White paper
Managing IT with Constrained Budgets

Most companies are managing their budgets with increasing intensity. But the need to invest in technology to stimulate growth, boost productivity and deliver efficiencies is still a significant contributor to business results. This paper looks into contemporary budgeting practices and how financing from technology vendors can help.

Contents

Introduction

For most of us, the budgeting cycle is something of an imposition, even when the economy is buoyant. The budgeting process often takes up a lot of management time, but doesn't appear to give back so very much. In a downturn, of course, it's much worse - producing a viable budget that our colleagues can believe in is almost impossible.

Then, thanks to intense competition for scarce resources, managers in some organisations are known to resort to underhand tactics in the hope of securing their budget for the upcoming year. This type of activity can turn important business decisions into elaborate exercises in gaming - something which seems increasingly commonplace.

As such, it didn't raise much criticism when noted Business School professor, Michael Jensen, wrote an article for the Harvard Business Review, the first line of which said: 'Corporate budgeting is a joke and everyone knows it'

Alternative Techniques

As a consequence, there have been many attempts to challenge conventional budgeting methods. When the global economy started to deteriorate, the consulting firm McKinsey looked at various alternatives to the standard approaches to corporate budgeting. They described four techniques.

Scenario Planning

Creating alternative scenarios is one way of trying to anticipate a range of possible outcomes. Companies which plan in this way usually still adopt a single budget, but with the addition of a range of options based on their chosen scenarios. The obvious benefit of this technique is planned responsiveness.

Zero-base Budgeting

This technique starts each new budgeting round with a blank sheet of paper. It challenges all prior assumptions and considers no expenditure to be sacrosanct. Operating and capital expenditure is prioritized according to its alignment with the organization's strategy, plus the target return on investment.

Rolling Forecasts

Instead of setting a budget once a year, some organizations have chosen to work on a rolling four, five or six quarters. This might not work for every revenue and cost line, but certainly for the more important financial variables. This style of budgeting seems to accommodate the flexibility needed when the future is so unpredictable.

Quarterly Budgeting

As its name suggests, quarterly budgeting focuses on the more knowable short term. While it has its uses when uncertainty is at its peak, McKinsey says that the lack of balance between the short term and the long term means that it should only be deployed with great care.

While it is possible to find evidence of each of these alternatives being used in quite a number of companies, most of us still have to work with budgeting for a full fiscal year in detail, and maybe the following year or two in outline. So let's consider how best to negotiate this arduous, frustrating, yet very necessary process.

Because the impact of budgeting decisions is quite different for capital budgets and operating budgets, we will start by looking at them separately.

Capital Expenditure

The capital budget is generally reserved for sizeable projects which include the acquisition of fixed assets - in other words, most computing hardware.

Corporate capital expenditure is typically characterized by a comparatively small number of high value transactions. This makes each project highly visible and subject to intense levels of scrutiny. In most organizations, aggressive sign-off rules mean that only modest capital purchases escape the machinations of the capital committee or the board.

As a consequence, a robust business case is almost always essential to demonstrate that any capital project will generate the necessary returns.

But the business case is a complex instrument. It needs to show all one-off and on-going costs, ideally covering the economic life of the project. And it needs to show the one-off and on-going benefits of the project too. All of these numbers are typically fed into a model which can calculate the likely rate of return, the net present value, and possibly the payback period.

Every firm seems to have its own unique formula for each of these calculations, but the principles are universal. In very simple terms, front-loaded costs coupled with back-loaded benefits never look attractive. Very few projects show high front-loaded benefits, so finding some way of smoothing out the costs and the benefits over time generally makes for an attractive business case.

Benefits, certainly for technology investments, can usually be separated into hard, firm and soft categories. Hard benefits are quantifiable and can be assigned a value. Firm benefits can also be measured, but they are usually difficult to value. And soft benefits can't even be measured.

Your technology supplier should be able to help here. They should have access to valuable experience which you can utilize to help construct a viable business case.

Right now though, even a robust business case does not guarantee sign-off from the capital committee. CapEx spend is constrained in many organizations, either as part of a policy edict to conserve cash, or as part of desire to keep the balance sheet looking attractive to investors, ratings agencies and others.

Operating Expenditure

While capital budgets are characterized by a small number of high value projects, operating expenditure is almost always comprised of a high volume of comparatively lower value transactions. OpEx are usually managed at the multiple intersections between cost centres and cost codes.

