A crisis presents unique challenges in making wise spending decisions. Zero-based principles can help leaders move SG&A investments where they should be—rather than where they have always been.

by Ankur Agrawal, Stefon Burns, Kyle Hawke, and Matt Jochim
The humanitarian cost of COVID-19 continues to unfold across the globe, affecting lives and livelihoods. Organizations are reassessing almost every aspect of their operations, asking urgent questions about how to allocate and deploy limited resources amid extraordinary stresses.

As the crisis evolves, with uncertain timelines and an unclear path to recovery, leaders are responding on multiple fronts simultaneously—working to safeguard their employees and customers and to understand significant volatility in demand, supply, and cost.

To support their businesses in the short term—and, ultimately, enable a recovery in the long term—organizations will need greater operational and financial flexibility. That will mean looking for opportunities both to preserve cash now and to be ready to reinvest nimbly for the future.

This requirement is leading CFOs to rethink how they can manage their sales, general, and administrative (SG&A) activities to identify opportunities for realigning spending in a rapidly changing business environment. Within separate business functions, leaders are also balancing the immediate need for resources against the longer-term need to build and maintain capabilities critical for a recovery, all while ensuring that their spending aligns with their corporate purpose and their many responsibilities to employees, customers, and communities.

One business leader noted that the easy decisions, such as those relating to travel and events, have already been made (or taken out of businesses’ hands completely). By contrast, the majority of spending choices involve harder trade-offs, requiring new levels of visibility, governance, and thoughtful discussion so that leaders can align on priorities in making some of the most consequential decisions they are likely to face.

Lessons from resilient leaders
In 2019, our colleagues demonstrated that resilient companies—those that most successfully weathered the 2008 downturn—moved faster to create balance-sheet flexibility than their peers, and then accelerated faster as economic conditions showed signs of recovery. They achieved three times the improvement in operating expenses as a percentage of revenue than their “nonresilient” peers, and did so substantially earlier, “saving their powder” and preserving capacity to invest in growth, while keeping SG&A in line with sales as revenue fell. Additionally, most companies classified as resilient stand apart from peers on multiple financial and operational metrics through both downturns and recovery, including revenue and earnings before interest, taxes, depreciation, and amortization.

Building on experience from prior downturns, and recognizing the unique characteristics of this global crisis, we suggest a four-phase approach to help organizations respond to COVID-19–related shocks and the potential for prolonged economic uncertainty across the SG&A spend base. By utilizing some of the core principles of zero-based productivity, the approach enables increased spend visibility, enhances spend-management mechanisms, and improves the links between business strategy, financial forecasting, and frontline spending.

The four phases correlate to the stages we expect companies will follow as they find their paths to the “next normal” (Exhibit 1). In “resolve,” companies manage an immediate reduction in spend. In building “resilience,” organizations enable better spending choices by a deeper understanding of trade-offs. The “return” phase shapes longer-term reallocation and investment. Finally, “reimagine and reform” builds on new capabilities and knowledge to create a healthier long-term approach to SG&A.

Resolve: Preserve savings
At this writing, many cities, states, and entire countries are currently under policies to shelter in place or stay at home, with varying levels of stringency. As a direct result, organizations are seeing an immediate reduction in some areas of spending due to lower activity levels from both employees and customers.
Reviewing all sales, general, and administrative investments helps leaders make conscious, strategic choices.

Sales, general, and administrative investments, illustrative, indexed to 100

Perhaps the most glaring example is travel spend, which has become effectively zero for many companies. Requirements for facilities maintenance and utilities are falling almost as quickly, as offices close and increasing numbers of people work remotely.

By taking quick steps to increase spend visibility, finance leaders can capture and preserve these savings—perhaps to fund immediate needs such as for new worker-safety measures—before they are absorbed elsewhere in the organization.

**Resilience: Understand short-term spending trade-offs**

A second set of spend categories within SG&A functions will also be affected by the crisis, but will not ebb on their own because the connections between the demand drivers and the resulting spend are not as straightforward. Instead, these categories will require a more involved set of choices about how to allocate resources—with a view not only to the immediate crisis but also to enabling longer-term changes as well.

In areas such as marketing, where return-on-investment (ROI) models often exist, a data-driven approach can inform decision making. For example, some campaigns, tactics, and brands that are no longer profitable will be easy to pause. Similarly, for products where volatile demand is outstripping available supply, uncommitted promotional spend can be curtailed. ROI-driven marketing models can also be used to reallocate investments across channels and geographies as consumer sentiment changes in specific markets.
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In the same fashion, investment in IT will likely need to be readjusted to free up resources in line with demand. Most large organizations are seeing major increases in demand for cloud computing, videoconferencing, and other remote-work technologies. Additional support may also be required for virtual selling channels as stores remain closed or salespeople are unable to meet with customers.

