Eleven Practical Ideas for Smarter Expense Planning and Budgeting In Both Downturns and Upswings

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Abstract

This paper lays out succinctly eleven handy suggestions for managing expenses gleaned from the collective wisdom of planning and business gurus. Following the recommendations is a brief examination of the elements of an effective planning system—analysis, modeling and team contribution—that puts the punch into expense management.

Overview

Volatility has become the norm rather than the exception in the world of business planning. The "mindful" or "expectant" corporate attitude is that which prevails—similar to the Confucian tale of the man who survives dropping down a waterfall because he has anticipated the turbulent nature of the water. The world economy continues to sputter, halt and lurch, all the while against the backdrop of internationalization. Ten years ago, you faced four competitors in your country; now there are 15 in three different sectors on five different continents and they don't let up with new offers or better ways to please their consumers and partners.

Spreadsheets and labor-intensive budgeting processes are simply not equipped to address expense planning/budgeting in today's economic climate. Instead, "smarter" expense planning best practices, some recommended by David Axson and other experts, can facilitate more effective, dynamic planning and forecasting, which in turn translate into business optimization. Such best practices include:

- Constant monitoring/analysis
- Linkage of operational drivers to financial targets
- Use of relative measures/ratios
- Scenario modeling for contingencies
- Deep, cross-functional contribution with workflow

Business problem

In this difficult, unpredictable economic climate, today's tools, such as spreadsheets, traditional planning methods and labor-intensive processes, cannot adequately address dynamic expense planning and budgeting, let alone promote best practices. Using these tools, your data aggregation for planning and re-planning is likely to be complicated and time-consuming. Results are not immediate and teams cannot plan together easily.

Additionally, an enterprise employing traditional processes and tools is not likely to be able to understand the interrelation of business drivers because the consolidated P&L presents limited detail. That enterprise might also struggle to obtain a detailed view of nondiscretionary versus discretionary expenses or to pose what-ifs for critical alternative scenario plans.

Business drivers

Practical approaches and best practices in expense planning can lead to more effective, dynamic analytics, enterprise planning and forecasting, which in turn translate into business transformation. These tested practices, which involve the use of information as a strategic driver, can assist you in innovating, optimizing business (processes) and improving your competitive edge.

Companies have just begun to realize and tap into the depth of detail available about leading economic indicators, key business drivers, customer behavior and supply chain performance, writes David Axson, co-founder of The Hackett Group and former Head of Planning at Bank of America. "Effective integration of these rich data sets into our performance management processes can revolutionize the quality and timeliness of the insights available to managers by providing earlier identification of potential opportunities and threats; tracking customer and supplier behavior; and continuously monitoring key business indicators."[1]

Eleven practical suggestions for intelligent expense management

Consider these practical best behaviors for expense management and planning, recommended for today's dynamic business environment.

1. Understand variable versus fixed.

Separate your discretionary costs from non-discretionary and seek a very detailed view of each. Look to pare back your discretionary spending. These expenses, which might be considered necessary for long-term profitability, can include all non-customer-related spending such as travel, supplies, training, memberships, and more costly recognition activity. Reduce judiciously your customer-related spending. Could your company, for example, take advantage of more online activities for interactivity with customers or moderate the spending for major customer events? Would local events be more effective and less costly? Temper marketing: With a reduction in advertising, customers will be understanding or even appreciative in some cases.

2. Dig for business drivers

Understand how operational drivers affect your financial expense targets so you can keep tabs on cash, margins and profitability. Getting a handle on the cause-and-effect relationships is probably one of the most important, yet most ignored "businesses" of your business. In addition to managing down variable expenses, examine transactions and processes from marketing to supply chain to logistics. According to Jeremy Hope, "Many 'bad' transactions are caused by errors and work not done right [the] first time. But costs can also be reduced by cutting the number of 'good' transactions such as those driven by purchase and customer orders, sales invoices and check payments."[2]

For example, if you're a lean manufacturer, you might consider value stream costing for product families that considers design, engineering, production, sales and customer-facing activities.[3] Services-based companies might likewise consider adopting many aspects of this costing strategy in their cycles to develop and provide service products, examining development, sales, operations and administration.

3. Analyze for profitability

It's certainly not enough simply to batten down the hatches and hide till the economic ill winds blow over. Hunker-down strategies, including indiscriminate cost management or across the board expense control, cannot lead to a profit sustaining enterprise. It's important to understand your areas of greatest profitability and continue to adjust, not just trim. Analyzing profitability over alternate dimensions, such as customer, channels and products, helps derive newer insights into expenses that can be adjusted in those business contexts.

