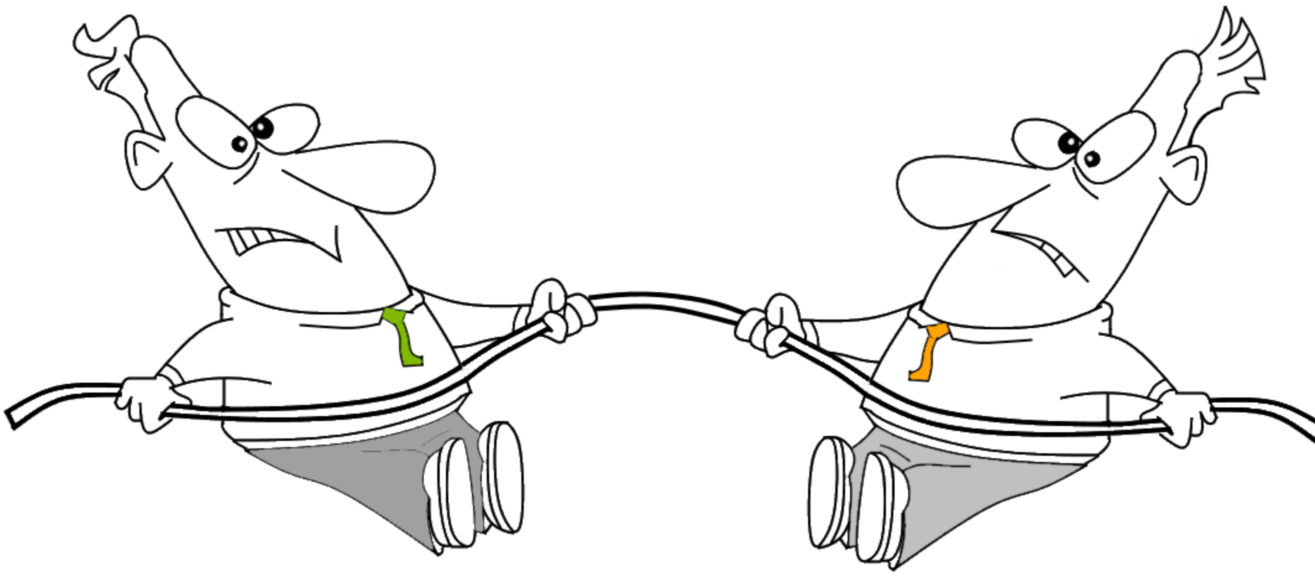
Budgeting Doesn't Have to Suck!



How clear priorities can make the budgeting season less painful!

transparent choice

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Budgeting is a PAIN!

The whole organization is tied up in endless meetings. Every manager is locked away playing with esoteric spreadsheets. Executives are seen roaming in conspiratorial packs.

It must be budgeting season.

It feels like months of wrangling. Politics and “selling” are the name of the game and the results often raise cries of “Huh?” from those who have to implement the plan. “How did *that* get cut?”

But it doesn't have to be like this. A clear set of priorities at the corporate level, priorities that can guide departmental priority setting, coupled with a clear process for assessing budgetary line-items and initiatives can transform budgeting from an opaque battle into a transparent and collaborative process.

The result? Action plans across the organization that are aligned with strategic priorities, fewer failed initiatives and better "value for money".

This document sets out the "why and how" of prioritization in the budgeting cycle and I have to say, it sounds wonderful. But to be fair, there is no magic formula: the budgeting process *is* complex and emotional – in many cases people's job security is at stake. Nothing will ever change that, but it can be more transparent, be fairer and – this is the big one – deliver a much higher return on investment.

Why it's difficult

So why is it so difficult? Well there are, of course, some technical challenges around simply managing the process, collecting and compiling input, building the models and running scenarios. But this is, to a large degree, the easy stuff. It's known and manageable. No, the things that really make budgeting difficult involve people.

The stakes are high

The annual budgeting cycle is a high-stess process. To understand why, let's consider a few players and what might be going through their heads during the process.

