

# SG&A Performance Management

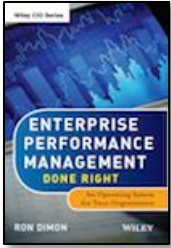
An Enterprise Performance Management Done Right Booklet

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## Who is this booklet for?

Everyone in the enterprise has an impact on SG&A expenses. From your salary, to the office supplies you use, to the travel you take on behalf of the company. It's everyone's job to help maintain and control these expenses. This booklet gives a background on SG&A performance management and explains some approaches to managing the impact that SG&A expenses can have in the organization. To that end, it will be especially useful for anyone in Finance, I.T. and business management – at all functions and layers of the organization. Hopefully, some of the ideas and approaches in this booklet will help you do your best thinking around optimizing SG&A expenses.

## What is SG&A?

Selling, General, and Administrative (SG&A) expenses consist of the combined costs of operating the company, which breaks down to:

- **Selling:** Cost of Sales, which includes salaries, advertising expenses, rent, and all expenses and taxes directly related to producing and selling product
- **General:** General operating expenses and taxes that are directly related to the general operation of the company, but don't relate to the other two categories.
- **Administration:** Executive salaries and general support and all associated taxes related to the overall administration of the company<sup>1</sup>

For companies that manufacture goods and services, these are sometimes referred to as nonmanufacturing overhead costs.

## Potential Areas for Improvement (SG&A accounts)

Depending on your industry, you may encounter some or all of the following SG&A expenses:

- Salaries and benefits for sales and administrative personnel
- Commission & Incentives
- Sales Headcount
- Channel Enablement
- Travel and Entertainment
- Professional / Consulting fees

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<sup>1</sup> Wikipedia - <http://en.wikipedia.org/wiki/SG%26A>

- Training expense
- Sponsorships
- Procurement (excluding materials/merchandise)
- Interest on business loans (depending on the size of business, this expense may have its own line item on the Profit & Loss Statement)
- Marketing and advertising costs
- I.T. expense
- Office supplies
- And the following expenses used by non-manufacturing functions:
  - Rent
  - Utilities
  - Insurance
  - Property Tax
  - Property, building, and equipment depreciation and maintenance

## **Sustainably managing SG&A**

SG&A Expenses help an enterprise deliver its objectives, including:

- Revenue Growth
- Operational Efficiency & Productivity
- Asset Utilization
- Cash Flow
- Customer & Employee Satisfaction

However, they should be optimized at the “right” level to help deliver on the promises of the organization. If they are at too low of a level, sales revenue could suffer. At too high a level, profitability could suffer. There are at least five approaches to impacting SG&A expenses, including

1. Removal and elimination of expenses
2. Reduction of expense amounts (partial elimination)
3. Reduction of expense frequency (partial elimination)
4. Avoiding incurring the expense in the first place (or avoiding future expenses)
5. Managing expenses in line with plans and expectations (controlling)

The goal is to get to the right level of expenses that allow the company to sustain growth (revenue) and be profitable (operating margin), while delivering goods and services that attract and retain customers.

## What's the potential impact of improving SG&A performance?

It's useful to take a holistic look at the organization and see how SG&A can have an impact in areas you may not have thought of. Using a 'value map' approach is one way to visualize what drives SG&A and what SG&A, in turn, drives.



In this value map we see that SG&A Expense has an impact on the amount of training delivered and that training can impact sales volume (sales training) and collections (negotiation training). If an investment is made in training in those areas, revenue can be expected to increase, and bad debt write-offs would decrease, which, in turn would improve the overall profitability of the business, and eventually would impact market share, brand, and other areas of the business. This is an example of a “self funding” SG&A expense.

This is just an example of how these value drivers may be interrelated in one particular organization, your drivers and connections (and business functions) may be different.

There are four performance management processes we can look at in more detail: gathering data (reporting), understanding that data (analytics), debating the right next course of action (what-if modeling), and making commitments for results (planning).