Profitability analysis can also help you understand expense items from a value-added perspective and, therefore, can help optimize resources, that is, you can plan for the relative impact of each expense item to its profit potential. For example, suppose your company funds a division just enough to keep it profitable. To increase the division's profitability to an even greater level, rather than increase its budget, you could reduce non-customer discretionary spending. You could then use those savings in other areas of the division, such as for the addition of the talent needed to generate more sales or profits.

4. Leverage growth markets
Focus on growth markets near term. Prudently allocate resources in lucrative regions but assess profitability frequently, making sure you don't underfund a promising new initiative. Consider a hold on hiring in the non-revenue, non-growth areas of the business with the exception of initiatives linked to increased profitability.

5. Model scenarios for plans and contingencies
Best-in-class companies operate in the framework of a sustainable cost strategy or with contingency strategies in their back pockets. The result is few surprises. So be able to build new scenarios and ask what-if questions against those models. For example, rapidly calculate your potential profitability level if your revenue drops by 10, 5 or 3 percent and plan for greater return. Test the investment benefit in an off-shore lab or facility. Following the good habit of industry leaders, be able to view and analyze the complete story about your resources and costs. As plans roll out, you can frequently assess them with comparisons to actuals.

6. Keep an eye on ratios
Build targets to track your relative expense ratios such as sales spending per sales head/revenue or the expenses of any particular business unit in relation to total spend. Trending is vital: assess month over month or more frequently, depending upon the spend rate. Run what-if scenarios for key expense ratios by region, segment and product and develop multiple contingency plans, including those for uplifts in the economy or profitability. With any highly fluctuating resources or commodities, you will want to track day-by-day or even hour-by-hour as well as long term.

7. Make adjustments in accounts receivable.
Set a policy for a disciplined focus on collection; adhere to collection terms and policies. Ask customers to finance payments to lower your risk and make collections as soon as possible.

8. Tap into industry benchmarks or league tables
Constant, effective monitoring and analysis against external comparisons can help a company move away from budget negotiations, that is, the preservation of budget to control turf versus budgeting for business improvement.

9. Reduce the time to collect data for analysis
The process of aggregating inputs from multiple users and spreadsheets inhibits planning effectiveness. Technology can speed up planning and forecasting and even reduce budget iterations. APQC and Beyond Budgeting Roundtable (BBRT) recently reported that "commercial and internally developed software applications are 145% more likely than spreadsheets to have real-time data fully available."[4]
This is illustrated in Figure 1.

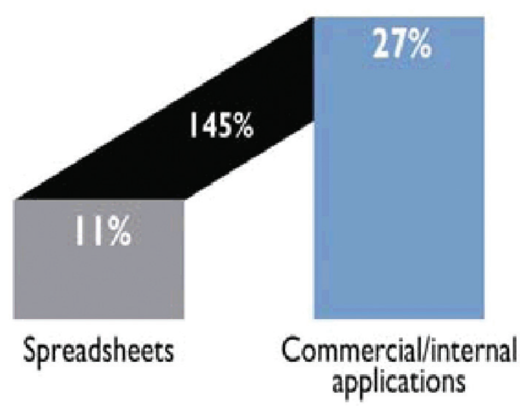

Figure 1 Real-time data availability

10. Approve exceptions rapidly
Make sure workflow for exceptions is clear and streamlined to expedite those needing attention, especially to remove blocks from initiatives.

11. Connect your financial reporting to planning processes
Given the changeable marketing conditions, can you reforecast revenue easily and rapidly from the P&L statement? For rapid planning, recasting or modifications to plans, and forecasting, your financial data should automatically feed your enterprise planning process. The objective is for you to have access to vital actuals such as revenue, headcount expenses and cash flow—perhaps even on a daily basis.

Expense management for all economies

For some enterprises, the ultimate best practice is to establish cost control as a key company metric—not just during challenging times. At a global card services company, where expense management is strategic, a planning and analytics solution powered by IBM Cognos software has helped the company adhere to its "rigorous focus on expense management" and thus perform continuously as a low-cost provider, according to the Vice President of Corporate Information Management.

Using the Web, cost center managers track their expenses against balances updated daily and every two hours during monthly close. And, they can drill down into GL expense details on demand. During quarterly forecasting cycles (and multiple times in each cycle), the company updates its expense drivers, such as percentage of customers contacting the call center or new card products developed by marketing.

With the solution, the company also runs full product profitability analysis by the tenth workday of each month. With this targeted information, the company can take appropriate strategic actions on unprofitable product lines—to turn them around or gauge the level of continued investment in each line. Reporting on complex aspects of business during the close cycle, such as its loan/loss model, can be completed in two hours rather than the two days required before the use of the planning solution.

