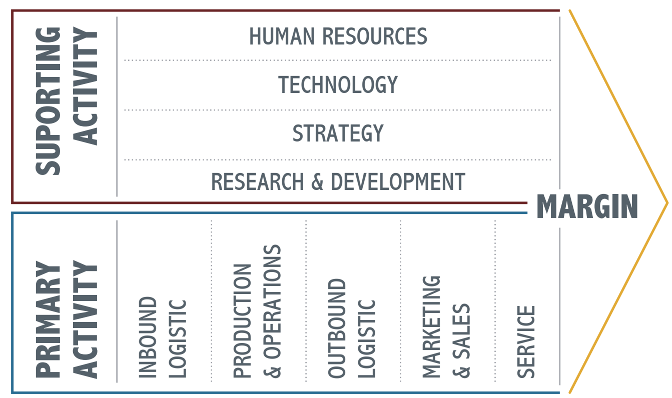
Overhead Cuts that Last

We all know cash is king, but chopping 10 to 30% in overhead costs across the board often yields meager savings in the short term. There is also a greater chance of dissolving any sense of company morale. Implementing Overhead Value Analysis helps make cuts structural and savings more long-term. It's important to cut the fat from your business but when you shave away the muscle and the bones then you risk breaking down the foundation of your business.

With a clear sense of direction and purpose, overhead corrections may be made to increase operational efficiencies. According to market leaders, entrepreneurs are passionate about primary business objectives and often view SG&A reports as complicated profit and loss findings. We've got to change that way of thinking. The primary business objective is ultimately to grow the company profitably. Sales, General & Administrative SG&A is the vehicle which gives insight into cost reduction priorities that you can focus on.



The largest overhead reduction priorities

No one likes the word downsizing. When you say it, everyone worries about being next on the unemployment line, and your "survivors" often feel demoralized, overworked, and frustrated. Recasting overhead reduction as a redesign to right-size the organization is not just paraphrasing to make it sound nice; there is a fundamental truth behind it.

If the ship *lists* to one side it becomes unstable and loses equilibrium. So do the businesses. Now is the time to take an impartial view of your enterprise from executives to entry-level employees, vendors to distribution, sales and marketing to your insurance coverage. What's waste? What needs an infusion of capital? Where can you save without compromising your business directives and company morale? Where do you start?

Ideally you and your CFO have an open door policy to engage in serious conversations about the direction of your company. Ultimately, it is the CEO who makes the final call so maybe it's time to ask, "Am I one of the hurdles?" How open are you to casting a wide net for new ideas and enabling key people to engage in change?

- **Supplier engagement.** Look to strategic sourcing or try to re-negotiate existing contracts.
- **Policy & procurement changes.** If cost outweighs the benefits it may be time to move on.
- **Indirect expense improvements.** How many lawyers and accountants do you really need on retainer? When was the last time you actively sought bids for communication and network lines?
- **Manufacturing & production improvements.** How can your operation run more efficiently?
- **Sales force realignment & effectiveness.** Do your salespeople have the right tools and initiatives to really sell your product?

WHAT WILL LEAD YOU TO THE GREATEST COST REDUCTIONS?

- Executory Implementation
- Leadership commitment and support
- Well-defined goals and financial targets
- Change-Management support
- Communication and some transparency throughout your organization
- Dedicated resources to achieve those initiatives
- Quality of recommendations
- Design for improvement

WHAT ARE THE THREE BIGGEST BARRIERS?

1. Leadership commitment
2. Execution
3. Resources

Ironically, the top three cost reduction strategies make up the largest hurdles.Too many CEOs want to micromanage - or worse, don't manage at all. Managing is not crunching numbers. It's making sure all the cogs in the wheel are well-oiled and moving smoothly; being on top of things when something breaks; executing a strategic plan, and shifting resources where they are most needed. You would not go deep sea diving with a half tank of air. Ideally you must have a good grasp of all areas of your business without choking it in a stranglehold.