## Gathering Data

A good place to start in managing your SG&A performance is to find out where you're at. You'll want to look at your total SG&A expense broken-out by line item for the current period (year, quarter, month). This data is usually stored in the General Ledger (GL) or, if you are a larger organization, stored across multiple general ledgers and consolidated either in a consolidation system like Oracle's Hyperion Financial Management, or in a corporate or main GL, or in a spreadsheet.

### Turning data into useful information

While SG&A line items for current periods is good raw-data, it's more useful to turn this in to something that may be more meaningful. Your organization probably has reporting or business intelligence tools to help you do this. For example, if you can look at SG&A line items side-by-side for business units or various geographies, along with corresponding sales revenue for those units or geographies, you could look at a comparable ratio of expense as a percentage of sales. You could also do it by the headcount per region to look at "SG&A per head." This will help you look for averages and outliers. When you find an outlier, you'll want to ask why it's an outlier – which brings us to the next step.

## Analysis and Understanding

It's one thing to look at a static point in time – your current actuals – and another thing to look at how that has been varying over time. With historical data you can see how SG&A as a percent of sales is trending over time, by comparable business units or geographies.

You'll also want to look at how those ratios (SG&A/Sales and SG&A/Headcount) vary from the prior period and from plans and forecasts. When you find a wide variance over time and over expectations, you can ask why that was. Getting to the root cause of why there's a variance helps you uncover problems or circumstances that may be avoided in the future. Likewise, if you find excellent performance, you can uncover best practices that you will want to repeat in other areas of the organization.

If your organization has a good multidimensional database like Oracle Essbase, you can add additional dimensions of the data to analyze. A dimension is simply that thing that follows the word "by" when you want to look at information, for example:

- By Month, quarter and year
- By Actuals versus Plan
- By Business Unit
- By Region, by Product
- By Channel
- By Account

- By Employee
- By Customer Type
- By Customer

And so forth.

Another thing you can do in a multidimensional database is drill-down from a summary level into more detail. So you can start your analysis at total SG&A and when you find the hot spots, drill into those to look for root causes.

## What-If Scenarios

Another step you can take in your SG&A performance management journey is to take all the facts you learned in your analyses and use those to create “what if” models to see the impact of making financial and operational changes in the organization going forward. You can make simple models in a spreadsheet, or you can use more powerful modeling tools to develop more complex scenarios.

A good starting place is to ask “what-if” you change (increase or decrease) the key drivers uncovered when you did the value map earlier. For example, what if you increase headcount by 10%, what’s the corresponding increase in SG&A (using SG&A as a percent of sales uncovered earlier), in sales revenue, and, eventually, in operating margin. With some models you have to make assumptions – perhaps ‘ramp time’ in this example, the time it takes to get a new sales rep performing to quota – so long as you expose those assumptions so they can be challenged. A great way to challenge an assumption is to go back and analyze the data you have and uncover the facts instead of guessing.

Modeling a scenario is a great opportunity to debate what initiatives should be adopted by the organization. Ideally, you’ll have a fact-based debate to arrive at the best scenarios.

## SG&A Performance Management Initiatives

In looking for actions and initiatives you can take to improve SG&A performance, there are several ingredients to consider, including:

- People – who will be impacted by new actions?
- Process – how will you do things differently?
- Tools/Technology – what tools can you use?
- Data – what data and information do you need?

Here are some options for each ingredient to help you think about designing your initiative:

People	Process	Tools	Data
Hiring	Centralize	Dashboard	Actuals
Reduction	Decentralize	Spreadsheet	Prior Period
Training	Automate	Repository	Historical
Certification	Speed-up	Portal	Plan / Forecast
Outsourcing	Slow-down	Database	Variance
Expertise	Customize	OLAP <sup>2</sup>	External
Rewarding	Standardize	Simulation	Unstructured
Accountability	Rationalize	Social Media	Statistics
Responsibility	Remove steps	Mobile Apps	Competitive
More junior	Combine steps	Modeling	Benchmark
More senior	Gamify <sup>3</sup>	Alerting	Internal / External

