APRIL 2014

# Funding growth: a global executive survey on sustainable overhead cost management

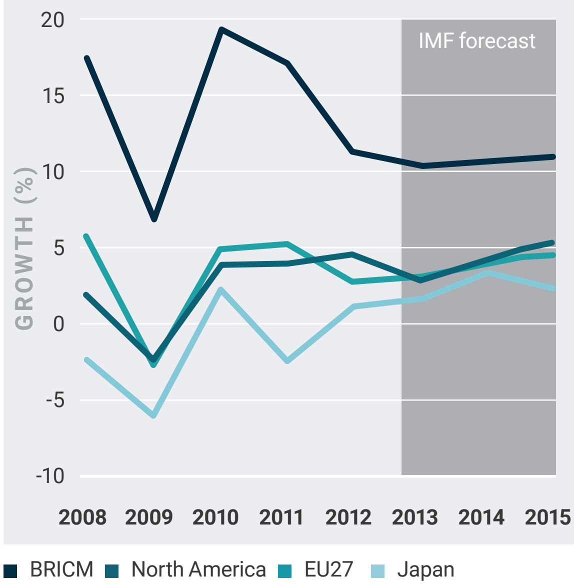
For the first time since the Great Recession, many business leaders entered the new year feeling cautiously optimistic about their companies' prospects. In many places around the globe, gross domestic product (GDP) has shown modest improvement, stock markets have rallied somewhat, and consumer confidence appears to be reviving. Manageable inflation and low interest rates constitute additional encouraging signs.

Yet according to AlixPartners' recent global executive survey[1], executives are not letting themselves grow complacent. Though market conditions are improving in some respects, the International Monetary Fund (IMF) anticipates that GDP growth will prove stagnant overall in developed as well as developing economies (figure 1). Moreover, our survey respondents identified a number of external factors that they believe will pose significant challenges for their companies in the next one or two years—factors that bring the contours of the changed business landscape into sharper relief. Specifically, executives cite competitive pressure as a critical issue, followed by rising labor costs (perhaps a function of wage pressure in Asia, the United States, and Europe) and the need to grow their markets (figure 2).

[1] SG&A, or overhead costs, consist of all personnel and nonpersonnel costs not directly allocated to a product, such as the costs of sales staff and administration staff as well as operating expenditures covering such items as information technology (IT), insurance, and corporate policies such as travel and expenses, relocation costs, and recruitment costs. During November-December 2013, AlixPartners conducted a global survey of more than 150 top and senior executives worldwide, representing diverse geographies, companies, and industries. Survey questions explored such areas as challenges facing respondents' companies, their cost-reduction experiences and plans, and their expectations for the future. Of our respondents, 78% hold CxO or senior management positions (such as president), 50% hail from companies recording revenues of over US$1 billion, and 68% work for companies employing 1,000 or more. 40% are based in the United States, 40% in Europe, and 20% in Asia.

**FIGURE 1:** EXPECTED FUTURE GROWTH IN GDP

**AFTER YEARS OF RECESSION, THE DEVELOPED WORLD IS TRANSITIONING INTO A LOW-GROWTH ENVIRONMENT (NOMINAL GDP GROWTH – LOCAL CURRENCIES)**




Source: IMF, AlixPartners analysis; North America includes US and Canada

**FIGURE 2:** TOP EXTERNAL FACTORS AFFECTING COMPANIES IN THE NEXT 12 TO 24 MONTHS

**SELECT THE TOP EXTERNAL FACTORS THAT YOU EXPECT TO HAVE A SIGNIFICANT IMPACT TO YOUR COMPANY OVER THE NEXT 12 TO 24 MONTHS**


Note: [1] For example: new service model, product innovation, new technology

To surmount these challenges, executives know they will need to channel their resources into driving growth. In fact, our study reveals that companies are still sharply focused on growth. But many view organic growth as having limited potential, so they're planning to step up merger-and-acquisition (M&A) activity as well as additional cost options to improve profitability. All this makes organizational "rightsizing" and postmerger integration key priorities.