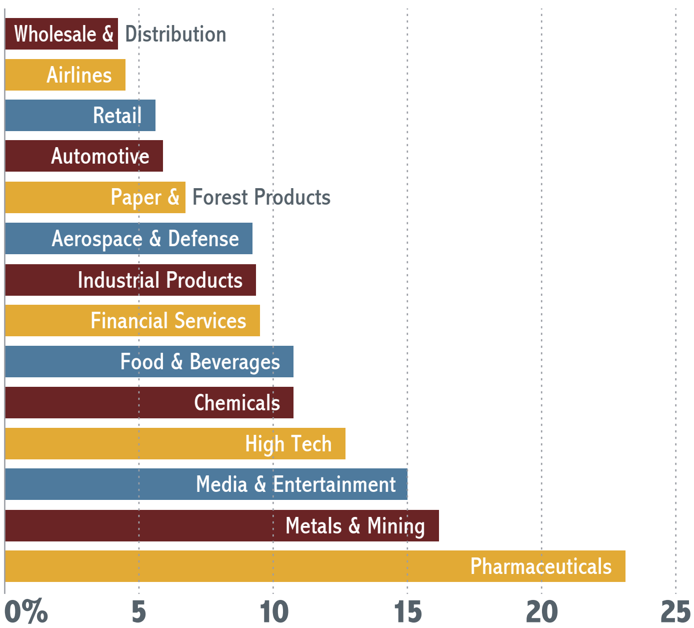
Zero-Based Budgeting (ZBB)

Many companies are changing their business strategies by revisiting product development pipelines and sales models. For others, the scale of the challenge also requires dramatically lowering their cost structures and making overhead changes. No one gets excited about zero growth. From 2008 to present day, there has been very sluggish GDP growth in developed markets (source IMP, AlixPartners Analysis), which observed North American markets including the United States and Canada, Japan, and Europe.

EBIT AND SG&A AS PERCENTAGES OF REVENUES VARY SIGNIFICANTLY ACROSS SECTORS

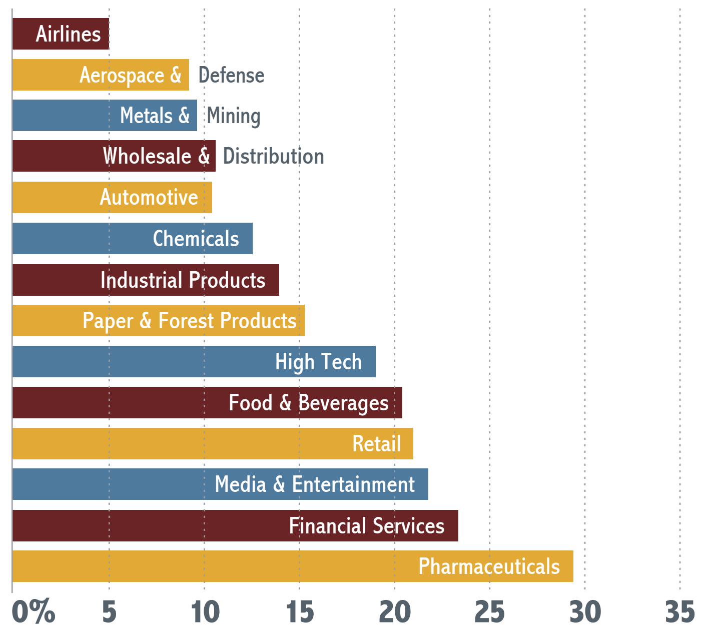
EBIT AS % OF REVENUES BY INDUSTRY SECTOR

COMPANIES IN EUROPE, NORTH AMERICA, JAPAN



SG&A COSTS AS % OF REVENUES BY INDUSTRY SECTOR

COMPANIES IN EUROPE, NORTH AMERICA, JAPAN



Note: The ratios outlined in this figure covevr average ratios for a number of sectors and cover a large number of companies with varying individual performance. Source: Capital IQ, Alix Partners Analysis.

