

Expense Allowables – An Executive Tool for Expense Management

The day-to-day managing of expenses is a practical art that relies heavily on a manager's ability to say "no" and/or to delay decisions that will cost money. The key is to attain or beat your expense goal at the end of the year. Most successful managers are able to do this year after year because they can do several things well. They are good negotiators, able to convince senior management to set reasonable or at least attainable goals. Once set they are also good at finding ways to meet these goals while still doing everything else. And lastly, they are usually good at saying "no" and making sure the goals are met.

If you are an executive, this is what you want your managers to do. None of this hard work will create the results you need, however, if you have not set the right goals -- and this is the role of the executive team. There are a number of ways of doing this. The one we have found to be most successful is to establish *expense allowables* for each department or team that has a budget.

What is an *expense allowable*? It is the amount of money a department or team can afford to spend (or is allowed to spend) in a year. It is usually shown as a formula, based on what is done and the value brought to their customers and the company. There are several advantages to having *expense allowables*.

- Once established, the formulas do not change from year-to-year. Everyone knows what to expect and what to plan for.
- The annual budgeting process becomes easier, simpler and fairer.
- The time, effort and resources spent in budget negotiations is eliminated, or at least greatly reduced. This shifts managerial emphasis from getting the best goal to attaining the right goals.
- The company and its stakeholders get better business results because expense allowables are based on what needs to be attained, not what is negotiated or what people think can be attained.

When you first introduce *expense allowables* there can be a large gap in many departments between what is currently being spent and what the *expense allowable* target is. Closing this gap takes time, planning and good management. Once closed, however, the results are worth the effort in better business results.

Companies that introduce expense allowables on their own without management consulting help tend to make two serious mistakes. First, they usually do not carry their analysis down to the department or team level where budgets are established and managed. Instead, they tend to stop at higher level – e.g., distribution costs, product costs, etc. This produces interesting cost numbers but misses the point of becoming useful in budgeting and actual cost control. The second mistake is to stop before they understand the "drivers" of their expenses for these departments. These companies never create the formulas. This means they have to redo their analysis each year. Instead of simplifying the budget process, they just added another step.

If expenses management and control is a continuing problem for your company, you may have an underlying problem in setting the right goals. Creating expense allowables may be a solution for you. I'd be happy to discuss how to make these changes in more detail. Also, please visit our web sight at McDonaldConsultingGroup.com, where you'll find further explanations of these ideas (and other exciting ideas) in our Concepts and Ideas section.