Complimentary Research

G&A ORGANIZATIONS HAVE FAILED THE AGILITY TEST

New data shows that G&A organizations at Global 1000 companies have been unable to keep costs in line with dec revenues

Management Issue

By Michel Janssen, Gene Sheikh and Sean Kracklauer

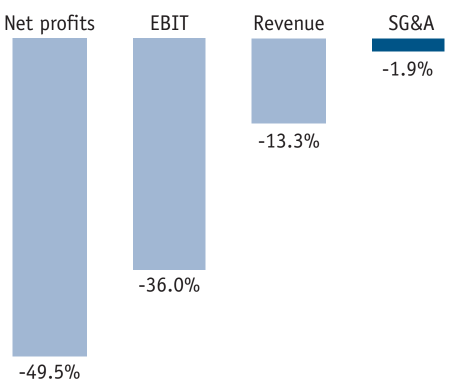
G&A Agility Defined

Defined broadly, G&A agility refers to organizations' ability to respond to changes in the economic conditions and/or business strategy.

From an expense basis, an organization should be able to rapidly reduce its overall G&A cost structure to match a 10%-35% revenue reduction within a 6-24 month time frame depending on industry, while maintaining acceptable service levels.

From a qualitative/market responsiveness basis, companies should be able to stay ahead of the curve in terms of overall G&A productivity improvements; match, exceed or lead industry-specific competitive advances in the business model; and react quickly to acquisitions or divestures by the business.

FIG. 1 Percent change in Global 1000 companies' key financials, Q1 2009 vs. Q1 2008



Note: n=496 of the Global 1000 organizations as we eliminated companies that have not reported 1Q-09 results yet or had missing and/or incomplete SG&A data

Source: Capital IQ; The Hackett Group

EXECUTIVE SUMMARY

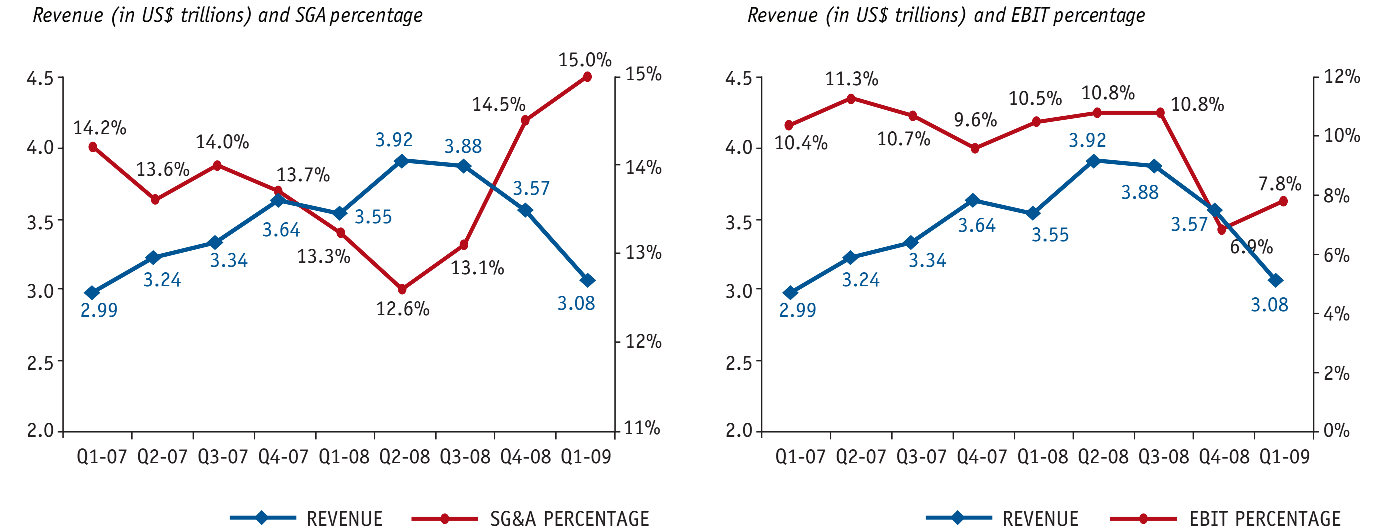
Unprecedented declines in consumer demand, heightened business uncertainty and intense global competitive pressure are testing the agility of G&A organizations as never before. What companies have experienced during this recession has forever changed the business environment as we know it. However, new Hackett research reveals that G&A organizations by and large have failed to demonstrate the appropriate agility to respond to the rapidly declining revenue trends and avoid being a drag on profits: Between Q1 2008 and Q1 2009, Global 1000 companies saw their revenues decline by 13.3%, while their SG&A costs declined by only 1.9%. Since one proven approach to increasing agility is optimization of their global G&A service delivery, executives should take action immediately to define and develop an appropriate Service Delivery Model for G&A.