Take a look at the Earnings Before Interest & Tax (EBIT), and SG&A as a percentage of revenue and how significant it is across major sectors. From retail to wholesale distributors; airlines to pharmaceuticals, mining, defense, industrial to food and beverage, there is an enormous cost of acquisition and the margin for revenue has remained stagnant or shown very little improvement.

Now you're in a market where everyone has a smartphone and the ability to do a lot of research before they approach you. Competition is fierce and believe it or not, it is a beauty contest. You must be attractive to your consumer and have the ability to provide instant gratification in a fast-paced marketplace. Prospective clients have the resources now to kick more tires and casually browse for services until they find a better deal or you satisfy their need. What makes you special? What puts you above the fray? Why would they pick you? How does zero-based budgeting help me guide those customers in my direction?

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WHAT IS ZERO-BASED BUDGETING?

Zero-based budgeting is a method of starting each period from zero through a rolling process that motivates your people for many years when thoughtfully implemented. Every function is analyzed for need and cost instead of broad stroke increases or decreases throughout the company.

Imagine fine tuning your cash distribution for initiatives that push business forward instead of weighing it down. ZBB justifies what to keep and what to remove through keystone analysis, focused initiatives and comprehensive design. The path of doing business is often paved with unnecessary activities, bloated or rationalized service levels, and top-heavy administrations.

TARGETED COST CUTTING		ZERO-BASED BUDGETING
Justifying **what to remove**	VS	Justifying **what to keep**
Focusing **scope** on narrower set of costs or cost reduction tools	VS	Leaving **"no stone unturned"** by examining every cost area with broadest possible set of cost reduction tools
Improving **how** activities should be performed (such as efficiency and effectiveness)	VS	Considering both **what** activities should be performed (eg., doing less) and **how** they should be performed
Creating **focused** initiative planning and execution	VS	Developing **detailed and comprehensive** initiative design, planning and execution

7 WAYS ZBB CUTS THE WEIGHT

By rationalizing the true purpose and direction of the business, you get a sense of want versus need. Overhead is often stuffed with things we want. Certainly the perks are nice, but nice doesn't pay the bills or make stockholders happy. Making money and growing your enterprise makes everyone happy. Insight for what you need propels you forward and up by cutting away the dead weight.

1. **Create focused initiatives with comprehensive design.** Is your current bonus structure a worthwhile endeavor? Find out what motivates your people from the top down and work on developing healthy competition for efficiency, safety, and improvement. Your workforce wants you to succeed. Give them a reason to go the extra mile.

   ·Eliminate redundancies ·Rationalize service levels ·Acknowledge vision and creativity

2. **Reward levels are not created equal.** Stop throwing everything at everyone. Let's take airlines and credit cards for example: You might have a special lounge for frequent fliers who use your service and product on a regular basis. It would be ridiculous to offer those same rewards to a budget flier who travels once a year. What message are you giving your dedicated consumers? Conversely, what are you doing to turn a single transaction into an exclusive client?

3. **How many high & mid-level executives does it take to change a light bulb?** The real question is: how many people have direct access to you, and more importantly, why? It may be more beneficial to put capital toward R&D and customer service and acquisitions rather than paying redundant staff.