The CFO is stressed because budgeting is a complex, spreadsheet-intensive process that involves lots of politics. The CFO is bombarded from every direction by budgetary requests, most of which have little or no "business narrative" to help him understand *why* you need that extra $20m.

The VPs are stressed because their power is measured by their headcount and their budget, and both are under threat at budget time – this is open season for politics and game-playing. Demands for reductions in budget from above, and requests for additional line-items from below, mean the VP is squeezed in the middle.

Department Heads are stressed. With a lack of clarity around goals, they are being asked to forecast everything from headcount to capital budget. With unclear priorities, it's impossible to prioritize budget requests and so it becomes a game of horse-trading, grabbing as much as you can in the hope that it's enough to get the job done. Oh, and my bonus is on the line if I can't get the job done!

Team leaders are stressed because their team is already stretched and they want us to cut how much? And I heard a rumor that they might cut the team altogether and I might lose my job…

Why it's difficult

Decisions are complex

It's obvious, but we often ignore just how complex prioritization decisions are. Every stakeholder has their own perspective, their own lens through which they view the business. They each carry with them a set of biases, personal agendas and prejudices… and they're all human. When you bring these different people together, the variables seem infinite.

Being human means that we are not very good at holding complex decision scenarios in our minds. This is one aspect of what neuro-physiologists call bounded rationality. We simply never evolved to make multi-criterion decisions; rather we evolved to identify repeated patterns and build "rules of thumb" to respond quickly. The problem is that, in business, we seldom repeat the same scenario – the environment, the challenges, the goals are different every time. We are just not well adapted to process complex decisions.

And these decisions ***are*** inherently complex.

You have multiple competing goals across multiple stakeholder groups, up-and-down organizational hierarchies. The initiatives that are competing for resources are very different from each other. No wonder most organizations, most people, wrestle with the annual planning cycle.

Lack of clear priorities

One very specific layer of complexity is the lack of clear priorities. If you understand your priorities, and have a framework for measuring the competing demands for resources against those priorities, then the decision becomes much easier.

Unfortunately, most organizations don't really have a clear and explicit list of priorities. It's rare that every executive has the same picture of the organization's competing goals and their relative importance. The further down the organization you go, the worse the problem becomes. Eventually, managers become task focused rather than focused on corporate priorities.

Little wonder, then, that budget requests don't align well with corporate strategy, and any investment that is not aligned with strategy is…. well, let's call it what it is: ***waste***.

Spare a thought for the CFO

Put yourself into the shoes of the CFO. Really, take a moment and imagine you're in the Hot Seat during planning season.

You have models coming out of your ears. You have budget requests from around the organization and it seems that everything is really, really important. And you've got to say ***"No!"***.

But, to be honest, how can you do that? You don't really understand what the budget requests are for. Do they support corporate goals or is someone empire building? Are they must-have projects or nice-to-haves? Are they good value for money or not? If you're lucky, you have some narative… but that was written by someone trying to "sell" you their view of the world.

It's impossible. Which is probably why many CFOs seem to turn into trolls around budgeting season.

But, if you had a set of clear corporate priorities, and a picture of how those map down to departmental priorities, then you can start to make rational decisions. This is made even easier when the different projects are presented in order of "value for money" (let's say we measure value for money as "alignment with corporate priorities divided by cost").

Now you can start to make real decisions, transparent decisions, ones that are neither personal nor political. Ones that are based on maximizing benefit to the organization with minimum spend.

And that makes for a happy CFO.

Enterprise Priorities? Really?

In the first chapter, we explored how, if you don't understand and communicate your priorities, you ***will*** waste resources.

But let's pretend for a moment that you *do* understand your priorities and their relative importance. Since we're in fantasy land, let's also pretend that every manager in your company knows what these priorities are and is able to measure their initiatives and budget requests against those priorities.

What would the world look like then?

How Better Priorities Help

Clear enterprise priorities would lead us into a fantasy world where…

Resources get allocated based on the benefit they deliver, not based on politics or the ability of a particular executive to “sell” her ideas

Managers at all levels are able to align their departmental budgets with corporate priorities, increasing the return on your investment

The budgeting process moves more quickly and with fewer rounds of negotiation required to get to a final plan

The CFO has a rational, transparent basis on which to make budgeting decisions, reducing both political pressure and stress.