As a further result of its meticulous expense management practices in combination with the IBM Cognos solution, the company's forecasts on controllable lines items, previously falling in the 5 percent range, are within 1 percent accuracy and have had favorable variances for 18 months running. Such figures are extremely accurate by any standards. "[IBM] Cognos TM1 has not only played a key role in increasing our forecasting accuracy, but has dramatically cut the time through each iteration within each forecasting cycle, easily saving us 200 hours in expense forecasting alone," said the Vice President of Corporate Information Management.

The solution

With unlimited business variables abounding, companies are either treading water—that is, surviving—or they're setting the pace by thriving. But whether you're surviving or thriving, "minding" your expenses (expense management) is a critical process. It's all the more imperative today to be vigilant in your expense control by:

- Constant monitoring, spotting issues such as a rapid drop in demand
- Revising plans as necessary, re-forecasting expenses dynamically
- Deeply involving employees in the planning process
- Rapidly communicating ongoing changes

Agile expense control is the key to achieving this mindfulness, not spreadsheets and current planning routines.

Why spreadsheets and aging practices are not the answer

A recent IBM Cognos® survey indicates that companies can spend up to 40% of their budgeting time in the data collection process alone, which leaves far less time for the important iterative analysis, plan setting and approval cycles (Figure 2). That doesn't even count the process of probing, analyzing and understanding resource issues in key operational areas and processes, such as supply chain, sales, headcount or distribution.

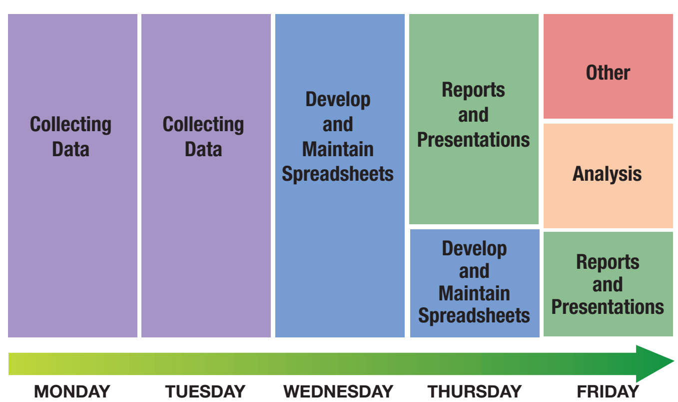

Figure 2: Data collection and management of spreadsheets consumes 60-70% of a Financial Analysts time during the planning cycle.

One major source of these planning inefficiencies is the spreadsheet—an inexpensive approach in software terms, but very costly in the long run because it cannot effectively support planning and forecasting processes because of these inhibitors:

- Version control quickly spins out of control with anything but the smallest of budgets and staffs.
- Operational tactics are not linked with financial goals.
- The business model, inadequately represented or difficult to maintain, does not easily reveal business drivers.
- Complex calculations that involve numerous formulas, organizational drivers such as gross-to-net planning or analyzing customer profitability, along with multidimensional reporting, are impossible.
- Files, usually hundreds of linked spreadsheets, are swapped frequently, but cross-company teams cannot work together easily.

Additionally, at the organizational level, the traditional expense planning methods that develop departmental or unit objectives, goals and tactics in silos result in plans that do not take into account departmental interdependencies and can even lack deep organizational involvement. Without the ability to communicate new ideas and alternative strategies rapidly, a company faces ineffective expense management and resource allocation, possible loss of market agility and subsequent short and long-term effects on performance.

Best solutions for agility in expense control

The most effective planning and analytics solutions for dynamic expense management help a company move:

- From limited participation and low-speed processes to high-participation, high frequency planning, analysis, forecasting and reporting
- From a finance-only focus to connected, driver-based forecasts and (expense) plans that transcend traditional finance and operations boundaries
- From static, long-horizon planning to a dynamic, rolling horizon
- From limited spreadsheet activity to role-based contributions in familiar environments

These planning solutions support the full range of business requirements:

- High-performance customer and profitability analysis
- Flexible modeling for best practices such as value stream costing, comparisons of variable to fixed costs and contingency planning
- Enterprise-level contribution for a broad range of user experiences—from manufacturing, sales and service to finance, human resources and marketing.

With enhanced strategic decision-making and best practice behaviors, leaders can quickly identify, analyze and forecast the impact of expense changes as they occur, counteracting the effects of a difficult economy and competitive challenges.