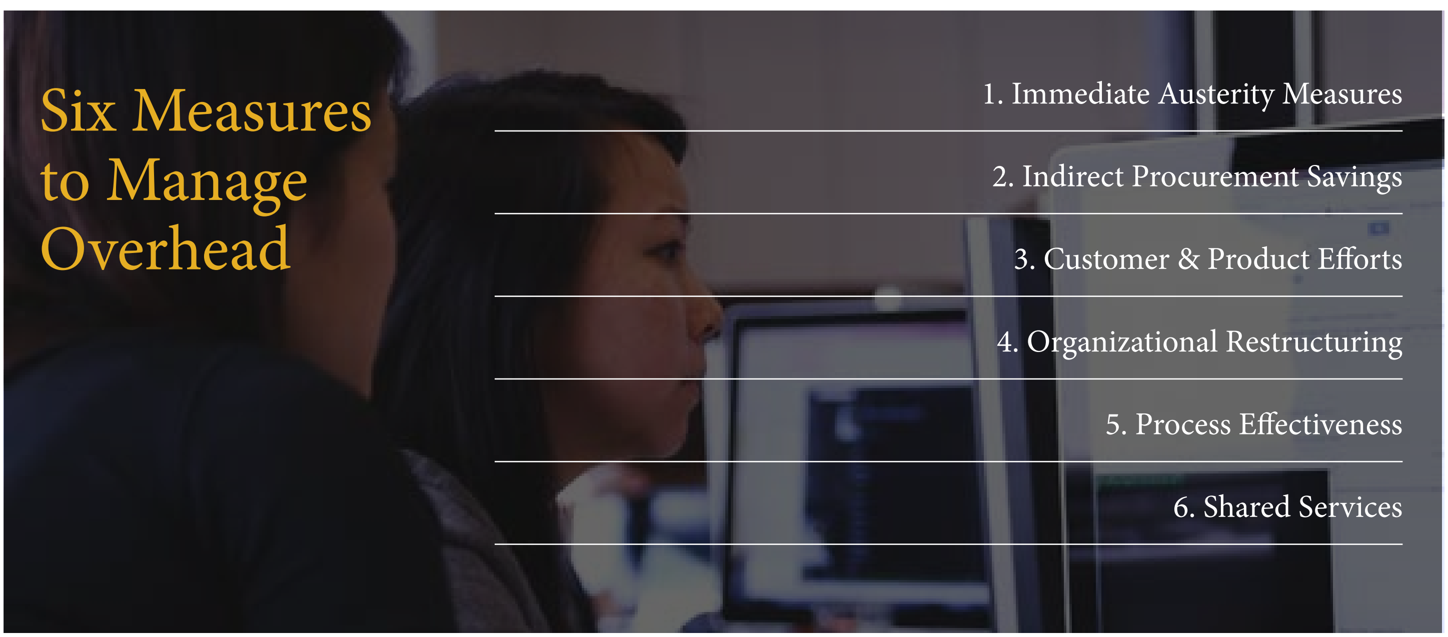
4. **Marketing.** Here is one area where cost-cutting measures may hurt you. No corporation, venture, or franchise is too big to fail. Cutting your visibility basically cuts your business. Out of sight, out of mind.

5. **Develop process and procedure.** Though not distinctly cost-cutting, understand that having processes helps control cost and maintain efficiency. There should be checks and balances without propagating redundancies.

6. **Trim mediocrity.** Jim Collins, author of Good to Great said, "Those who build and perpetuate mediocrity…are motivated more by the fear of being left behind." Where does that leave you? In the center of all the other mediocre people. Aspire for greater things.

7. **Toss miscellaneous.** To manage overhead you must get rid of the catch-all of miscellaneous spending. What is it? Why does it exist? It is too easy to lose track of why it exists. Know where your money is going.

> Using zero-based budgeting helps analyze impact areas on a quarterly basis allowing you to evaluate progress, find and eliminate redundancies, and ultimately free up working capital for new initiatives.



Immediate Austerity Measures. Empower senior leadership team to review and authorize spending. If you have a good team in place, give them parameters and empower them to seek efficiencies. Dedicated, hands-on people will have a clearer understanding of want vs. need in their department.

Tighten travel policies. Everyone has a smartphone and internet access. Real-time meetings can be achieved through conference calls, video chat, and webinars. Certainly there should be an investment on networking and learning opportunities but reserve them for key people who can share their knowledge with the rest of the company.

Control your marketing expenses. What works? What puts you in front of your target demographic? Using ZBB, you can find out where your clients are coming from - or why they're leaving you. If your website has no retention, why not put your marketing dollars into high quality mailers instead.

Indirect Procurement Savings. Renegotiate better pricing and payment terms with your suppliers. It may also benefit you to consolidate the suppliers you have. There is a greater chance of bigger discounts if the bulk of your supplies are delivered from one source. Additionally, you have fewer invoices to deal with.