To sustain greater flexibility while making spending choices, organizations will likely need a mechanism for challenging spending requests—including those that are usually preapproved—based on a rigorous, ROI-focused process. These practices will reveal fast opportunities to implement shifts in strategy and policy as the crisis continues to unfold.

One organization recently launched a centralized spend-management team across its wide and distributed network of manufacturing sites. At each location, representatives from finance and procurement serve as spend challengers whose task is to question proposed allocations to make sure that each one has a thoughtful supporting ROI case. After remote training, the challengers now join daily videoconference sessions to review purchase requests across all indirect-spend categories. Purchase orders are approved, deferred, or denied based on rationale and criticality, freeing up resources almost immediately.

Through a similar process, organizations can challenge service levels across SG&A functions, embracing a zero-based approach by linking requests to essential requirements rather than the previous budget allocation.

**Return: Make long-term resource-allocation choices in recovery**

As the weeks and months progress, a recovery will ultimately appear on the horizon. Organizations will start to move beyond day-to-day crisis management, creating an opening to focus on decisions about how to reallocate resources to support recovery. One executive recently said, “Coming out of this, I want to put resources where they should be, rather than where they have always been.”

The strategic implications from longer-term application of zero-based approaches will naturally vary, but a few examples have repeatedly proved fruitful for businesses facing dramatic changes in their competitive situations.

— Shifting from fixed to variable-based arrangements with external service providers allows for increased flexibility and agility as revenue uncertainty continues. When revenue outlook becomes more certain, these shifts could be reserved, reverting to more dedicated structures.
— Rethinking the balance of dedicated external sales staff and inside sales teams to focus higher-cost resources on the higher-value interactions and potentially reduce cost.

— Reevaluating service models, such as by creating tiered service levels (gold, silver, bronze) for different parts of the business. The team responsible for contract management, for example, would automatically route requests from sales teams serving key accounts to the highest-level service team, while requests from sales teams serving smaller customers would be routed to a self-service option based on contract forms.

For example, one company—with a postcrisis reallocation in mind—has scaled its reskilling initiatives with a focus on known areas of future investment, expanding its curriculum for customer-service managers to cover new digital and analytics capabilities. This first wave of trainees will form a stable future pipeline of shared-service-center managers, who will be well equipped to lead the updated function as the business emerges from the crisis.

Reimagine and reform: Reset the approach to SG&A

With volatility already a rising concern for leaders over the past decade, the likelihood that reverberations will become part of the normal course of business seems high. Companies that realign their SG&A management can build in even more flexibility and resilience. This is a time to codify innovation into entirely new ways of working, based on robust, virtual working capabilities, strengthened collaboration tools, and expanded channels and modes of communication.

To sustain new ways of working, managers will need to develop and deploy talent more effectively, such as through targeted, accessible, on-demand capability building to help teams work better in a remote environment. Managers themselves will likely need new training to oversee centralized pools of employees, replacing the duplicative “shadow functions” structure in which business units staffed their own HR, IT, or legal teams, often in addition to headquarters functions. And for everyone, opportunities for up- and reskilling will aid retention and transition as redesigned processes enable people to focus less on repetitive, low-value-added tasks and more on valuable decision-focused skills.

The final move to consider is to align incentives and role-model new practices. At one organization, a finance director took on a “cost category leadership” role to demonstrate the behaviors expected from other leaders. While her role was focused on optimizing spend in the category she led, she talked regularly with individual team members, sharing best practices, communicating challenges to senior leadership, and celebrating achievements so that everyone in the organization could see that the way people worked was really changing—and that everyone from the top team down thought the changes were important and valuable. Other organizations add a new budget-transparency component to their core performance-management systems, so that new behaviors and mechanisms are maintained postrecovery and reset cultural norms.

Shift the operating model

To implement the new methods described above, three shifts in financial-planning and performance-management processes can help. These relate to spend visibility, budgeting, and resource reallocation (Exhibit 2). Across all three of these is one common theme: move SG&A investments where they should be—rather than where they have always been.

Improve spend visibility

Too often, corporate leaders have only limited understanding of what their organizations are really spending on. This is partially due to IT and financial-planning systems, and partially to a reluctance to share details by the people most directly responsible for costs—the cost-center owners.
But better visibility leads to better dialogues, choices, and trade-offs. The best type of visibility is always forward looking, so managers can make better decisions on spending before it occurs. Looking backward (for example, at budgeted amounts versus actual spending) is also helpful, as this visibility leads to a better understanding of any variances in budgets or plans. That helps cost-center owners develop action plans for future spending.