## LEAN OVERHEAD COSTS NEEDED FOR COMPETITIVENESS AND GROWTH

Companies will also have to build a competitive and sustainable platform for growth. Yet resources remain scarce. Thus enterprises will have to squeeze as much "fat" as they can from some operational areas and convert it into "muscle" (new capacity, efficiencies, and strategies) to power construction of such a platform. Savvy management of costs will prove critical. Indeed, our survey findings suggest that companies have been focused on cost reduction for some time but plan to take more costs out in the next few years, with a sharp focus on organization redesign, lean manufacturing, and smarter sourcing. Reductions in selling, general, and administrative (SG&A), or overhead costs, will continue to play a central role in these efforts.

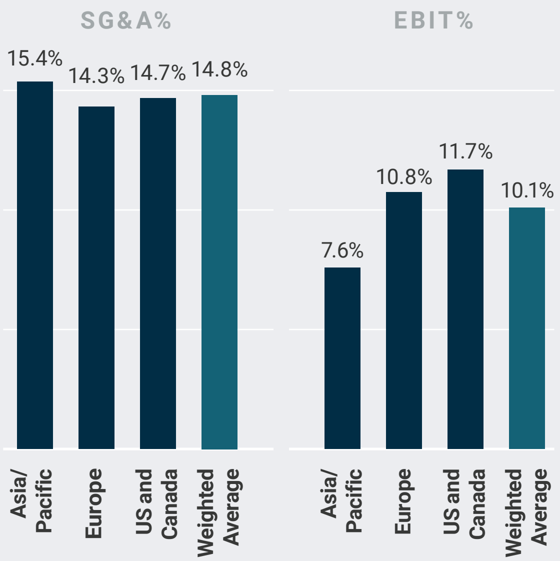
Our analysis reveals that reported average SG&A spend is 14.8% of total revenue, while operating income averages 10.1% of revenue (figure 3). As much as 63% of our respondents reported having initiated an overhead cost-reduction program in the past 24 months, and a large number anticipate pursuing such an initiative in the short to medium term. The scale of savings planned is significant, with 66% of the companies surveyed looking to remove up to 10% in SG&A costs and 34% seeking savings of 10% to 20% or more (figure 4).

## FOCUS OF FUTURE OVERHEAD COST OPTIMIZATION EFFORTS

When asked where they would focus on cost-reduction efforts in the next 12 to 24 months, executives cited organization design and rightsizing, followed closely by supplier sourcing and indirect expenses, as top priorities in all geographies (figure 5). In Asia, executives also reported a strong focus on lean manufacturing, perhaps reflecting increasing labor costs and the need to balance growth with efficiency as those markets mature.

**FIGURE 3:** OVERHEAD COSTS AND OPERATING INCOME AS A PERCENTAGE OF REVENUE ACROSS REGIONS

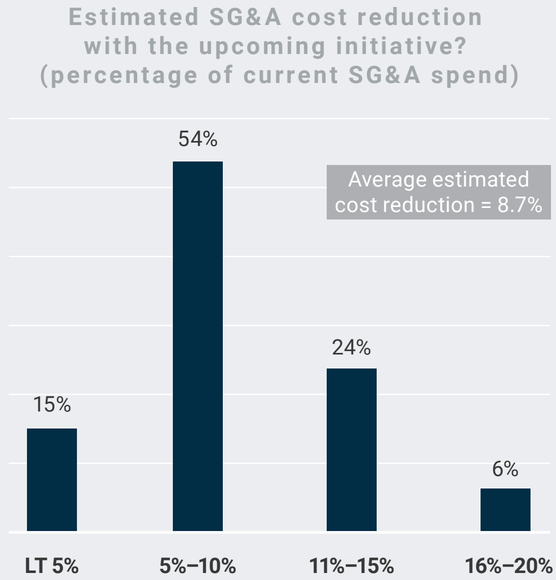
REPORTED AVERAGE SG&A SPEND IS APPROXIMATELY 15% OF TOTAL REVENUE – OPERATING INCOME AVERAGES APPROXIMATELY 10%




Source: Capital IQ

**FIGURE 4:** FUTURE OVERHEAD COST REDUCTION TARGETS

OF THESE, 2/3 OF COMPANIES ARE EMBARKING ON OVERHEAD COST REDUCTIONS OF UP TO 10% AND 1/3 ARE LOOKING TO SAVE 10% TO 20% OR MORE




Source: Capital IQ

## OVERHEAD COST MANAGEMENT: IT'S GOING TO BE HARDER THAN EVER

The problem is that companies have already achieved considerable overhead cost reductions in the past, through incremental, iterative moves such as cutting travel budgets or squeezing greater efficiency out of their back-office processes. Some have mandated across-the-board cuts in overhead. These and other moves may boost margins in the short term, but they also come with painful trade-offs. For one thing, because such cost reductions are temporary, the advantages they generate are not sustainable. And as budget pressures ease, overhead costs tend to creep back in, often disproportionately.

