Budget for Improvement

The Systematic Manager - Issue 17 (An Exploration)

To what extent do you ensure improvement through integrating the costs and benefits of it within the budgeting process? How much of your investment is specifically targeted at improvement? And how will you ensure/manage the financial benefits of those improvements as they come to fruition?

The following is not in any way intended (or purporting) to be a definitive statement on the topic - but merely a ramble through some of the thinking that exists in this area, and perhaps a stimulus for further debate.

In many organisations, budgeting has sadly become a stultified, bureaucratic burden. The mindset is often one of negotiation and limitations. Indeed, even the word, to 'budget', seems to imply planned frugality in response to financial restrictions. As a result, the budgeting process tends to be introspective and pedestrian; and seen more as a policing and controlling event, than as a visionary planning opportunity.

I'm not saying that it is wrong to make the numbers add up to what is available, but what I am saying is that the process we often use to do this is blatantly conservative, predominantly defensive, and usually political. The question in the mind of the 'budgetor' is: "How much of what we are currently working on can I conserve?" and sometimes even "How do I play this budgeting game to protect what I am working on?"

Healthier budgeting questions would be: "What process improvement can I economically justify?"; "How much of those resource needs are provided by the returns from past improvements?"; "What is the shortfall, and who will cover it at the intended rate of return?" Budgeting needs to be aggressive, not defensive; it needs to be about expanding your sphere of influence, not simply maintaining it; it should be driving interdependence and alliances, not independence and introspection. Budgeting should be an ambitious and integral part of the planning (QFD) cycle.

In this short paper we will look at four aspects of a more proactive budgeting process:

- Budgeting for improvement effort
- Budgeting for improvement results
- The budgeting process
- Monitoring returns

Budgeting for Improvement Effort

Do you know why such a large proportion of key projects in so many organisations tend to overrun on cost and timescale, and why so few under-run? (In fact the concept is so alien that my spell checker says that 'underrun' isn't a valid word) The reason is quite simple: it is not in the project team's interests to fully understand the real risks and costs/timescales involved: a) it would take more time; b) they'd be less likely to get the project approved; c) whatever they say, someone will demand that its done quicker and cheaper anyway. In other words (and putting my most cynical hat on), budgeting for improvement is often a farcical dance, which few people believe in, but some believe will cover their butts and allow them to pass the blame when it goes wrong.

Perhaps that is too cynical, but the truth of the matter is that we tend to under-budget for improvement because the pressures encourage us to do so. We lean towards the optimistic, we focus on the direct costs, and we forget to allow for many of the hidden costs. For instance, we don't always think through the time implications on people, and the consequences of them taking their eye off the ball in other areas. We often expect people to simply fit things in on top of an already busy schedule, and as a result things get done half-heartedly and often late. Every time we save some money by imagining that people will simply 'find the time' we pay for it five-fold in the missed opportunities and implications in other areas.

In budgeting for improvement effort, we need to understand not just the physical costs, but also the costs of freeing off people to allow them serious and dedicated thinking time to making the project happen. These costs may be in additional contract labour to support them, or in the cost of not doing other things that are less important than the project.

A recent development in one company has been to establish a dedicated department of project managers, whose role has been to ensure that the right amount of thought does get invested in their key projects. These fifteen people have been a significant investment for the company concerned, but they believe that the costs will be more than justified by more timely delivery of the projects. And I strongly suspect that they are right.

We also need to understand the risks involved in the project, and in particular learn from things that went wrong in past projects. Typically, this happens very poorly because it is not properly budgeted for: At the start of the project, the pressure is on to deliver, and no one seems to have time to look at what can be learned from past projects that might be relevant to this one; and at the end of the project, no one seems to have the time to look back over the new learning generated, and to develop it into a form that can be used by later projects. And so the knowledge that would assist people to budget effectively is to all intents and purposes lost.

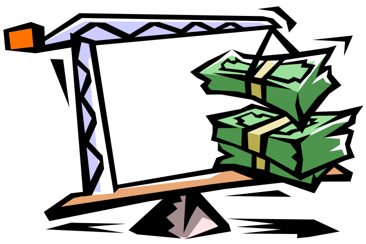
We will know that we have made some headway on our attitudes to the budgeting process when our cost and time overruns are matched by the under-runs.

Budgeting for Improvement Results

But budgeting for the costs of improvement is only half of the equation. The benefits need to be included in the budgeting process too.

(C. Northcote) Parkinson's Law states that 'Work expands to fill the time available' and so the danger is that often the benefits of improvement activities are simply swallowed up and absorbed into the business. It is quite common for an improvement that is said to save forty hours a week not to result in a reduction in the department's headcount – there is always something that needs to be done!

If improvements are to increase performance, enhance quality, reduce waste or save time (and what improvements aren't) then the benefits must be realisable in increased revenue or reduced costs, and the budget needs to reflect this. Any financial investment in one part of the budget should be more than balanced by a financial return in another part. If it isn't, then there is a very real danger that the thinking is not sufficiently ambitious and aggressive, or the organisation is not taking enough control of its circumstances.



Does this sound a little hard-nosed? Do all improvements have to have a financial rationale? What about the view that organisations should be interested in deeper things than money?