Achieving better visibility can be as simple as defining standard forecasting templates or tools, which are easy to aggregate and make comparisons across functions and geographies. The inherent uncertainty surrounding COVID-19 suggests that planning processes would ideally incorporate several forecasted scenarios. Nevertheless, with consistent application of the templates and tools across the scenarios, a simple set of key performance indicators can allow leaders to identify outliers, ask questions, and probe on granular investment decisions. This is in contrast to a black-box process, where forecasts are reviewed for SG&A in total at the business-unit level, and only compared to the prior year.

Move toward zero-based budgeting
The second enabling shift allows for budgets and forecasts that work from the bottom up to identify what is required to meet current internal and external demands, especially when those demands are frequently changing. This can take one of two forms: a driver-based plan or a zero-based plan.
Driver-based plans are helpful for indirect spend and transactional activities where a productivity rate can be defined. A driver-based plan takes three inputs—the volume demanded, a rate of productivity, and a price per unit—to calculate the budget automatically and adjust the plan as volume changes. For example, a telecommunications company used a driver-based plan to model how many outsourced call-center agents would be required as call volume increased and decreased. An automotive-distribution company is using a driver-based plan to flex their driver and fleet capacity as volume declines in the near term and comes back in the recovery. In both examples, the companies have effectively merged their financial and operational plans to eliminate duplicative work and keep the two plans in sync.

A zero-based plan is relevant for more strategic and discretionary activities. A zero-based plan means truly starting with a clean slate, with no reference point or other inputs, which forces the manager to define what they truly need. For example, an appliance manufacturer is using a zero-based budget to define, force-rank, and prioritize all outside services spend. This organization started by asking cost-center owners to plan all one-time projects from a cleansheet and do their own prioritization. This function-level prioritization was then aggregated for the executive team to review and decide how to allocate scarce financial and human resources. In this example, the executive team defined multiple thresholds that allowed them to pull back or further invest as market conditions evolved.

**Dynamically reallocate resources**
The final operating shift required is toward dynamic resource reallocation, which requires cost centers to plan in two steps: first, only for their bare minimum needs, and second—separately—for value-added investments and strategic initiatives. This simple change enables decisions to be made as business scenarios unfold, so that management teams can promptly defer, pause, or accelerate strategic initiatives. It is also powerful in unlocking the tight grip managers hold on their budgets, and identifying which spend is truly discretionary.

In the first step, managers identify what is required to “keep the lights on,” using a simple but clear definition. For example, “If I don’t spend this for two years, will we lose significant sales or market share?” In the second step, managers propose value-added activities, including both cost and benefits (financial or otherwise). These are aggregated and compared across the enterprise to make choices, and accept the implications.

Some companies choose to implement an “investment pool” approach. The executive team can make allocation decisions from a central pool of funds until they run out of good ideas or the fund is depleted. The first step is done annually to minimize work for the organization, and the second step is typically done on a quarterly (or even monthly) basis to fund new priorities as they come up throughout the fiscal year.

Other companies find a more workshop-driven approach to be helpful to create alignment. For example, the CEO of a European consumer-products company convened the leadership team for a series of full-day working sessions to discuss productivity proposals across businesses and functions, including the appropriate level of ambition, recommended changes, and implications across the business (such as for new processes, service levels, and ways of working). The team reached consensus on everything from harmonizing disparate management-report formats and changing the frequency and granularity of business-forecast updates to the role that HR business partners should play. The outcome was an aligned view of how the team would run the business going forward—and the productivity improvements they would be accountable for (collectively and individually) as a result.
These sorts of changes are best supported by a compelling change story that helps managers see how their actions support enterprise priorities when they might conflict with function-specific ones. At one industrial company, this was supported under the banner of “margin resiliency” and a series of communications to show how individual actions could allow the enterprise to emerge from the crisis stronger than they were coming in.

The current crisis has sharpened the imperative for CFOs to drive SG&A cost transparency and capital preservation. And while aftershocks and uncertainty will likely continue in the short term, organizations should remain vigilant and hopeful, identifying spending opportunities, making short- and long-term spending choices, and resetting their cost bases—guided by the operating-model foundations of better spend visibility, zero-based budgeting, and dynamic resource reallocation.

A crisis presents unique challenges complicated by uncertainty. Zero-based principles can help organizations thoughtfully align on what’s important and put SG&A investments where they should be, rather than where they have always been.

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The authors wish to thank Brooke Daniels, Denis Fomin, Abhishek Shirali, and Jason Wright for their contributions to this article.