Cutting overhead safely and sustainably in the future will prove considerably more difficult than it has previously, and the way forward will be much less obvious. The executives participating in our survey have acknowledged that they expect future overhead cost savings to be lower than those achieved in earlier years. Historically, the companies represented in our survey targeted overhead savings of 14% on average, with 15% of them targeting more than 20% in savings. In the next 12 to 24 months, they project an average of just 9% in savings. To successfully manage costs in the future and increase the odds of beating these projections, companies will have to achieve both near-term savings and sustainable improvements. Striking this balance won't be easy. Businesses will need to optimize their organizational structures and reduce indirect costs—efforts that can work only if they're underpinned by robust operational plans, top-down management, and highly skilled execution.

**FIGURE 5:** COST REDUCTION PRIORITIES GOING FORWARD

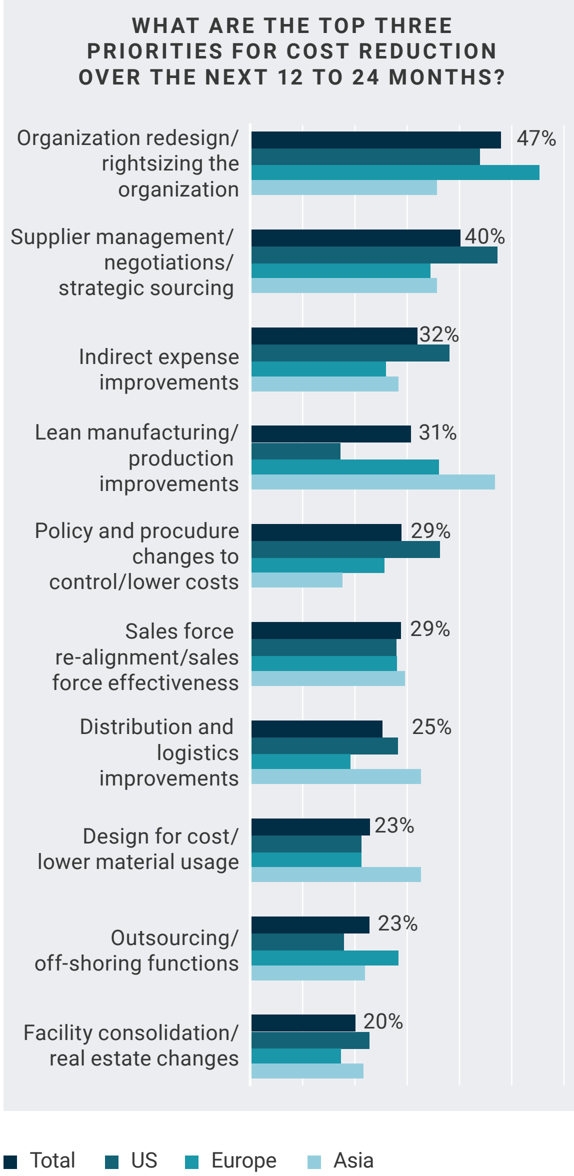
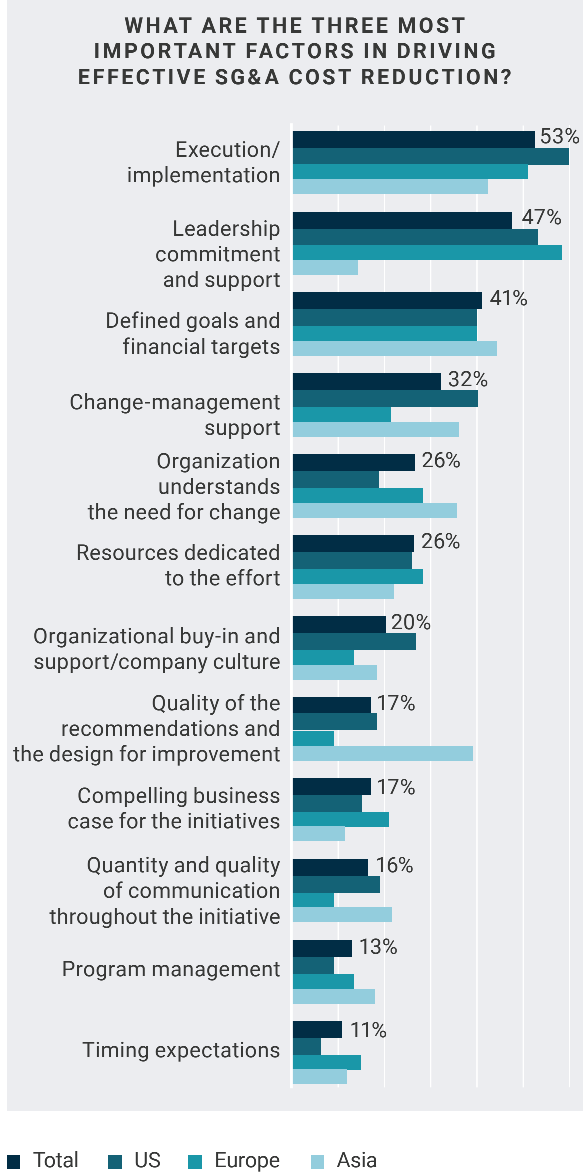



