

# OVERPAYING ON SG&A IS A SILENT KILLER FOR OIL FIELD SERVICES EBITDA

By Joseph Morrison

Oil prices have experienced a resurgence as of late from the January 2016 low, but with the common volatility of oil prices, the current increase may or may not hold. The increase in oil prices also does not guarantee that oil field services will be able to raise prices to keep pace. In these uncertain times in the market, oil field service companies should assess their Selling, General and Administrative Expenses (SG&A) efficiency and effectiveness to stay competitive. Additionally, this is an opportune time to reconfigure SG&A to be scalable to maximize EBITDA should this price rebound hold.

By identifying SG&A overspending, evaluating the root causes of that overspending and applying suitable cures, oil field service companies can improve their EBITDA in this volatile market.

## How Do You Know If Your Company Has an Issue with SG&A Costs?

There are many internal and external symptoms of overspending on SG&A expenses. Some of the most common symptoms of overspending are:

**Financial stress.** The most common way to identify financial stress is by examining financial results at a department level after proper allocations to determine true EBITDA. Then, SG&A should be reviewed as a percentage of revenue against the industry average.

**Disparate processes between organizations.** Identifying disparate processes between departments requires an understanding of how your company functions, mapping the process flows of each department, and examining places where there are breakdowns that cause manual work and workarounds within each department.

**Ineffective or inaccurate reporting.** Ineffective reporting is often evident when leaders either receive multiple reports with the same information or when generated reports are not reviewed. Inaccurate reports are often discovered when different departments within the same umbrella show different results from different systems. The groups must then come together to reconcile the disparity.

**Financial surprises.** Quarterly and annual SG&A spend above budget can be a sign that the department is adding temporary or overtime labor and therefore does not have scalable or effective processes.

## What Are Some of the Root Causes of SG&A Issues?

Depending on which types of symptoms are being displayed, there are several potential causes, including:

**Inefficient services.** Often a lack of centralized services causes redundancies throughout the different departments. Companies who have adopted centralized services may be falling short of meeting a department's needs, causing them to supplement the deficit with their own hires and creating redundancies.

**Inherited processes.** As a company matures, many of its processes may be the results of organic growth rather than well architected decisions. These processes are often inefficient and lack the effectiveness needed to support the customer base both internally and externally.

**Ineffective systems.** Another common process issue is a result of systems that haven't been fully integrated, systems that don't communicate with each other, and/or systems that haven't grown with the organization and cannot meet evolving business needs.

**Improper organizational structure.** Often, there are issues with management that has both too low and too high spans of control. Spans of control that are too low may show that there are too many managers, who are often higher-paid employees. Too high spans of control may show that managers are not as effective as they can be due to their time being spread too thin.

Additionally, a company may be in a position where there are too many layers in the organization, and thus high-paid managers operate at low levels. A review of each department at the various levels for minimum compensation, maximum compensation, average compensation and time of service can highlight issues where

companies are spending too much on employees who are low in the organization or too little for employees who are high in the organization.

Lack of mobility through the organization may pose an issue as well. Issues with compensation and low mobility are related: Average- and low-performing employees with low mobility may be overpaid due to compounding raises for the same output. A long tenure at a lower level may indicate that a high-performing employee is being underutilized.

## How Can a Company Cure These Issues with SG&A?

Just as the symptoms and the causes are diverse, there are several possible ways to cure these SG&A issues. Some common cures include:

**Centralized services.** One possible cure is consolidating SG&A functions into centralized services. Effectively developing centralized services allows for a company to design functional roles and scalable best-of-breed processes and systems to effectively serve the company's demands.

**Outsourcing.** Conversely, the "make vs. buy" decision may lead to the realization that outsourcing pieces of the company to external vendors is the best course. Be sure to choose a vendor that specializes in creating and executing custom solutions for their clients; this vendor's efficiencies may outweigh the cost of maintaining these solutions internally.

**Level setting.** For companies where consolidating or outsourcing is not possible, getting each department on the same systems and the same set of best practices can reduce the overall spend required while improving efficiency and scalability. This approach requires a granular review of each department to determine the best method to implement at each step of the process flow.

**Organizational restructuring.** Often structural changes are also required to maximize the efficiency of department spend. Consolidating managers, reducing department levels, creating mobility opportunities for high-performing employees and cycling out low-performing employees are all potential cures for structural issues.

## How to Transform Oil Field Services SG&A

By identifying SG&A overspending, evaluating the root causes of that overspending and applying suitable cures, oil field service companies can improve their EBITDA in this volatile market. These companies should follow a proven change management approach to ensure their chosen cures have the greatest impact.



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