“CPM projects are often viewed as strategic applications, because they provide a link between strategy and tactical execution,” according to John E. Van Decker, Gartner, Inc. “Based on client inquiries, Gartner has observed that CPM can provide as high as 50% (but 20% to 25% is more typical) reductions in operating expenses and significant top- and bottom-line benefits as well as reduced close times and shorter planning cycles with fewer full-time equivalents to complete this process.”[5]

With a solid enterprise planning and analysis solution, your company has dynamic control over the processes and you don’t deal with chinks in your expense planning, overall planning and forecasting. Highly effective enterprise planning emerges when analytics, modular modeling and extensive and deep contribution intersect. Your plans are linked throughout the company and completed top-down and bottom-up so that forecasts can be performed rapidly and with increased accuracy. You have greater visibility and control of your resources and thus performance against your goals.

More specific capabilities and benefits include:

- Analytics: With advanced, deep analysis capabilities, you can readily validate expense assumptions: You meet the dynamic needs of your organization and provide fact-based approaches to the planning process before you set planning assumptions. On-demand aggregation supports the iterative process and multiple what-if scenarios for rapid adaptation to changing constraints, assumptions and structures. For example, if you're halfway through the budgeting cycle and you've acquired a new subsidiary or want to add new products to your portfolio, your budgeting solution must adapt rapidly and smoothly, covering all departmental input. A high-performance analytics solution will also enable you to work with the high data volumes required for wider and deeper views of drivers, allocations, dependencies, profitability and any other key metrics.
- Modular modeling: With a modeling approach, you not only build plans efficiently in days, not months, but you can facilitate rapid adoption of best practices such as driver-based planning, profitability analysis and scenario analysis for the best outcomes and the least amount of risk. Business units and finance adapt the solution to their planning and forecasting processes so they can meet the diverse forecasting needs of the entire organization. The all-important business drivers are tied to forecasts, visible to all stakeholders, not hidden away in a drawer somewhere.

  The powerful modeling capabilities in a planning and analytics solution gives planners the ability to balance all of their organization's resources and initiatives by providing the flexibility to build, link and assess alternative business scenarios and assumptions. All plans can be developed by each department individually and then linked to model the entire company's plans. You consolidate the plan with a keystroke and centrally manage data models and metadata for consistent, linked data.
- Contribution: With planned contribution capabilities, including rich workflow and personalized input, you are able to build consensus for your expense forecasts and develop timeframe-appropriate plans with high participation. You track the process and alert managers of activity status. Components from individual plans can be linked to provide an on-demand, complete view. A familiar spreadsheet interface and the Web enable participation anytime, anywhere.

Conclusion

To thrive in today's business clime—or even just to survive—you can't afford not to improve or be "smarter" about your expenses and the activities that support managing them: expense analytics, planning, forecasting and reporting. And when it comes to choosing software for the tasks, enterprise planning and analysis solutions powered by the IBM Cognos 8 platform can help you win in this highly challenging economy. The innovative combination of high-performance analysis, modular modeling and intuitive, flexible contribution creates a dynamic, effective solution that will empower your employees to make the intelligent expense choices that can lead to business optimization, profitable growth and accurate enterprise planning.

About IBM Cognos BI and Performance Management:

IBM Cognos business intelligence (BI) and performance management solutions deliver world-leading enterprise planning, consolidation and BI software, support and services to help companies plan, understand and manage financial and operational performance. IBM Cognos solutions bring together technology, analytical applications, best practices, and a broad network of partners to give customers an open, adaptive and complete performance solution. Over 23,000 customers in more than 135 countries around the world choose IBM Cognos solutions.

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Endnotes

[1] From "Succeeding in a Volatile World: How the Best Managers and Organizations are Adapting to the New Economic Realities," IBM Cognos's Innovation in Action Series, March 2009, p. 4.

[2] From "Know How to Cut Costs without Cutting Value," Paper #5 in the series "How Performance Management Can Help You to Navigate through Turbulent Times," by Jeremy Hope, Research Director, Beyond the Budgeting Roundtable, p. 4

[3] For further information, see "41. Why You Should Manage Total (Value Stream) Costs Rather Than Unit (Standard) Costs," by Jeremy Hope and Peter Bunce, Directors, Beyond Budgeting Roundtable, August 2009.

[4] "Charting the Course in Stormy Seas: Planning and Forecasting in Turbulent Times," by APQC and Beyond the Budgeting Round Table, 2009, p. 4.

[5] Gartner, Inc., Research G00167083 "Q&A: CPM Reduces Operating Expenses in a Troubled Economy," by John E. Van Decker, p. 2.

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