The Necessary Evil

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"Hi, boss. Time for my annual review. . . ."

"Hi, Pat. Come on in."

"Thanks. Well, it's been a tough year, but we've kept things running pretty well, eh!?"

"That's true, Pat. You have kept things running. But I've got to be frank with you. In preparation for your review, I've talked with most of the business-unit leaders; and we're not entirely satisfied with IT these days."
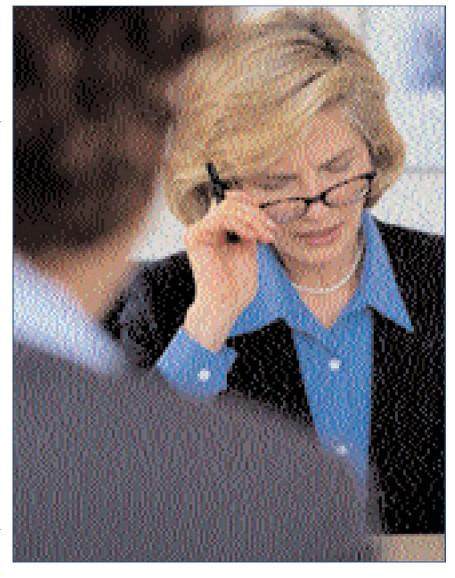
"What's wrong? We've had no significant business interruptions all year. We've satisfied everyone's requests based on the priorities set by the steering committee. We've been through customer-focus training. We got the intranet portal up. The ERP project is on schedule. Why aren't they happy?"

"Pat, I know your folks are working hard and doing some good stuff. But that's not enough. We've been talking about the strategic value of IT for years now. And we really haven't seen it. Isn't it your job as CIO to align IT with enterprise strategy?"

"I'd love to. Believe me, I would! But we're so swamped just keeping our current systems up and doing all the little enhancements they're throwing at us. We just don't have the resources to take on anything new. So until we work through the backlog, I can't see going out and generating ideas and expectations for new projects."

"You think you'll ever work through that backlog?"

"Probably not. It seems to fill up faster than we can work it. Now if we had more resources . . . ."

"Pat, you know the corporation can only afford to spend so much on IT. It's your job to take what we have to spend and align it with strategy. And that's where I see a problem."

"Hang on a second…. I'm supposed to be customer-focused and let the business set our priorities; and yet I'm the one who's accountable if they keep putting off strategic projects in favor of all the little stuff!? What am I supposed to do?"

"Pat, you're an executive. I expect you to figure that out!"

The Root of the Problem

Are all the legacy systems really worth supporting?

Are all those little enhancements really worth doing?

Are we missing high-payoff investments in strategic projects because budget is arbitrarily limited to last year's level?

To improve strategic alignment, you have to cut back spending on low-payoff things, and identify just the right projects to fund (perhaps increasing your budget if the payoff is there). And while it may not be Pat's job to unilaterally make those decisions, Pat is certainly responsible for setting up a process where the right people make those decisions based on the facts.

What facts?

Budget decision-makers need to understand the benefits and costs of all your deliverables—of all the individual services and projects that will consume resources.

The benefits side of the equation is generally better understood. Whether or not it's quantified, executives have an intuitive feel for the ways in which legacy systems and new projects contribute to their bottom lines.

But the cost side of the equation is often unclear. Traditional budgets that talk about compensation, travel, and training don't tell executives the cost of each product and service. So the only way executives can make decisions about that familiar sort of budget is with benchmarks like spending in prior years – a number which has little to do with the needs of the business or the investment opportunities in the coming year.

And with the growing number of legacy systems to support, an increasing portion of each year's budget goes to keeping things running, with less and less available for innovative, strategic projects.

The Way Out

The answer to this dilemma is to present the IT budget in a different form: an "investment-based budget."

Imagine Pat opening budget discussions like this:

"Here are the services required to keep things running, and the full cost of each. Now that you see the price, do you want to shut down any old systems?

"And here are the costs of each and every new project that your people have asked for. It adds up to twice last year's budget. I know we can't afford them all. But some are very strategic. Which do you want to fund?"

Note that when budgets are presented this way, clients can defend their projects. And it's easier to justify budget increases when executives understand what they'll get for their money.

In fact, we've seen IT budgets go up when the rest of the corporation is cutting back because, with an investment-based budget, executives saw that spending more on IT would save (or make) money elsewhere.

Practicalities

To do an investment-based budget, you have to define your catalog of products and services, forecast demand per client business unit for each catalog item (the deliverables), plan direct costs for each deliverable, and apportion fixed and indirect costs to those deliverables.

In other words, it requires a business planning process – with an imbedded service-costing model – that produces both a catalog with rates, and a budget that forecasts the costs of what you plan to sell (not just what you plan to spend).

This may seem daunting. A simple service-costing model can calculate rates for your catalog items. But budgeting this way entails a lot more detail. Costs must be assigned to sales of those catalog items to each business unit and each project, including necessary operational services, anticipated repairs and enhancements, and all the new projects that clients are demanding.

And all this must be done before the year begins (not after-the-fact "show-backs").

Fortunately, with an annual business and budget planning process (a documented method) and tools designed to support it (a planning tool, not a cost model or accounting/invoicing system), investment-based budgeting is quite practical.

With an investment-based budget, funding decisions can be made based on payoff. With a limited "checkbook" of money to spend on IT and a clearly documented portfolio of projects and services (with costs), budget decision-makers will shut down marginal "keep the lights on" services and low-payoff enhancements, and fund the truly strategic projects they really need. ❒

For a library of information and case studies on investment-based budgeting, the method, and the tool, go to fullcost.com. *And CIOs interested in a private sounding board on their resource-governance processes may enjoy a private consultation with Dean Meyer. Contact NDMA at 203-790-1100, or* info@ndma.com.