BUDGETING BEST PRACTICES
volume 2, number 1

No More Games!

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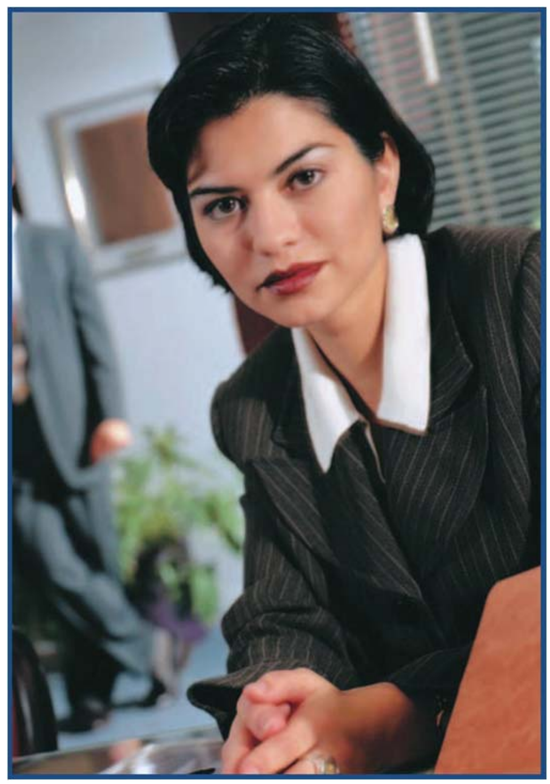
Sarah used to dread her budget review.

As CIO, she was expected to defend her budget, as did all the other executives. But year after year, clients were demanding more and more – business volumes went up; new applications and new services came on-stream; and the business required more bandwidth, higher levels of support, and better security.

Sure, some hardware costs were going down. But personnel costs and new requirements were eating up those savings many times over.

She knew what was coming…. Do all that, but hold the line on your budget. Or worse, take a cut – the old "do more with less" fantasy.

Sarah used to cringe in anticipation of these meetings. But this year was different. She was actually looking forward to her turn in the hot seat.



Let's see how her budget review went….

The Challenge

"So the bottom line is, to do everything we did last year will require a budget increase of around 5 percent. And on top of that, you're asking for around $50 million in new projects."

"Sarah, that's ridiculous! You know revenues are flat. How can you think we're going to give you an increase!?"

"Yeah, Sarah. What makes you think we're going to give you more money to do the same things as last year!?"

"And Sarah, you know perfectly well that we've got a problem with margins. Flat revenues and shrinking profits. My division is taking a cut. Why can't you do your share like the rest of us!?"

"That's right! If we're going to cut anywhere, it should be overhead like IT!"

Exactly as she expected, her peers on the executive team piled on. But Sarah just sat there and smiled.

The Answer

After they all vented, she quietly said, "My friends, I appreciate all your concerns. Of course, I'd love to be able to do everything you want for less than last year. But that's just not possible. Let me show you the facts...."

With that, she projected a spreadsheet on the screen. "First, let's look at unit costs, our rates…. Our cost per desktop – down. Our cost per Windows instance – down. Our cost per tier-one gigabyte of storage – down. Our cost per applications-developer hour – even, despite increasing compensation costs, thanks to our offshoring program. Across the board, we're giving you a better deal than last year – just as we've done every year I've been here. And you'll recall the benchmarking study we did…. In almost every tower, we're in the top quartile. And where we're not, we have programs in place to get there. I'm confident that you're not going to get a better deal on IT anywhere else."

"So why are you asking for more budget?"

Sarah projected another spreadsheet. "Here's what you're asking us to deliver in the coming year in the way of operational services – our base budget. Pete, your sales are up 15 percent, so that means more transactions volume, more storage, more network traffic, etc."

"I get it. But you can't put all the blame on me!"

"Of course not. John, let's look at just your division." With another click, she filtered the data for his business unit only. "You added over 90 new desktops last year, and are planning at least that same growth in the coming year. You must be doing something right to grow your business that way!"

"Thank you, Sarah. We're fortunate to be in a good market segment with a great product. But I'm still wondering why you cost so much."

"Well, for those additional users, you expect desktop support, networking, access to collaborative tools like email, and so on. Your volume went up over 10 percent. But because of our cost initiatives, your IT costs only went up 6 percent. Good deal, eh?"

John reluctantly sat back, quiet.

"Pete and John, you're just examples of what's happening across the enterprise. It's good news – we're growing the company. On top of that, last year we deployed these new applications." With another click, she displays the list. "You all remember approving these projects?"

"Yes, we remember."

"So next year our hosting costs are up, we have to support those apps in the help desk; you'll need repairs, vendor releases, enhancements. Whenever you deploy new applications, our base goes up.