Designate one person or group to manage indirect spending. With email and cloud sharing, the days of facsimiles are gone. Do you really need to order a pallet of paper? Be sure to review and challenge indirect expenditures across the board especially if they are non-essential items.

Customer & Product Efforts. Review ongoing profitability of customers, products, markets, and channels. These segments need to cover general and incremental overhead for specific countries, accounts, and products around the globe. If cost outweighs the effort, consider terminating those areas for re-evaluation and analysis before more time and money is invested.

Organizational Restructuring. If you are a global enterprise, examine opportunities to consolidate multiple business areas by country, region, and demographic. Make sure your product lines compliment your customer verticals. You aren't going to sell hay in the city and you probably can't justify a million dollar effort to sell Gucci to farmers. You cannot be everything to everybody. Pick your battles.

Process Effectiveness. Ensure that the right tasks (sales, R&D) are being done by the right people in the right way. If you have an introverted, analytical thinker would you rather have them on your sales team or in your accounting department? Reviews are often under-utilized yet powerful tools for analyzing skill and strengthen. You want smart, hungry, scrappy people using their natural talent to enhance your business.

Shared Services. Consolidate transactional activities into shared-service centers. Remove redundant activities and resources in such functions as finance, supply chains, management, engineering, and R&D. There is no need to recreate the wheel. Instead of leasing office space, how many people can telecommute?

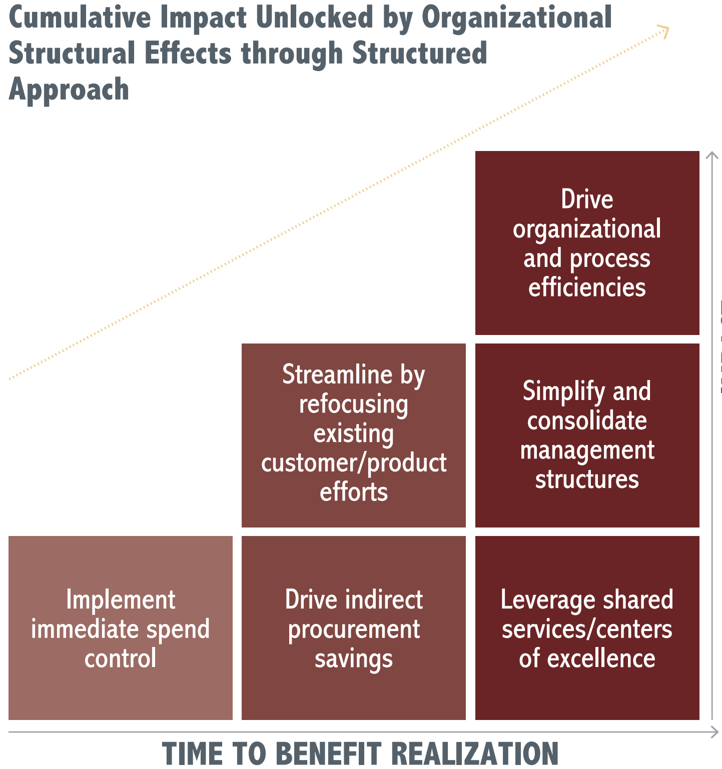
Cumulative Impact for Cumulative Benefits

If you take a structured approach, you will begin to see the cumulative impact of your structural changes. First and foremost, you have to implement immediate spend controls. Really look at where your money is going.

Drive indirect procurement savings and streamline those efforts by refocusing existing customer and product efforts. Drive organizational and procedural efficiencies by revealing core competencies. In essence, make your business work more with less without demoralizing your employees and aggravating your clients. Simplify and consolidate management structure so redundancies are kept to a minimum.

Cutting staff, dissolving vendor relationships, and refocusing your market is going to taste like bad medicine. Just remember it is curative.

Cumulative Impact Unlocked by Organizational Structural Effects through Structured Approach



Source: Alix Partners Analysis.