### The Scope of an Initiative

For each SG&A improvement initiative, consider the scope of its impact. Or another way to say that is to think about who is involved. You can include:

- A person or team
- One or more Departments
- A Group (e.g.: a region, an office, all senior managers, etc.)
- The Company
- External parties

### Prioritizing Initiatives

In a good brainstorming session, it's not unusual to come up with dozens of possible actions or initiatives that will positively impact SG&A. So how do you prioritize those and find out which ones to do first? The easy answer is that you need some criteria for prioritization. The hard answer can be coming up with those criteria. Some organizations just want the fast and cheap ones, some want the ones with the largest long-term benefit, but usually, we find that the following to be a good place to start: Value to the business, and Ease of Implementation.

Value to the business is usually ranked on a materiality scale, meaning which initiative will have the highest positive impact on revenue or margin. However, other factors can be used to gauge value including customer satisfaction, share price, or overall impact to the most parts of the organization.

Ease of implementation can include a variety of factors like availability of systems, quality of data, and organizational readiness.

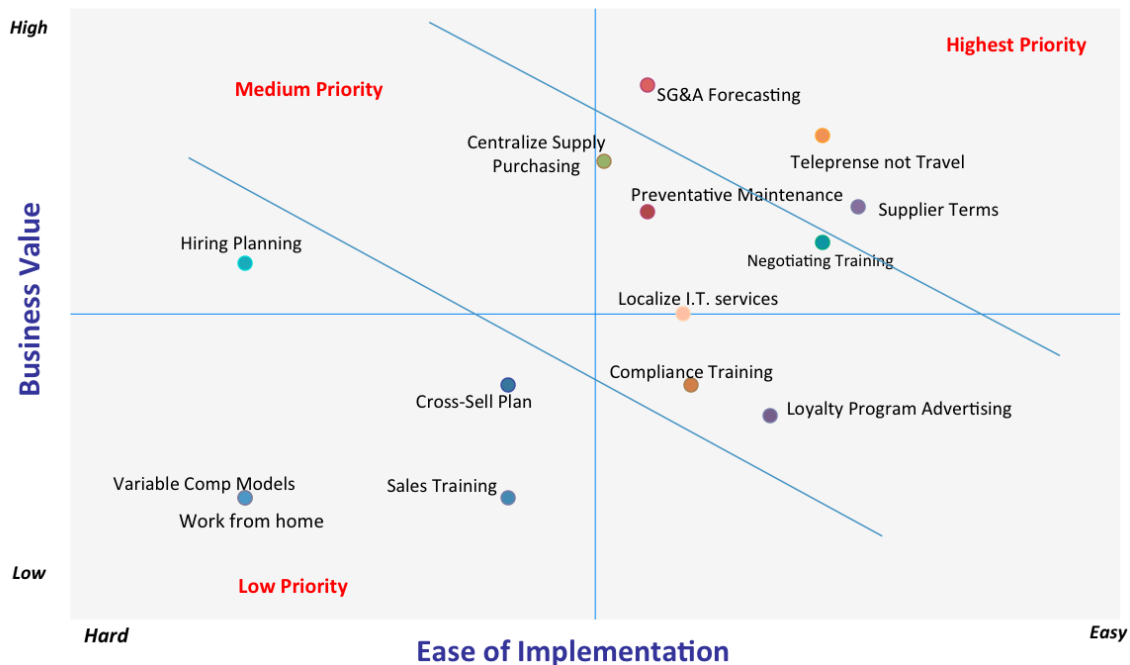
<sup>2</sup> OLAP stands for On-Line Analytical Processing and is also know as a multidimensional database or a "cube." Think of it as a pivot-table on steroids.

<sup>3</sup> Gamification is the process of adding game-like features to a process, including awarding points, ranking players, and increasing difficulty of challenges.



A good process for coming to consensus is to score all of the initiatives across each of the ‘value to the business’ and ‘ease of implementation’ criteria, and even to weight those criteria.

