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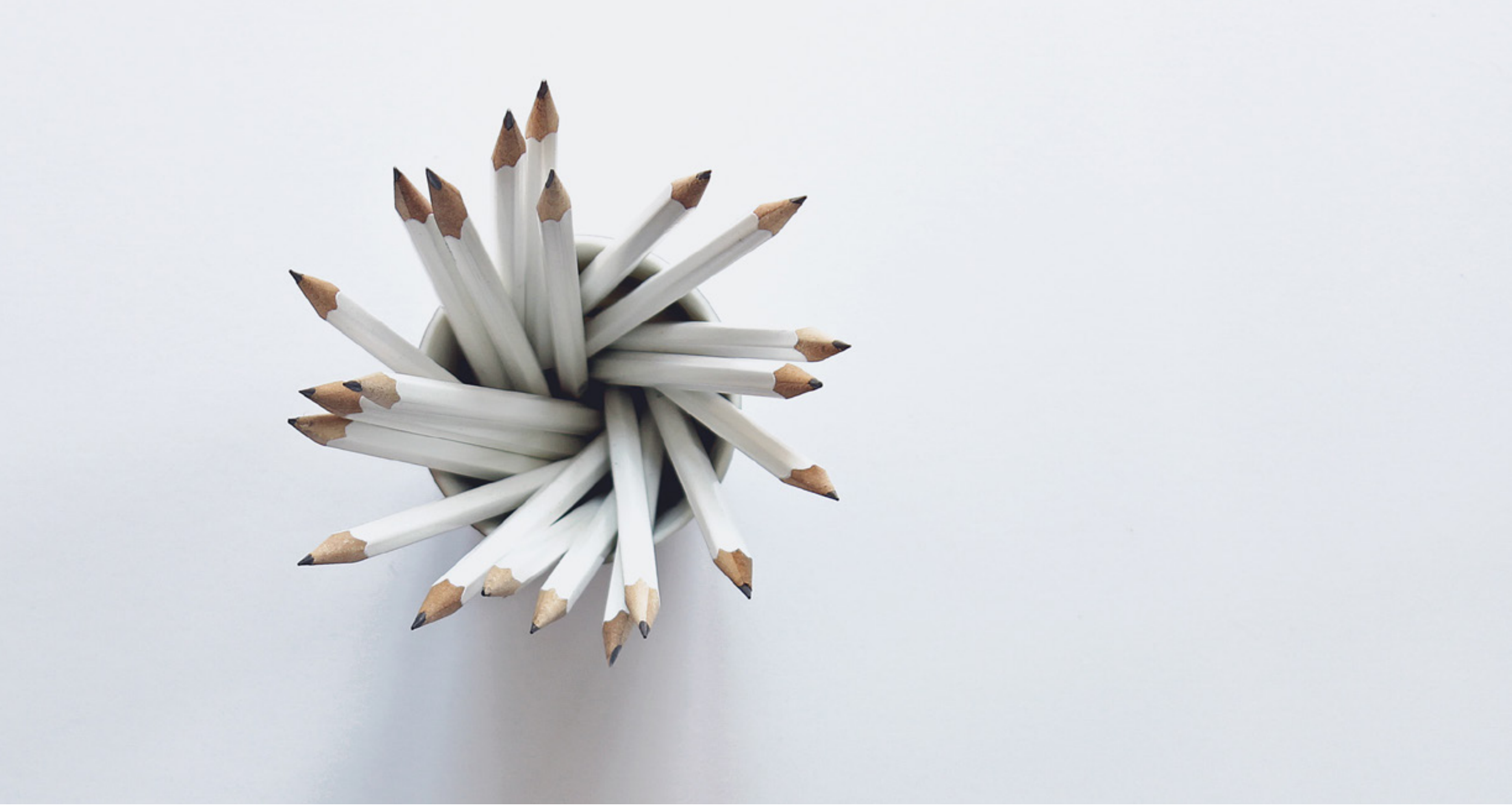
Operations Practice

Do you know where your budget is?

Businesses that can't see where their resources are going are flying blind. To respond to the unexpected, managers need new capabilities that show where they are and how much room they have to maneuver.

by Mike Emsley, Matthew Maloney, Michael Parrott, and Abhishek Shirali



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What if, this afternoon, a major crisis hit your business—a major customer announces that it's terminating its contract, a new mega-competitor enters your market, or an earthquake cuts off access to a critical supplier? Would you know where to find the resources you need to switch from plan A to plan B?

Or maybe the news is good: you can see that sales are skyrocketing in one of your markets, where you now have a unique marketing opportunity. Do you know where the extra funds should come from?

Even though these events are just a part of doing business, too often the answer is "no."