Perhaps it is a little hard-nosed. Organisations should have deeper purposes than simply 'making money', but, in the commercial world at least, money provides a good indicator that the organisation is doing those things well. So if an organisation seeks to improve how it invests in its people, it should see reducing recruitment costs, and an increase in performance resulting from that investment. And if it cannot see those things, then perhaps it might be appropriate to question whether it is seriously investing in its people, or simply paying lip service to the concept because it 'seems like a good thing to do'.

And even the most philanthropic of organisations has to financially maintain itself. Ensuring that investment is balanced by appropriate returns is good way to make sure that the business stays around to keep 'doing good', and perhaps even to start 'doing better'. Money should not be the 'end', but as a 'means' to drive rigorous and responsible thinking, you have to go a long way to beat it.

However, if the budget is to best serve an organisation in this regard, perhaps it needs to reflect more than the visible financials. If it fails to do so, very real 'hidden costs' will continue to be compromised in order to meet the tangible costs reflected in the budget. To illustrate this, consider that character we probably all know, at least by reputation: The 'Axeman', brought in by an organisation to increase all the financial ratios that the city loves and thereby raise its share price, perhaps for sale. And so the Axeman sets to work, ripping out everything that is not vital to the next two years, driving the business to price-based suppliers, removing the vision, demanding more of people than they are willing to give, ripping the heart from the business. And costs go down, and profits go up, and all the visible numbers look great – for a while! The Axeman wins the race, but wrecks the car in the process; only no one outside can see that because the numbers don't show it.

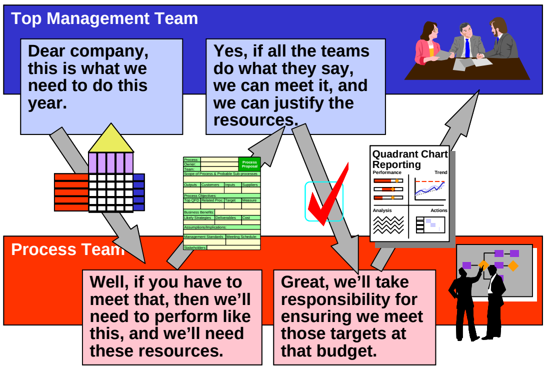
In the same way as the organisation's balance sheet can show good-will, departmental and process budget sheets need to be able to objectively reflect the inherent (longer term) financial potential of their people, their systems and their relationships. And then budgeting for improvement results can be a far more effective process.

Perhaps one of the most stunning ways to budget for results however, is to make achieving them essential. The July-August 1999 issue of Harvard Business Review tells the story of Granite Rock, a century old company in California, which in an effort to improve customer relations told its customers, before it had addressed its quality issues, that they could simply not pay for any item with which they were not fully satisfied.

In this way, the organisation made the intangible highly tangible, and budgetable. The resulting management focus on the problem has generated consistent growth of market share, at a 6% price premium and increasing profit margins.

The Budgeting Process

If the budgeting process is to be a visionary aggressive activity, as opposed to a defensive protective one, then it is vital that it takes place in a way that enables people to contribute their dreams and fully commit to delivering them.



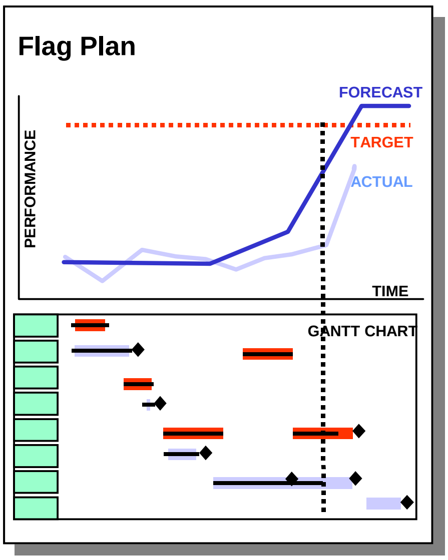
The best means for encouraging this to happen is the QFD cascade process, based on the principles of Hoshin Planning, and illustrated by the diagram on the right. In this form of budgeting process, the management team does not cascade demands and settle for compromise, instead the management team sets out its vision and invites its groups to submit proposals to make it happen.

In this way the creative energy of the people is focused on finding economic answers to the question, not on constructing valid excuses to avoid it. And the budget represents the means to make it happen – a basis for prioritising and phasing what will be done, and ensuring it has the requisite resources to make it happen.

The cascade outlined here can be repeated through successive levels of the organisation, and even out to external alliances and partnerships. It is a means to harness ideas, commitment and interdependence to deliver the optimum solution to the opportunities that are presented. In reality it is only limited by the extent of the organisation's vision.

Monitoring Returns

Stimulating the vision and agreeing the deliverables is one thing, but ensuring you reap the harvest is another thing altogether. Where budgets reflect business as usual or the tightening of belts it is easy to use monthly reports to evaluate performance to that budget, but what do you do when the budget is based on improvements that will take time to be realised?



Flag Plans provide the effective means to do this. A Flag Plan is a plan which links forecast performance improvement to the planned execution of activities, see diagram on the right.

By thinking through the benefits impact of the milestones on a Gantt chart, the planner can identify how performance will grow over time and can plot this. By doing so it becomes possible to assess not only the progress of a project, but also the quality of its execution. And by including the forecast benefits in the budget, any issues with project progress or performance are flagged at the management level at an early stage.

