

Budgeting is Simply Not Enough!

One of the most time consuming processes in the industrial organization is probably the budgeting process. Some organizations do simple budgeting by taking last years expenditures and adding or subtracting deltas according to factors such as sales, inflation, and required investment etc. Many companies on the other hand build budgets department by department, line-item by line-item from scratch (ground-up or zero based), following a set of preset criteria or assumptions.

The idea is to reach a number which everyone agrees upon and which then becomes the department's / business unit's (BU) budget for the next year. Unfortunately, this is rarely so easy. Mostly the bottoms-up estimate of expenditures etc. far exceeds the management expectation. This happens for a number of reasons. Firstly, estimating exact income and expenditure can be very difficult, unless the business is very stable and constant. Most are not. Secondly, many people are cautious, and have a tendency for whatever reason to "pad" the numbers, protecting themselves to some extent and often leading to endless discussions.

Latest during the budget reviews, top management is forced to intervene, by setting financial targets for the departments / BUs in order to reach the level of profit (or cost), which the entire organization is expected to achieve. When this happens, there is a process break. Top management have made a target or decision based on the assumption that the colleagues have been padding the numbers or that the numbers are not accurate and that the new number (target) is realistic or must be made realistic. The department and BU management on the other hand worked hard to establish and justify the original numbers, and are frustrated that the bar is being set too high, without concrete solutions.

Now that the budget is completed, everybody breathes a sigh of relief, and goes about their normal daily business or takes a few days off. Here is the problem. We have a budget. The management assume it's achievable, and the departments think it's not. Often the budget (planned in advance) is put on the back-burner while department/BU leaders get back to their normal day-to-day activities. This is also a process break. Caused by the fact that the budget is an annual event, rather than an ongoing process.

One potential result is that the departments/BUs realize too late that the numbers are soft or the costs high, and the opportunity to implement counter-measures is late or missed entirely. This can result in the notorious year-end management surprises. Red faces and irritation all around.

Our proposal for top management is to follow the budgeting process as normal, but combine it with a cost improvement strategy. This ensures that the gap between the original budget numbers and the management targets is always visible, and that a process is in place to systematically reduce the gap during the year.

The departments/BUs define a set of actions or measures equal to or exceeding the gap between management and department/BU expectations. These measures are then systematically implemented under a structured cost improvement program, where they are monitored and tracked to successful completion.

This concept has three advantages. Firstly, there are concrete activities in place rather than just vague financial targets. Secondly, the activities are transparent. Management can quickly tell through monthly report-outs, whether the activities are actually being implemented or not, and the likely-hood of goal achievement or whether corrective action is necessary. Lastly, the management of the measures under an organized structured framework keeps the department / business unit leaders focused on these activities. It also creates a cost awareness culture within the organization.

Budgets are important, but they are more reliable when supported by a cost improvement program.

About Cost Improvement

Our focus is continuous cost improvement – Our speciality is structuring cost savings programs – Our value proposition is target achievement.

We work with customers who recognize the need to implement a cost savings, cost improvement or turnaround program, and see the benefits of managing the cost saving activities under one project or program. We bring the structure – Our customers bring the savings ideas – although we can help here too, if requested.

Cost Improvement Consultants has its roots in the global Automotive Industry. Each partner has at least 15 years of hands-on operational experience. We represent many industry sectors and business functions. We understand the importance of working in a pragmatic, no-nonsense spirit with our client's team.

As an international team, we understand the challenges faced by cross-cultural and matrixed organizations, and can therefore operate effectively both nationally or internationally.

Over the years, we have seen a lot of cost-improvement activities. Some were good, but many were only marginally successful. This experience together with the events of the Financial Crisis, gave us the drive to set-up the practice, with the vision of establishing a far higher standard in the area of cost-improvement.

We hope you share our vision, and look forward to working together.