What you probably have instead are hierarchies of high-level categories. For instance, your internal reports will give you a few line items covering personnel expenses; add them up and in theory you know what you're spending on people costs. Scratch the surface, though, and you may find contractor and temporary-labor costs hiding everywhere from IT or marketing and sales to professional services—or the perpetual favorite category, "miscellaneous." In organizations we have analyzed, these types of misallocations add up to equal 20 percent or more of the officially-recognized personnel costs.

To get a sense of the scope of the problem, we asked 30 senior executives across a wide range of functions at large organizations about their perceptions of spend visibility (see sidebar, "Note on the research"). More than half of the surveyed leaders said that they were dissatisfied with their level of visibility into general and administrative spending (Exhibit 1).

Exhibit 1

A majority of executives say that general and administrative spending (G&A spend) is too opaque in their organization.

Sidebar

Note on the research

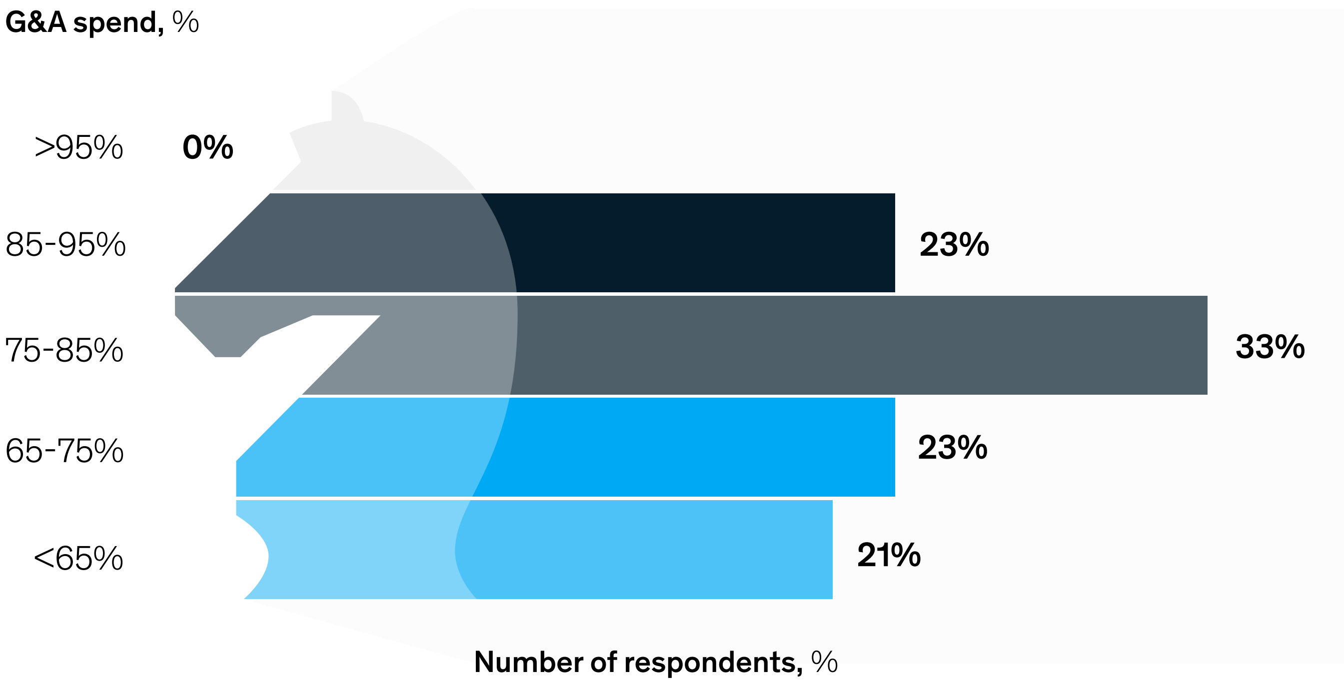
The research is based on a survey conducted online in May 2019. Of the 30 executives surveyed, 27 percent were at the "director" level or equivalent, 33 percent were vice presidents, 27 percent were senior VPs, and 13 percent were in the C-suite. All of the organizations represented showed at least $2 billion in annual revenues and at least 2,000 employees; more than 75 percent had more than $5 billion in revenues and 10,000 employees. Two-thirds of the organizations operated on at least two continents.

The reality is that it's never been more essential to ensure that your business's money is going where its strategy is. But the survey suggests that there can be a significant gap between how an organization thinks it spends its money and how it actually does (Exhibit 2).

A chronic mismatch has consequences. Think of just one example: How can any business succeed at digital transformation if it can't see what it's currently spending on IT? And even if it manages to achieve that clarity once, can it do so again—systematically, month after month, and in a standardized, centralized way?

Exhibit 2

Almost half of respondents said that at least 25% of their organization's G&A spend was invested in the wrong areas relative to business strategy.