Cool!

Challenges

But wait: it doesn't have to be fantasy. It's not that hard to build a clear picture of corporate priorities. It's not even something that would require a million-dollar investment, which is refreshing. But it does take a little effort to overcome the challenges. So let's see what some of those challenges are.

Lack of Common Language

The first challenge is to provide a common language.

To understand this challenge, we have to remember that organizations don't make decisions. *People* make decisions and each person takes a different path through life. This means that they each understand the world differently.

Let's take a simple notion – customer service. To the CEO, customer success means that customer's CEOs tells him how much they value a strategic relationship with your company.

To the sales VP, it means that the buyers are happy and place lots of orders. It means that delivery happens on time and in budget and so we get repeat sales.

To the warehouse guy, customer satisfaction might be measured in product returns.

One simple notion, but little common understanding.

Non-aligned goals

Local optimization.

Business schools around the world have studied this to death, but it's a behavior that, itself, refuses to die. We've all seen it. Procurement focuses on price above all-else because that's what they're measured on… even if the products they buy cause pain and extra costs elsewhere in the organization. Or sales closes the deal at all costs as you near year-end – never mind that the product isn't ready and the delivery team have to burn the midnight oil, incurring heavy overtime costs, to make the customer successful.

When making decisions, everyone at the table has different goals. Most are business goals but some are personal. If these goals are not aligned, you're going to get some screwy decisions.

And the problem gets worse if the goals are not explicit, or are deliberately hidden. For example, is the person across the table really disagreeing for good business reasons, or is it because their team will shrink and their own position will be weakened?

Challenges

Poor understanding of the benefits and of value for money

The sales team and the operations team are requesting resources to support their initiatives. To make it trickier, each team promises to improve profits by $1m per year. But you don't have budget for both – which do you approve?

Well, profit, net present value, return on investment are all good ways to measure the financial return to an organization, but they seldom tell the whole truth. Other factors such as customer satisfaction, environmental impact, the winning of market share may also be considerations.

Without a solid framework of priorities across the organization, it's impossible to assign a value to these different dimensions of business benefit. Without a balanced notion of business benefit, it's impossible to assess the value for money of each project. And without a clear understanding of value for money, it's impossible to maximize value from a given budget.

The Politicians

How do your executives and managers measure their own worth? In some organizations, it's by what they deliver, what they achieve in the interests of the company. In most cases, however, it's all about the resources they control and the influence they exert.

Executives will often resist initiatives that reduce their power-base, their team's size, the budget they control. None of these things is remotely connected to the performance of the business.

So, budgeting season is usually also the season of back-stabbing, long lunches, informal networking and…. well, politics.

We are all human. We all want to feel like we're valued, but when personal interests start to get in the way of running the business efficiently, it's a problem. Is there nothing we can do?

Lack of organizational maturity

Many organizations don't have a mindset that is oriented to rational decision making. They don't really understand their goals, so any performance measures are, at best, limited.

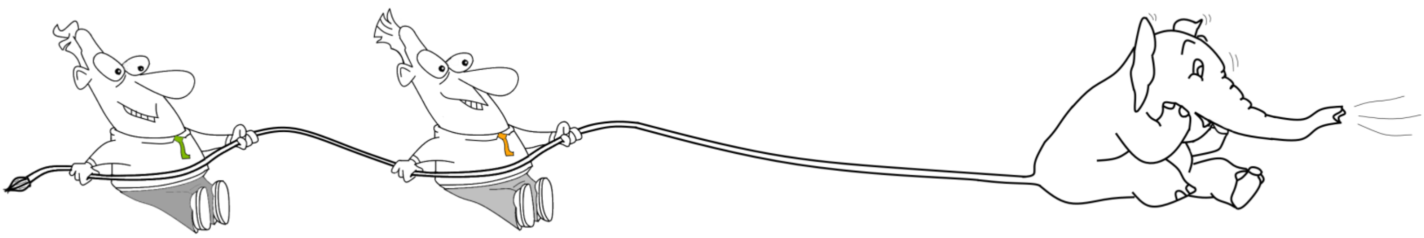
The coordination across teams is often weak with few formal processes to ensure alignment.