**FIGURE 6:** KEY SUCCESS FACTORS FOR OVERHEAD OPTIMIZATION EFFORTS




## CAREFULLY CRAFTED PLANS AND SKILLED EXECUTION ARE KEY

Yet overhead cost improvements are notoriously difficult to execute. To implement them, companies have to excel at multiple activities ranging from upfront analysis to detailed planning to careful change management. Indeed, the executives in our study identified execution/implementation as the most critical factor in driving effective reductions in overhead costs, followed by leadership commitment and support and the need for clearly defined goals and aggressive financial targets (figure 6).

But even as execution and leadership constitute critical success factors for cost-reduction initiatives, they're also the two greatest challenges, according to our survey findings. As much as 43% of respondents identified leadership commitment and support as the top barrier to success in reducing overhead costs, while 33% cited execution as the second most daunting hurdle (figure 7). In Asia, executives were concerned with getting the right design and recommendations, whereas executives in Europe and the US viewed top-level commitment and support as critical.

**FIGURE 7:** KEY CHALLENGES IN OVERHEAD OPTIMIZATION EFFORTS

WHAT ARE THE THREE MOST SIGNIFICANT BARRIERS TO SUCCESS IN AN SG&A COST REDUCTION INITIATIVE?


**FIGURE 8:** MEETING OVERALL COST REDUCTION GOALS

HOW WOULD YOU RATE THE SUCCESS OF YOUR COMPANY'S COST REDUCTION INITIATIVE IN MEETING THE FOLLOWING GOALS?