FEW G&A ORGANIZATIONS ARE AGILE ENOUGH TO MEET TODAY'S BUSINESS CHALLENGES

Once the recession eases and growth returns, revenue will no doubt be tougher to win back as the world becomes more efficient, increasingly borderless and more competitive. Complicating this situation is a shift of the total economic pie away from North America and Europe, foreshadowing a period of slower growth in these regions in favor of higher growth in developing and emerging markets, primarily in Asia.

For G&A organizations, these trends point to a need for greater agility and a significant rethinking of their back office or G&A Service Delivery Models. At a time when agility is proving to be a primary competitive weapon, new Hackett research shows that most G&A organizations are burdened with inflexible contract commitments, which do not properly leverage economies of skill and scale, and lack global and regional standards. Between the first quarter of 2008 and the first quarter of 2009, Global 1000 companies saw their revenues decline by 13.3%, while their SG&A costs declined by only 1.9%. Moreover, SG&A costs played a disproportionate role in driving profits down relative to declines in revenue **(Fig. 1)**. We refer to this disparity of 11+ percentage points between the drop in revenue and the drop in SG&A expenses as the Hackett Agility Gap. We expect that this gap will only widen as revenue declines are further highlighted when Q2 and Q3 results are reported.

FIG. 2 Global 1000 G&A organizations lack agility and that is costing real money



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Source: Capital IQ; The Hackett Group, 2009

The G&A Service Delivery Strategy and Service Delivery Model

G&A Service Delivery Strategy (SDS) is defined as an organization's Service Delivery Model requirements based on the organization's overall business plan with the appropriate agility that allows an organization to plan for rapid planned or unplanned events. The SDS defines what work gets executed where, how and by whom and the plan on how to get the organization's G&A infrastructure to the desired cost, service level and agility requirements that allows G&A to strategically enable a business.

The G&A Service Delivery Model (SDM) is an integral part of the SDS and includes the organizational model, technology platforms, function sourcing model, service placement strategy, end-to-end process design, governance model, and talent strategies needed to deliver G&A services efficiently and effectively.

Service placement and management are critical components of the SDM, defining which G&A processes are executed at the corporate or business unit level, or via self-service or leveraged services (Global Business Services).

New Hackett research reveals that few G&A organizations are agile enough to keep pace with broader revenue trends in the marketplace **(Fig. 2)**. This lack of agility is evident in all major regions of the world, in year-over-year comparisons, and across all major industries.

The challenge for G&A has been especially acute for US and European organizations, where declines in revenue have been the sharpest. During the fourth quarter of 2008, many organization responded by freezing discretionary spend and/or making across-the-board cuts.[1] While the economic picture remained murky throughout the early part of 2009, as we move into the second half of 2009 we now have a pretty good idea of the magnitude of the drop. Most senior executives have reconciled themselves that any eventual market comeback may be protracted, making it essential to shape their G&A organizations in a way that will help them be competitive within the context of the new global operating environment. This reality has led most G&A leaders to plan for the worst and hope for the best but more importantly, also requires them to rethink their G&A Service Delivery Model as they deal with the tactical requirements brought by declining and volatile revenues.

We believe that from Q2 2008 to Q2 2009, we will see the Hackett Agility Gap expand substantially as companies experience an even steeper drop in revenues on year-over-year basis – which will further highlight and put even more cost pressure on G&A functions. We also believe that many cost reductions actions have been taken without a clear and documented changes in service levels that resulted from the abrupt reduction in cost structures. Service level reconciliation will prove to be another issue that companies will have to address during this transition period.

[1] "Finance: 51 Ways to Take Action and Respond to Recessionary Conditions," *Hackett Executive Insight*, December 2008

Agility is a design criterion

Hackett analysis shows that maximum agility is possible only with a holistic, well-defined and developed G&A Service Delivery Strategy (SDS). One of the most important elements of such a strategy is to have specific design criteria that enable swift, appropriate realignment of G&A cost structure as marketplace conditions change.