Turn adversity into opportunities

Turning uncertain economic conditions into opportunities has been the key growth factor for many companies in financial crisis. Following strategies will help you execute the necessary actions during the periods of economic uncertainty. You absolutely cannot know the true health of your business if you're looking at analytics and spreadsheets. Get in the field!

Uncertainty Tolerance

Are you strong enough to weather the storm? Well-led organizations show greater tolerance and they are more adept at operating under uncertainty. The goal is not to eliminate uncertainty but rather to benefit from it through strategic actions.

"Economic slowdowns are a time when companies can strengthen themselves by writing out slack resources, improving efficiencies and re-cementing relationships with valued customers." Dr. John A. Pearce, Strategic Management and Entrepreneurship

Maintain Service Excellence

Although you probably want to reduce expenses in many areas of your business, you need to continue serving customers with the same standards of excellence.

Proactively seek feedback about your products and service contacts from your customers, formally or informally. The one-on-one time will reinforce your company's interest in your customers and can help address small problems before they become too big to handle. Your service and how you interact with your customers and clients will separate you from your competitors. Make sure it's enforced.

Support Distributors

In adjusting, often virulent markets, no one wants to bind their working capital in excess inventory. Early-buy allowances, extensions on financing, and generous return policies motivate distributors to stock your full product line. Now may be the time to drop your weaker distributors.

Be Diverse Without Being Overwhelming

A big fish in a smaller pond gets more attention than the tiny fish lost in the ocean. If you have 300,000 SKUs and a six-inch thick catalogue, it would be impossible for your sales people to pitch prospects in 20 seconds. They only want a clear answer to whether you can help them or not. Are you giving your front line people the tools to be efficient?

Continue Marketing Initiatives

Marketing is the strategic investment of values. If you must cut back, do so selectively while maintaining your market initiatives. Do not dilute the visibility, viability and vigor of your brand.

Maintain marketing spending

Uncertain period is not the time to cut your advertising. It is documented that brands that increase advertising during a recession can improve market share and ROI at lower cost than during good economic times, especially when competitors are cutting back.

Adjust product portfolios

Marketers must reforecast demand for each item in their product line as consumers often trade down to models that stress good value. What are you doing to learn from these different interactions? Your salespeople know what moves, what doesn't, and what they need to close a deal. If you have 100 products and your customers are only excited about 50, why would you keep 50 SKUs collecting dust in the warehouse?

Look for ways to deepen key customer relationships

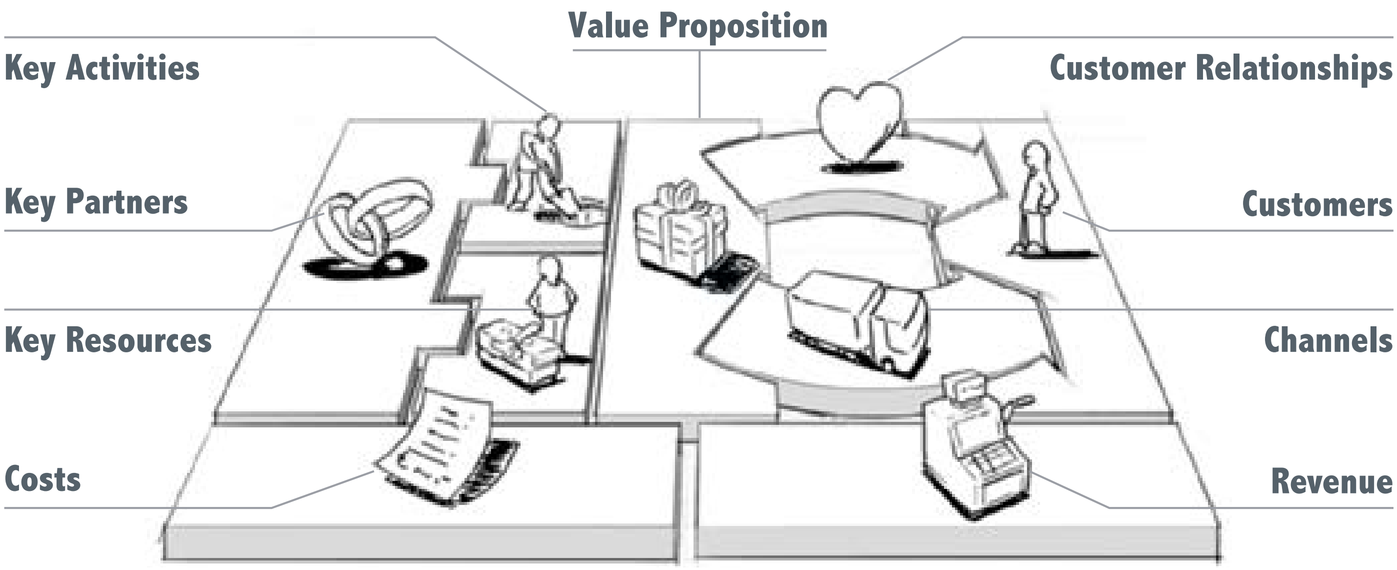
We are fundamentally in the relationship business and always need to make sure their experiences are positive - and if not, proactively seek ways to mend it. A 30-second phone call could gain invaluable information.