The consensus debate is generally revealing and useful in itself. Here’s a sample output from one prioritization process:



After debating and plotting each initiative, three strata were created to further divide the initiatives into high, medium, and lower priority since the organization had limited resources to tackle more than a few initiatives at once.

### Making and Tracking Commitments

Once you’ve agreed on the right initiatives to tackle, your project management expertise will kick-in to ensure execution. One final step in SG&A performance management is to document the expectations and commitments made by the accountable parties. This is best done in a plan with targets and a forecast to track progress against plan. In order to have targets, you’ll need to quantify what results the initiative is expected to deliver.

For example, if your initiative is to use video conferencing or telepresence capabilities to replace some travel expenses, one of the highest priorities in the example above, you will need to quantify:

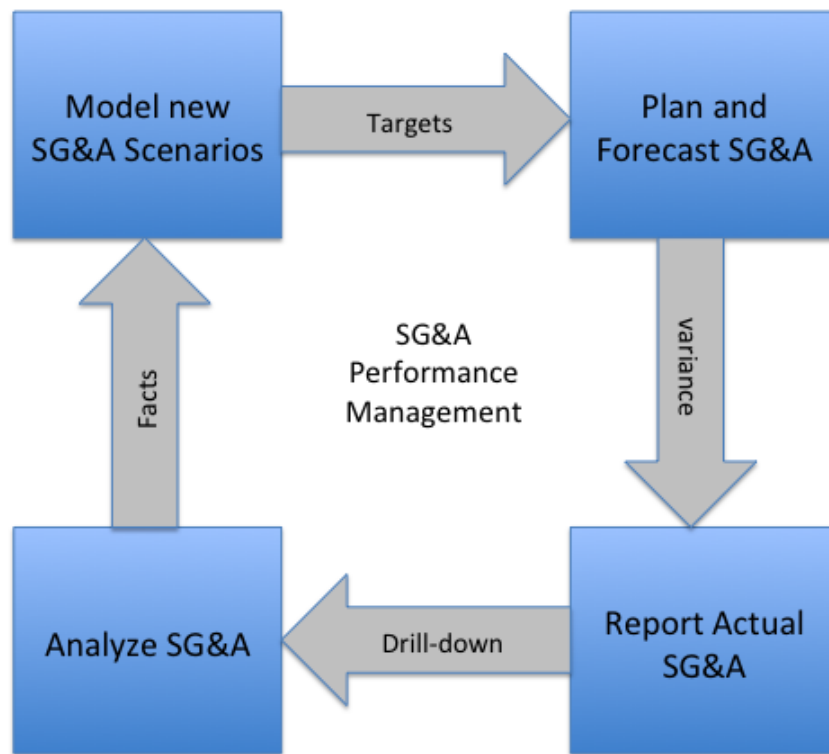
- The cost to acquire (rent or buy) and use (operate) and support the new capabilities
- The number of people who will be required to use video instead of air travel
- The expected reduction in travel expenditures



Then each of those targets will be spread by month and by business unit and/or department to create more granular sub-targets. This becomes the plan and concerned parties work the plan. Each month actual results are reported against the plan, and the concerned parties may have an opportunity to forecast what they think will happen for a certain time period in the future. By looking at the variance of actuals plus forecast against the plan, and drilling into the details, you'll be able to manage departments to their commitments.

## Summary

Managing SG&A Performance is a process. Each of the steps above is not done in isolation, and each depends on the other for a system of performance management. It looks like this:



And SG&A Performance Management answers the questions:

- Where are we now? (Reporting)
- Why did we get our results? (Analysis)
- What can we do about it? (Modeling), and
- Who is going to do what, by when? (Planning)

Hopefully this booklet can help you in thinking about ways to improve SG&A performance sustainably and continuously and make an impact on your organizations' profitability.

If you would like more information, read "Enterprise Performance Management Done Right" (John Wiley & Sons, 2013) available on amazon.com or visit <http://www.rondimon.com>