In the worst cases, the organization is a series of little kingdoms with each manager out for what he or she can get.

Without structure, metrics and some degree of cohesion, an organization is destined to under-perform. In the context of the budgeting cycle, we usually see long, politically heated discussions with little real data driving the decision… and a CFO at the end of her tether.

> "Is there nothing we can do?"

Is there nothing



we can do?

As it happens there is a ***lot*** we can do.

In previous chapters, we talked about what executives and managers can achieve if their priorities are clear and aligned, but there are some significant challenges to getting this alignment.

Some very simple principles and tools, applied consistently, can make a major difference. The barriers mentioned in the previous chapter can be dramatically reduced, leading to a more productive business environment and a more efficient organization with less politics.

Oh, and a much easier budgeting cycle with a clear set of goals and priorities at its heart. Let's see how…

Simplify the complex

We briefly mentioned the limitations of the human mind when it comes to making decisions. There were two main factors that limit our ability to make good decisions;

- individuals don't make good decisions in a complex environment and
- groups find it hard to collaborate effectively and productively.

In this section we shall look at how a branch of decision science called Analytic Hierarchy Process (AHP – we'll come back to this later) addresses these two factors.

Simplifying the Complex

CRITERIA

ALTERNATIVES

JUDGEMENTS

If people aren't very good at making complex decisions, the solution appears to be obvious: break the problem down into chunks that we ***can*** handle. But how?

Well, it turns out that the answer is deceptively simple.

First, decide what's important to you, what your priorities are. Your list of priorities becomes a set of weighted criteria that you can then use to measure the different proposals and initiatives which we call alternatives.

This process of defining criteria and using them to score the alternatives is common sense. The only tricky part is working out the relative importance of your criteria… the rest is just arithmatic. This problem of determining the weights of your criteria has been extensively studied over the last 4 decades, and researchers have developed and refined a method of solving this problem. It's called Analytic Hierarchy Process (AHP). TransparentChoice uses AHP to help you identify your personal priorities by breaking a big, complex decision down into simple judgments. More on that later.

That's simple. Job done? Well, not quite.

Changing the Organization

Every large organization budgets, yet I've never met a manager or executive who enjoys the process. So why does nobody change it? Often people try, putting in place big, complex modeling tools but it's a complex process, it's an iterative process, it's a human process. Every time you nail it down, something changes, so people get frustrated, give up.

But it's relatively easy to make one change; one that's manageable and that will speed up the planning and budgeting process. One that will lead to a set of activities and initiatives across the organization that are aligned with corporate goals. And I bet you know what I'm going to say because, well, you've read this far!

It is relatively easy to put in place a mechanism to define corporate priorities and to have those priorities reflected across the organization. Priorities don't change very often, even though the ideas for how to achieve those priorities might change every day. Your priorities, and the criteria they become, let your team organize and present their plans in a common language, structured in a way that lets you directly compare "budget request 1" with "budget request 2".

But someone still has to be the first to stop banging her head against the wall.

Changing the Organization

There are two ways to get started; top down and bottom up. Let's start with the more obvious of the two; top down.

Top Down

Simply put, to make a change like this, the CEO and/or CFO need to get their heads together and say, "We're going to do something different this time!" By using the tools to define the enterprise level priorities and then rolling the system out to their executives and managers, they quickly get the benefit from the new approach to budgeting.

But there is, sometimes, resistance to top-down initiatives. People are used to the way things are done, they've spent years (or even decades) building relationships that are leveraged come planning season and they don't want to lose that advantage.

This is where it's important to share the benefit. Yes, senior executives will have a better time if budget proposals come packaged pre-mapped to corporate objectives, but what's in it for the individual manager? For the manager, the benefits include more chance of "getting it right first time", less time spent budgeting and fewer political run-ins.

Needless to say, some training and support of managers is key to success and, with support, top down implementations can be extremely successful.