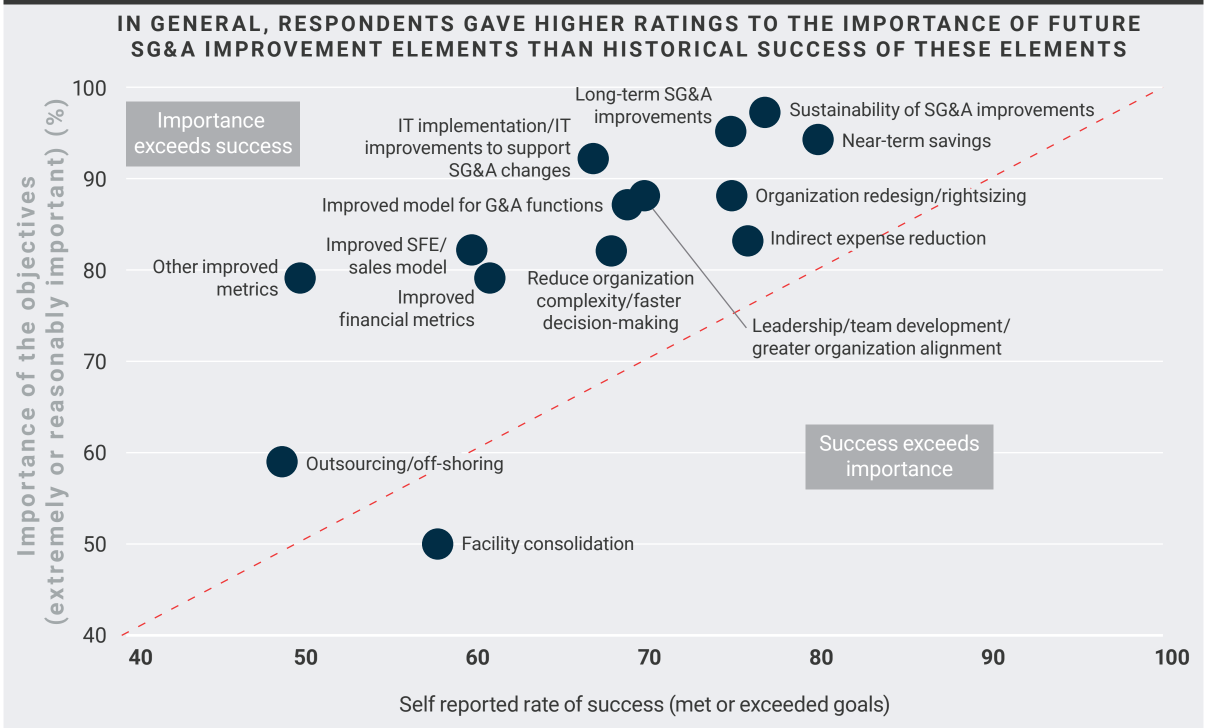

To gain additional insight into our survey respondents' overhead cost-management initiatives, we asked them for their assessments of their previous efforts as well as their thoughts on their overhead cost reduction plans going forward.

## PAST EXPERIENCE SHOULD INFORM FUTURE APPROACHES TO OVERHEAD COST INITIATIVES

They reported moderate success with the overhead cost reduction initiatives they had launched in the past, with near-term savings proving most successful and outsourcing/offshoring of selected G&A functions the most challenging (figure 8). Meanwhile, improvements in performance on financial metrics received less-than-stellar ratings, suggesting that many overhead cost programs deliver qualitative benefits rather than quantitative impact. Enterprises need to ensure that overhead cost savings materialize and are sustainable.

Executives placed almost equal importance on the sustainability of their overhead cost initiatives as they did on achieving near-term savings. Additionally, they apparently believe that these two criteria will be even more essential in the future. Indeed, achieving the objectives behind all of their future overhead cost reduction efforts seems more important than the successes gained from previous efforts (figure 9).

**FIGURE 9:** FUTURE OVERHEAD OPTIMIZATION EFFORTS MORE IMPORTANT THAN EVER




## NEXT STEPS FOR EXECUTIVES

Overhead cost improvement initiatives remain a critical item on nearly all business leaders' strategic agenda, regardless of their company's current performance. Growing companies are seeking to scale overhead to enable further growth. Stable companies with plateauing performance want to widen their profit margins through tactics including overhead cost reduction. And underperforming companies aim to increase efficiency to rebuild their earnings before interest, taxes, depreciation, and amortization (EBITDA) record. For enterprises in any of these categories, designing the right overhead cost structure to build a sustainable platform for future growth, combat competitive pressure, and manage rising labor costs remains a key CxO-level imperative.

Effectively managing overhead costs can help executives meet this imperative. But in the future, executing overhead cost reduction initiatives will be more challenging than ever. That's in part because businesses will need to strike a delicate balance between achieving near-term savings while also laying the foundation for long-term, sustainable gains. Moreover, the kinds of initiatives executives see as more critical for future cost reductions—including organizational realignments—also count among the most complex when it comes to execution.

Companies have been pruning their overhead costs for years now, and they've already harvested the low-hanging fruit. To make the sustainable overhead cost reductions needed to nurture fresh growth, they'll need to master a far more sophisticated approach. A

## CONTACT THE AUTHORS:

Michael Weyrich and Douglas Tsang.

## FOR MORE INFORMATION, CONTACT:

**Michael Weyrich**
Managing Director
+44 20 7098 7413
mweyrich@alixpartners.com

## ABOUT US

In today's fast paced global market timing is everything. You want to protect, grow or transform your business. To meet these challenges we offer clients small teams of highly qualified experts with profound sector and operational insight. Our clients include corporate boards and management, law firms, investment banks, investors and others who appreciate the candor, dedication, and transformative expertise of our teams. We will ensure insight drives action at that exact moment that is critical for success. When it really matters. alixpartners.com