To improve agility and bring costs more in line with revenue, strategies that leverage globalization and shared services are necessary – but not in themselves fully sufficient. In conjunction with the SDS, the Service Delivery Model (SDM) should address all aspects of G&A efficiency and effectiveness.

G&A agility is not accidental

Coming into this latest round of economic uncertainty, only a few companies had well-defined plans for their G&A organization in the event of a serious business downturn. While few to our knowledge anticipated the magnitude of the downturn, those that had prepared were able to move quickly and decisively – in other words, they were more agile.

To understand what agility meant for Caterpillar – the world's largest maker of construction and mining equipment, diesel and natural gas engines, and industrial gas turbines – consider this April 2009 statement from Jim Owens, Chairman and CEO, relating to the company's plans for working through what it calls a "trough":

> "Our trough planning was designed to reduce period cost by 20%-25% within in a year. We've essentially taken that much out in four months, and you'll see more in our second quarter run rates...Our first-quarter results and our outlook for the year are benefiting from the trough plans we put in place and have worked to refine since 2005..."

Agility is more than a math exercise

Notwithstanding the need to react to changing cost structures, there are qualitative aspects of agility that should not be ignored. Qualitative agility can take many forms and requires participation of every G&A function. For example, HR must change its workforce profiles in new locales around the world, which allows for quick ramp up or contraction. Procurement must evaluate new and different supply chain risks that provide for rapidly changing demand planning requirements. IT must architect an IT infrastructure that allows it to deal with demand changes. And, finance must strengthen its capabilities so it can support different types of business analytics, including cash forecasting, customer creditworthiness and business forecasting. These types of agility factors represent large opportunities for the organization because they transcend actual G&A spend and can be a critical multiplier of the overall success of the business.

In short, G&A organizations have largely failed the agility test to date from both the cost and service level requirement perspectives. For G&A leaders, the real work lies ahead. Systemic changes are needed to create a new sustainable environment that is tuned to world-class levels of efficiency and effectiveness.

So What Can You Do Right Now to Create Agility for Your Organization?

Agility implies action. But action without the right plan often leads to regrets. The simplest starting point is to build a principles-based set of design criteria for change. This doesn't have to be a lengthy process but it needs to be well thought-out and agreed to by the executive team. Some parameters for this first step include:

- What is the right amount of spend and what are expected service levels for the G&A function?
- How much of the cost structure should be variable (both up and down) in nature?
- Are we willing to tackle tough issues regarding prior organizational decisions that may have created suboptimal operating structures?
- Are we willing to stop providing some services currently being offered?
- Can we change the way we interact with clients and/or suppliers?
- How much change can the organization absorb and how fast?
- What is our tolerance for investment and what is the required payback period?

Setting boundaries around these types of parameters makes specific initiatives that impact the Service Delivery Model much less emotional. By starting with principles, and making tough decisions based upon those principles, the path often becomes clear for the entire leadership team in the context of your Service Delivery Model. All organizations will need to build an execution pathway that divides initiatives between short and long-term impact, given where they are in their journey to world-class, the maturity of their processes, and the overall willingness of the executive team to implement change.

Based on Hackett's market research and work with leading companies, we have compiled a list of actions companies are taking now to improve their G&A agility **(Fig. 3)**.

The question you should ask yourself is, "Which of the above initiatives are right for my organization?" Hackett believes all of the above initiatives have the potential to improve G&A agility significantly if pursued in the context of your overall Service Delivery Model. And finally, agility is not just about the numbers. It is just as much a mindset of flexibility and enablement for the G&A functions in meeting the business requirements of the organization.

FIG. 3 Top actions to drive G&A agility improvements

Type	Actions
Structural	**Increase economies of scale and skill -** Take full advantage of economies of scale/skill by reassessing your leverage model, expanding process, functional, technology and geographic scope; optimize work into Global Business Services/shared services, Centers of Excellence, etc.
	Reduce complexity - Extend end-to-end process design and standardization from upstream local support/vendors through delivery of services.
	Reevaluate process sourcing mix - Expand usage of captive offshore centers and find appropriate balance of insourcing versus outsourcing to reduce cost of service.
	Restructure the talent mix - Set and enforce broader spans of control; cross-training/generalists; more targeted use of specialists; formalize talent management programs; extended contingent labor mix.
Operational	**Rationalize service levels -** Map and rationalize customer requirements against revised budgets; develop new service levels expectations that are both acceptable and sustainable.
	Reprioritize business investments and capital expenditures - Prioritize where to invest now and what to stop.
	Renegotiate or optimize third-party contracts - Create variability of contract structures for ITO/BPO, real estate, and technology implementations; look at all contracts for price and/or terms improvements.
	Centralize spend - Compel usage of global agreements with suppliers for price concessions, standardization of terms, vendor rationalization for efficiency gains.