"So," Sarah continued, "you're getting a better deal, but my total costs are up because the business is buying more stuff from us."

"Alright, Sarah, you've made your point. But we still have to hold the line on IT spending. What do you suggest?"

Sarah displayed another spreadsheet. "Here are your legacy applications. Do you see any we can shut down? And here are the general support services you're consuming. Do you really need all those Blackberries? And is the video-conferencing service really worthwhile?"

Sarah was on a roll. Next, she displayed new projects. "And here are the projects you've requested, categorized by enterprise strategies. Are we sure the ROI is there for them all? Maybe we should scale back some of our requirements?"

Larry then took the offensive. "Alright, Sarah, what's in that E-commerce category that's costing $30 million?"

Sarah double-clicked on E-commerce. "Here are the ongoing support costs for what we currently have up. In the course of the past year, we added over 30 percent to our corporate web site in terms of page count, and brought on a whole new generation of integrated web services that allow our customers to update our databases and manage their orders interactively. And with all that, costs are only up 7 percent. Meanwhile, Larry, here's your supply-chain project. Pretty big chunk of that $30 million, right?"

"Well, you know that project got Board approval already."

"And I'm happy for you. That's why it's in the base budget, not on the list of discretionary items in the growth scenario."

"And that's where it belongs. We absolutely need that system. You can't cut that from the budget."

"Thank you, Larry. I knew you'd come around to defending my budget, because you're one of the prime beneficiaries."

Larry nodded assertively. Then, looking a bit puzzled, he too sat back and shut up.

With her peers on the executive team looking quite uncomfortable, Sarah went for the close. "My point is, you can cut my budget all you want. All you have to do is tell me what projects and services to cut."

Next in line, Harvey, the controller, took up the charge. "How do I know you don't have some fluff built into these numbers? We always challenge you to go sharpen your pencil, and you do, and you come back with a lower budget. We're just asking you to do the same thing this year."

"What's different this year, Harvey, is that we didn't build in fluff. I promise you, these are the true costs to shareholders of each product and service. Your auditors are welcome to drill down into every detail. All the calculations are completely transparent. But I assure you, I've already done that, and this is the best we can do – and it's pretty darn good, I might add, given all the new demands you're placing on us."

Her fellow executives scanned the list of IT services, all scowling. Finally, one said, "Okay, we need all that stuff."

At this point, Carl, the president, stepped in. "Sarah, we've worked together many years. You're a professional, you're honest, and I trust you. Now, what you've done with your budget this year is very different. It takes some getting used to. But I like it. Good work."

"Thank you, Carl. We put a lot of effort into this change in our budget-planning process, and I'm glad you appreciate it. And you know I've implemented cost-cutting initiatives all through the year, and will continue to do so. Beating me up in the budget process doesn't suddenly make my staff more efficient."

"I realize that. The game of you padding your numbers, then we put some pressure on you, then you go off and take the padding out – I never did understand the business value of that. So tell me, if these really are the true costs of your products, how can we cut costs?"

"Well, of course I'm going to continue to drive unit costs down. But right now, the only way to reduce the IT budget is to cut consumption. We can go through the products and services, and you folks can decide what you're willing to do without."

"Let's do that," Carl commanded. "I'd like each of you to meet with Sarah off-line and review exactly what's in her budget for your business unit. Cut what you can, and we'll have to fund what you need to run the business. I also want you division VPs to come back to this table with business justifications for anything new you're asking Sarah to do for you. Now, shall we have a look at the HR budget?"

How They Did It

The old game – padding, then taking the padding out, and finally promising more for less despite its impossibility – wasn't working for Sarah's IT department. It never had, and never will. Her IT staff never had the resources they needed to fulfill expectations, and they looked bad when they couldn't do the impossible.

So during the last year, Sarah implemented a new budget planning process – investment-based budgeting.

Using an off-the-shelf method and tool, her managers calculated the true, full cost of each of their products and services – the deliverables they sold to clients and to the enterprise as a whole (corporate-good services), as well as the capital and self-improvement projects they wanted to propose.

They worked together to calculate the total cost of client deliverables, combining their individual costs whenever teams were required.

Sarah scrutinized their inputs, looking for any padding or unnecessary costs, until she was absolutely confident that the model represented a frugal and realistic plan.

The software gave them the ability to cut the data-cube by corporate strategy, business unit, or product line; and with absolute transparency, it documented how all the numbers were calculated.

With the facts in hand, Sarah stood her ground during the budget negotiation process. Ultimately, Sarah's business unit clients accepted responsibility for defending her budget, which, after all, benefited them. Some client demands were withdrawn. And for those that were approved, IT was given the resources it needed to fulfill clients' expectations. ❒

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.