

Expense Management Focusing Everyone on the Right Goals

Autumn is a time of excitement and energy as children start back to school, football becomes a major weekend interest and families put away summer things and prepare for winter and the coming holidays. In business this is the time when we start the annual process of preparing next year's plans and budgets. If you listen carefully, you can almost hear the groans of anticipation as managers prepare for their annual cost reduction battles.

The cumulative decibel level of your manager's reaction to the budgeting and expense management process is a good indication of how effective it is. Contrary to what some might think, a loud reaction is not good. Strong negative reactions to the budgeting process are usually caused by a lot of extra work piled on top of an already full workload, expense targets that appear arbitrary and unrealistic, negotiations and budget decisions that appear unfair and an unhealthy amount of time spent on office politics. If your approach was truly effective, everyone would be continually focused on managing expenses year round and the budget process would be seen as a rational and appropriate process where everyone is pulling on the same end of the rope.

There are some tools and approaches you can employ to make this process easier, faster and more effective. Even if your "groan factor" is not especially high, you might want to consider upgrading how you're using them. Here are the main ideas we would recommend to get everyone properly focused expense management year round.

First, remove the arbitrariness from budget goal-setting. The best way to accomplish this is to establish a process of determining allowable expense levels for each department that is based on your product pricing formulas. This is an excellent way to create a fair and level playing field for all of your managers. Everyone will understand, and hopefully accept, the logic behind how expense dollars need to be spent. When done correctly, this eliminates surprises. Every manager knows how sales and other assumptions for the upcoming year will impact their budget.

Creating expense allowables can be done in several ways but they seem to fall into two basic approaches. Both start with senior management agreeing on how to best spend the company's expense dollars. Agreements are then reached with each department on the logic behind determining how their budgets will be determined each year. When this is done well, the resulting actual budget numbers will produce the financial results the company needs and will support the pricing assumptions in the company's products.

In the simpler of the two approaches, these agreements are usually expressed as a percentage of revenue and then fine-tuned manually each year. A more sophisticated approach is to go beyond this and determine the departmental formulas that will not only determine their annual budget expense goals but will also determine the monthly and quarterly expense allowables as your actual sales and other results unfold. A brief description of the process used to determine these formulas can be found in the "Concepts and Ideas" section of our website in our monthly letter dated – August, 2002: Is it Time to Move to Expense Allowables?

There are a lot of benefits from moving to an approach that uses expense allowables as the basis for budgeting and expense management. One of the most important is that it includes everyone. Too many expense management processes just focus on the operational and customer service areas of

companies and don't include staff and support departments. This approach sets financial goals for everyone to attain.

If you need to focus on expense management in your operational areas, one of the best tools you can use are staffing models. When designed properly, they are an essential tool in helping management understand how many and what type of employee is needed to get the work done and meet their customer service standards. Since employee costs usually account for at least 70% of expenses on a direct or indirect basis in these departments, controlling these expenses is significant. The best of these models can effectively control an even higher percentage of costs and are very effective at analyzing and predicting cost levels under a wide variety of situations and scenarios.

Unfortunately, staffing "models" come in a variety of flavors. Some of them are worth little but still popular, usually in environments where management either doesn't realize there are better tools available or they don't want a tool that strips the mystery away from staffing needs. At the bottom of the usefulness ladder are "staffing guidelines." They are usually expressed as – "Our Claims Adjusters can handle an average of 135 open claims. I know that I need to add an adjuster when the average reaches 145." Or another common guideline is – "I look at our overtime numbers carefully. When they get high and when employees complain about working hard, I know it's time to add to staff." Both can be useful under some circumstances but they are not staffing models.

Good staffing models are based on the way you do your work and take time to design and implement. They have a significant analytical capability in both determining staffing needs and in helping you identify where efficiencies are needed and available. They also help everyone manage staffing needs monthly as work volumes and staff availability changes throughout the year. They take the mystery out of staffing and bring leaders and their teams together in solving and managing this common challenge.

If you want to learn more about the various types of models available please go to in the "Concepts and Ideas" section of our website in our monthly letter dated – [July, 2005: A Buyers Guide to Staffing Models](#).

Last but probably the best way to manage expenses is by including expense management goals in everyone's incentive compensation plan. This assumes everyone has an incentive plan, of course. This approach ties in nicely with the previous two approaches but adds the personal emphasis of rewarding each employee when their team or department surpasses their expense goals . . . while still maintaining service and other standards.

To be effective, departments must be focused on attaining and surpassing their specific expense goals. Rewarding everyone when the company beats its goal is a waste of money. The connection between actions, results and rewards must be up close and personal for incentives to work. The best approach is an incentive plan where employees share in the gain they create. This is called a Gain-sharing plan.

We've been designing these plans for insurance clients since our firm was started. These plans must be specifically designed to fit your specific needs but they come in two basic designs – Gainsharing and Gainsharing Light. Both are effective. The difference is in the way they are funded.

The most important first step in expense management is to make sure everyone understands how important this is and then have goals they can be accountable for attaining. Expense management goals and approaches must be up close and personal for them to be effective. Please visit our web sight at McDonaldConsultingGroup.com. You'll find further explanations of these ideas in our Concepts and Ideas section.