Source: The Hackett Group

Strategic Implications

The global economy has sustained a traumatic shock, and more should be expected. The challenge is not knowing where they will come from: a large devaluation to the dollar, a debilitating strike in a vital area of the economy, an unexpected war, changing governmental policies, or all of the above?

Regardless of what happens next, G&A organization need to be prepared and agile. At a minimum, make sure costs are in line with new realities. Instead of playing catch-up, G&A organizations should focus on lowering costs and driving effectiveness through a holistic approach to optimize service delivery. If done well, G&A can actually be a strategic enabler through optimization of its Service Delivery Strategy and Service Delivery Model.

Related Hackett Research

"Without the Appropriate G&A Service Delivery Strategy, Companies' Ability To Be Truly Optimized Is Lost," May 2009

"Finance: 51 Ways to Take Action and Respond to Recessionary Conditions," December 2008

About The Hackett Group

The Hackett Group, a global strategic advisory firm, is a leader in best practice implementation, advisory, benchmarking, and transformation consulting services, including shared services, offshoring and outsourcing advice. Utilizing best practices and implementation insights from more than 4,000 benchmarking engagements, executives use Hackett's empirically based approach to quickly define and prioritize initiatives to enable world-class performance. Through its REL brand, Hackett offers working capital solutions focused on delivering significant cash flow improvements. Through its Hackett Technology Solutions group, Hackett offers business application consulting services that helps maximize returns on IT investments. Hackett has worked with 2,700 major corporations and government agencies, including 97% of the Dow Jones Industrials, 73% of the Fortune 100, 73% of the DAX 30 and 45% of the FTSE 100.

Founded in 1991, The Hackett Group was acquired by Answerthink, which was renamed The Hackett Group in 2008. The Hackett Group has global offices in the United States, Europe, Australia and India and is publicly traded on the NASDAQ as HCKT.

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Mr. Janssen is responsible for analysis, thought leadership and research activities for The Hackett Group's advisory programs. In addition, he leads the firm's efforts in advising clients on world-class sourcing and outsourcing. During a career spanning over two decades in outsourcing leadership positions, he has been a major contributor to the industry's development and designed strategies for creating effective relationships between service organizations and their clients in a wide range of industries and business processes. Prior to joining The Hackett Group, he was president of Supplier Solutions for Everest Group, a consultancy specializing in strategic, management and transactional advice to buyers and suppliers of outsourcing services, and co-founder of the Everest Research Institute. In addition, he provided strategic oversight for Everest Group's Outsourcing Center, the world's largest outsourcing community and vehicle for identifying early industry trends. Previously, he was a senior director in Gartner Group's strategic sourcing practice and held numerous management positions with EDS.

Gene Sheikh

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Mr. Sheikh is responsible for leading The Hackett Group's finance executive and research agenda across a range of issues in finance, including transformation, business insight, globalization, partnering and talent management. Previously, Mr. Sheikh spent a number of years in strategy consulting at A.T. Kearney and Bain & Company as well as in industry with GE Healthcare and United Airlines. While at Bain & Company, he developed corporate and growth strategies for Fortune 100 clients in the US and Asia, advised private equity firms on M&A strategy and performed strategic due diligence.

Sean Kracklauer

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Until his appointment to head The Hackett Group's Research and Advisory Services, Mr. Kracklauer led the company's Finance Transformation practice, where he was responsible for assisting CFOs and other senior finance executives with setting strategy, structuring organizational and process redesign, and implementing solutions to improve the effectiveness and efficiency of the finance organization. He has held consulting and executive financial management positions in the financial services and technology industries over the past 19 years. His expertise includes Sarbanes-Oxley Section 404 compliance, finance and accounting business process outsourcing, rationalizing accounting operations processes, finance strategy, business performance management, planning and budgeting process redesign, activity based management, and functional design for business intelligence systems.