The human side of the data problem

At best, most corporate centers nowadays can access only aggregated data, sometimes a month or even a quarter out of date, about what has already been spent within organizational hierarchies and budget categories that may have made sense at one time, but no longer do. None of that data will translate to specific returns on investment. And the process itself will be painful, with finance and operators speaking two different languages.

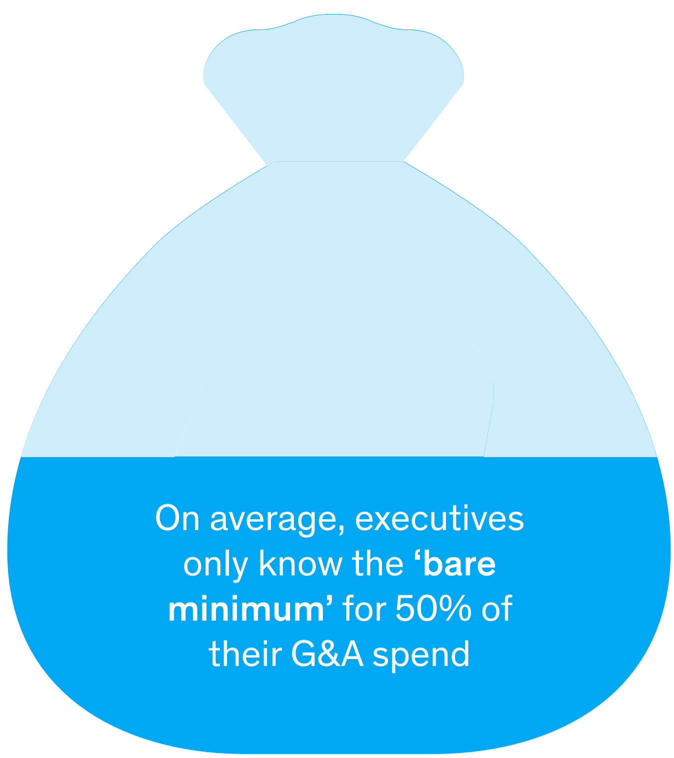
Legacy ERP systems, often cobbled together from years of acquisitions, won't be much help. The data they generate usually isn't standardized enough for timely business-intelligence reporting, and they're too inflexible to support rapid resource reallocation. Highly skilled human beings—always a scarce commodity—can make up for the systems' shortcomings when there's a crisis and resources simply must be found. But for the average manager, the usual practice is simply to start from the previous year's budget and adjust up or down—effectively locking people in to decisions made (many) years ago. Not surprisingly, for many categories of spending, executives say they don't know what the "bare minimum" is (Exhibit 3).

As a result, your organization may not quite be flying blind, but you may feel a lot more like Amelia Earhart in 1937 than today's airline pilot in a glass-cockpit jet. And it's not just a question of buying the new jet. Even a pilot as skilled as Amelia Earhart would need to learn how to use the new technology effectively—and do so well before the plane hits turbulence.

That's where human judgment becomes critical. When implemented well, technology enables more humans to engage in better judgment, while also creating a budget structure that's much more

Exhibit 3

For many categories of spending, executives don't know how much they could safely cut.



modular so they can act on their judgment more quickly and accurately (see sidebar, "What visibility produces").

Build tools that build people

Today, even in high-performing organizations, most managers and executives are too busy to engage deeply in internal financial reporting. The exceptions tend to be prized specialists sent on missions to find hidden pockets of money or sort out financial problems after they occur. Their skills are too advanced (and expensive) to scale well across a whole enterprise.

A few organizations have enhanced transparency and rigor by investing heavily in large financial-reporting departments. The talent requirements are lower under such a structure, but the sheer number of people involved means the cost still adds up. And, unlike the have-calculator-will-travel financial sharpshooters, the size of these organizations means they aren't exactly nimble: learning new skills takes much longer when spread among a larger unit.

How can a business create more sharpshooters without breaking the bank? By building a capability that equips ordinary people with sharpshooter-quality insights. The result doesn't just increase the supply of accounting superheroes; it creates better conversations that deepen collaboration between experts throughout the organization, so that they collectively engage in better judgement. To do that, organizations engage three elements that reinforce one another:

- better systems that serve as a single source of truth
- thoughtful and clear benchmarking of key performance indicators (KPIs) to identify where the biggest opportunities lie, and
- Most important of all, a structured set of conversations to support the changes over the long term.

One system, one truth

The weaknesses of typical ERP systems are well known; moreover, a Fortune-100 conglomerate can easily end up with dozens of them. The resulting complexity and inconsistency create what is perhaps the single highest barrier between organizations and the detailed financial data that would let them make faster, better-informed decisions. Indeed, just in the finance function, research has found that people often spend only 20 percent of their time on strategic activities—leaving 80 percent devoted to low-value tasks such as collecting, filtering, and formatting data into reports.