Emphasize core values

CEOs must spend more time with customers and employees. Managing working capital can easily dominate managing customer relations, and CEOs must counter this. Successful companies do not abandon their marketing strategies in recession; they adapt them. Strengthen your relationships. Focus on your brand and your culture.

Business modeling

Business Model Canvas by Alexander Osterwalder, is a template for strategic management highlighting nine business model building blocks.



TO QUICKLY REVIEW

Cost Structures. What are the most important costs inherent to your business model? Are you cost driven or value driven?

Revenue Streams. What are your products and services really worth? What are your pricing models? How much are your customers willing to pay for your services?

Key Resources. What type of property do you have: Physical, Intellectual, Financial, or Human. What are the resources you require to keep the operation moving smoothly?

Channels. How do your customers want to be reached? How do you want them to reach you? Is there brand awareness in the market? Are customers being approached for feedback after delivery?

Key Partners. Who are you going to in order to work efficiently and effectively? Who are your peers and mentors? Who can you call for advice or an introduction?

Key Activities. What are you doing to increase value in production, networking, or problem solving?

Value Propositions. This is all about communication. How are you reaching your customers? How do they prefer to do business with you? Where do you rate with innovation, customization, price, and support?

Customer Relationships. Who are you creating your products for? What is your demographic? How do your customers expect to be treated? Are you more self-service, automated, community-oriented, or personally invested?

Customer Segments. For whom are you creating value? Who are your important customers? Do you lean toward mass market or niche marketing; segmented or diversified?

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Conclusion

When it comes to rating the success of some of these initiatives remember that your near-term goals are going to be hit with a certain amount of acceptance or backlash. In a fluid and often turbulent market they key falls to simple physics: An object in motion stays in motion with the same speed and same direction unless acted upon - Newton's Law.

Vigilance is required to effectively manage your overhead. If you find that you're happy with the status quo rather than challenging it, you will never realize the growth and potential for your business.

FINAL THOUGHTS

Organization Efficiency. Streamline your current operations – less about just cost cutting and more about operational efficiency!

Real Change. Better is incrementalism. Different is real innovation!

Making Them Last. Fight organizational norms to return to status quo!

ABOUT THE AUTHOR
David Nour – CEO, The Nour Group

David Nour is an enterprise growth strategist and the thought leader on Relationship Economics® —the quantifiable value of business relationships. In a global economy that is becoming increasingly disconnected, The Nour Group, Inc. has attracted consulting engagements from over 100 marquee organizations in driving unprecedented growth through unique return on their strategic relationships. Nour has pioneered the phenomenon that relationships are the greatest off balance sheet asset any organizations possesses, large and small, public and private. He is the author of several books including the best selling *Relationship Economics*— Revised (Wiley), *ConnectAbility* (McGraw-Hill), *The Entrepreneur's Guide to Raising Capital* (Praeger) and *Return on Impact—Leadership Strategies for the age of Connected Relationships* (ASAE).

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