Bottom Up

Surprisingly, better budgeting and planning can start at the bottom, with a lone manager. We've seen cases where, for example, an IT manager found planning difficult because the organization didn't have a clear picture of its priorities. By driving the discussion around priorities for IT, the executives realized that they had, in fact, come up with a list of priorities for the whole organization…

Bottom-up changes may take longer, but they are a great way for an organization to "try on" a new approach to budgeting. The insights generated can help plan a larger roll-out across the whole organization.

Technology and Process

We can't duck this any longer. We know that building a good picture of priorities is like eating your veggies – it's just good for you. But what is the process or technology that will help us do it?

There are several ways to manage the prioritization process. We believe in the analytic hierarchy process – AHP – as the best solution for a number of reasons. And we're not alone. But AHP is not the only option. Whatever "technology" you use, you should be able to clearly define your alternatives, collect input from experts, executives and other stakeholders, build consensus amongst the decision-making team and then publish and distribute the results quickly and easily. It should be transparent and comprehensible by the participants. The following table shows the difference between some of the more common tools.

	Spreadsheets	AHP Software	ERP Software
Speed	Unstructured environment slows the process down	Fast and clear process leads to quick decisions	Usually falls into the "big, heavy and slow" category
Cost	Seems free, but takes time to set up and manage the model and needs experienced facilitator	Typically a few thousand $	Typically expensive both in software and serivces
Consensus Building	Requires an experienced facilitator	Powerful collaboration build into the process	Typically more about number crunching, not humans
Structured Process	No – requires facilitator – open to manipulation / bias	Well structured and proven process, eliminates bias	Rigid process
Ability to publish and communicate priorities	Typically opaque results and reasoning	Clear results with explicit rationale, accessible to all	Very limited
Transparent	Limited transparency into model	Transparent process, rationale and results	No
Comprehensible	Limited, but the owner of the spreadsheet can hide details	Easily understood (see below)	Often a bit of a "black box"

Analytic Hierarchy Process

Now you're beginning to see why we like AHP. When you combine its solid process with 40 years of academic research into its use in planning, it really would be a brave person who uses anything else. So despite the scary name, it's time to ask: ***what is AHP?***

There are two main ways in which AHP helps. First, it breaks a big, complex decision down into a series of small, structured judgments. The judgments are about the different priorities (often called criteria) and about how the different budget requests stack up against those criteria.

This overcomes the limitations of the human brain to handle complex decisions, but it also dramatically reduces the effect of the biases that we all carry.

> "Don't worry, this won't hurt a bit"

The second way in which AHP helps is through collaborative consensus building. By introducing structure and by breaking the decision down into its component parts, AHP lets decision makers focus on just one aspect of a decision at a time. This helps eliminate the “not on the same page” barrier we talked about earlier as the team explores these “molecular” judgments.

The software also speeds the decision process by highlighting areas of consensus and areas of disagreement. You don’t need to talk about the consensus items and can invest your time where it counts; where there is real disagreement or misunderstanding.

AHP makes it much more difficult for politics to feature in decisions. Small, clear judgments can be reviewed as a group and any “jockeying for position” becomes readily apparent. Moreover, group biases such as “bullying” are reduced through the process of structured input and review.

The output of the AHP process is a score for each budget proposal or initiative. The scores map to the benefit of each proposal as measured against the priorities of the organization. This means that you can easily compare different proposals and can measure “value for money” in a much more sophisticated way than simple RoI or NPV allows.

In short, AHP addresses all of the barriers to better priority setting and does it quickly and cost-effectively.

To learn more about AHP, click here.

Next Steps

In this short book, we've looked at how having clear priorities helps an organization budget more effectively… and with less pain. We also saw how AHP knocks down the barriers to clearer priority setting by overcoming the lack of a common language, overcoming the limitations of our human brains in decision-making and reducing poor group dynamics (included the dreaded politics!)

To help you take the next steps, we've put together some useful resources. I hope you enjoy them.

But whatever you do, do something.

Stop wasting time. Stop wasting resources. Engage the organization in a discussion about priorities before you start arguing about line-items.

Make a difference today.

Free Consultation

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Book a free one-hour consulting session to:

- Clarify the barriers to better priority setting
- Identify the best barrier-busting approach for you
- Define the RoI for you of better priority setting

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