Sidebar

What visibility produces

At a mid-size durable-goods manufacturer, for example, a team of less than a half-dozen people took 10 weeks to build a modern cost-visibility platform. Once in the hands of managers, it quickly became a gold mine: With only a few mouse clicks, the marketing team found that non-working spend—related to costs for creation of new content such as ad campaigns—had overtaken working spend, for promotion of existing campaigns. Reworking the balance helped strengthen brand perceptions without any additional outlay. Throughout the organization, people finally had the ability to act on hunches about where costs were hiding and could be redeployed for better results—to the tune of more than $25 million.

Better IT is part of the answer. Today's cloud technology allows for a simpler solution that vacuums up millions of transaction-level details into a single source of truth, revealing previously unimaginable detail. But without careful design, "unimaginable detail" turns into "unmanageable detail."

What organizations need is a reliable way to structure their data so that it drives genuine insights and better decisions. In a sense, it's taking the knowledge that rests inside the heads of the most senior, experienced finance experts and making it available—and, more importantly, improvable—by anyone in the organization.

In practice, that means ensuring that the single source of truth is intuitive, simple to use, and widely accessible, so that everyone can contribute to making the data it produces more reliable. "Intuitive" means creating clear category rules that minimize ambiguity and overlap, so that (for example) cleaning contracts are always categorized under "building services" rather than "contractors" or "miscellaneous." "Simplicity" means the system itself should be user-friendly, requiring minimal training for anyone with budgetary authority. And "widely accessible" covers not just who can use the system, but which data they can see: no more hoarding of information by self-appointed gatekeepers in individual business units or functions.

At a North American manufacturing conglomerate, the results from this type of investment weren't just financial—they changed the way the entire business was managed. Now that almost anyone could access the data, a senior IT official could quickly see that some of the spending in other cost centers seemed to be IT-related. In a meeting of the C-suite executives, he began asking the product-development team about some of projects whose spending was being detailed for the first time. As they began explaining, he realized that the technologies they were building already existed in the IT department.

A benchmark for comparison

A universally usable and accessible system enables the second critical factor: rapid, thorough tracking and communication of KPIs across a wide range of both financial inputs and performance outputs. The combination quickly reveals significant opportunities not just to reduce cost, but also to increase effectiveness throughout the company by reallocating resources to more-productive uses.

This sort of benchmarking revealed significant opportunities for the conglomerate. The company had long aligned its sales representatives to overall volume and sales trends for its products, which showed little growth. A new data-tracking system revealed that sales through newer channels were growing quickly even as incumbent channels stagnated or fell. That very basic insight allowed managers to reallocate sales-rep time so that they could capture more of the growth—raising sales while also boosting bonuses for the sales team.

By including nuanced measurements of impact in their benchmarks, companies can better understand even complex areas of spending, as in marketing—home of the famous complaint that although everyone knows half of the budget is wasted, no one knows which half. Once companies can compare variables such as sales-growth rates, non-working marketing costs, and return on investment by campaign, they get a much better idea of which marketing activities are making a difference. One US-based manufacturer found that for several of its mature product lines, managers were paying for new campaigns even though previous campaigns showed surprisingly little spending on working media. With benchmark ratios in place, managers learned to question how they were allocating their budgets so that fewer, better-targeted campaigns could achieve higher impact.

Enabling conversations

The final step is to institutionalize a constant cycle of questioning in which leaders, managers, and their reports continually reexamine what they're spending money on, how much they're spending, and why—and whether changes are needed. These dialogues become crucial channel for finding ways to use resources more effectively. Current technologies make the process much less resource-intensive than it once was: at a multinational wholesaler company with more than 100 business units, preparations for budget-challenge sessions—in which senior managers challenge one another's budget numbers—take only minutes, rather than the weeks of spreadsheet hell they would have required five or ten years ago.

Near-instantaneous visibility into cost drivers in the budget now allows variances to be quickly identified and corrected. Challenge sessions have become extremely effective as variances are automatically flagged by the system and discussions can focus on underlying drivers of excessive spend in the category. Overall, this automated challenging process has yielded more than $50 million to be reinvested into better business priorities.

The lasting effect has been to help change the way managers think about their budgets. Rather than just report results as they are, they engage in real questioning: how could we get even more out of our investments? What could we do to respond faster to opportunities?

Building budget transparency therefore builds decision transparency, making managers and leaders at every level of the organization more effective. Over time, the habits it instills can help an organization prepare for even greater resource-driven insights, such as through zero-basing current activities. It starts by recognizing that while technology may help break through longtime budgetary logjams, the real opportunity comes when people are able to use that technology to its fullest potential.

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