Most of us understand the rigors of managing a cost centre. We have to fight for our rightful allocation. Then, at regular intervals, we have to explain any variances between our planned and actual expenditure. And as the years go on, we have less and less room for manoeuvre as more and more of our costs are taken by head office allocations from shared services and other central overheads.

In many organizations, of course, IT itself is managed as a shared service, or as a profit centre, or maybe as a cross-charging overhead. Chargeback techniques started to become popular in the mid-1970s as the IT function needed to find a way of demonstrating its value to the organisation. But the mechanics of calculating and disseminating 'fair' charging systems have often created more problems than they have solved. And until quite recently, the systems and tools haven't been available to fully automate the chargeback process

Today, though, chargeback seems to be coming back into fashion. This is partly due to economic pressures, and the need to make internal services accountable with a high degree of cost transparency. It may also be due to the increase in more mature chargeback tools.

Much of the effort that goes into chargeback mechanisms is the calculation and communication of the rate or charge per user. Most organizations seem to offer a blend of standard rates and actual or estimated usage-based rates. But finding a way of making these charges transparent, and then ensuring that users feel as if they getting value for money is still a challenge.

For some organizations, the calculations themselves are difficult enough. Actually charging internal users is even more problematic. For example, a couple of years ago, one analyst firm described chargeback as 'a political minefield and an administrative hassle'. This may be one of the reasons why showback has gained some popularity over chargeback. Showback, or 'notional charging', is where the costs are calculated and communicated to users, but no actual cross-charging takes place. The thinking here is that an awareness of what IT actually costs may pave the way to making internal users more responsible for their consumption of IT resources.

Switsching Budgets

Both CapEx and OpEx budgets have their difficulties, and these difficulties are exacerbated when the economy is under duress. But that doesn't stop the pace of demand for productivity-enhancing technology which seems to go on unabated. Fortunately, remedies are available, thanks to the changing nature of technology itself, plus the range of financing options on offer.

Perhaps the most noticeable change in the last little while has been the inexorable movement of technology assets from the balance sheet of the users to the balance sheet of the providers. As such, many IT functions are now less likely to be owners of assets, and increasingly likely to be operators of assets owned by others. This means a shift from using a CapEx budget to acquire technology assets, to using an OpEx budget to rent or hire assets, or subscribe to services.

For the CIO, there are several advantages to working with OpEx rather than CapEx funds.

Control

Once a multi-year service agreement becomes a part of an annual operating plan, it is generally difficult for that on-going expenditure to be opposed. This is in stark contrast to periodic requests for CapEx spend, where there is increasingly little certainty that the expenditure will be approved. In addition, if the services contract is built with a degree of flexibility, it is possible that an upgrade or refresh path can be built into the initial contract.

Consumption

While not true for all technology solutions, with certain contracts it is possible to match capacity with consumption. The metered service, or the per seat contract, are two ways of matching not only supply with the demand, but also cost with use – in other words, a perfect input to chargeout calculations. Apart from the economic merits of only paying for what you need, it also makes the initial business case that much more compelling as costs are often aligned with benefits.

Disposal

There are several aspects of disposing of old and tired technology which can give the CIO huge problems, and associated costs. The safe and environmentally-friendly disposal of much technology hardware is a costly problem. Data security is another problem - making sure that all stored data is safely cleansed before disposal or recycling. By utilizing the assets owned by others, these problems can be transferred to the supplier, with specific terms for disposal built into the contract.

This trend towards outsourced contracts and managed services contracts has recently been given an extra kick from the comparatively new world of software-as-a-service and other cloud-based solutions. But let's not loose sight of what's probably the oldest method of providing budgetary flexibility – vendor financing.

Vendor Financing

Some technology vendors choose to offer a suite of financing options which range from straightforward lease or rental options through to highly tailored contracts which meet very precise customer needs.

Subscription

There are the several variations of managed 'subscription services'. This is where you pay for what you use. As such, costs are generally more predictable; they're usually connected to some type of variable - perhaps usage or seats; and they're nearly always expensed rather than capitalized.

For example, the need for additional server or storage capacity can be driven by all manner of business need, and at times demand can be irregular, resulting in difficult-to-predict peaks and troughs. Where it meets a need, some vendors can offer services which are structured to accommodate a base level requirement, and then flexed with incremental buffer capacity which is only charged for when needed.

Migration

Migrating from one technology platform to another, or consolidating some or all of your storage or server capacity, can also be managed via a structured lease contract. Combining various products and services thanks, say, to an acquisition or a planned relocation can also be managed in this way.

These highly bespoke agreements provide for the valuation, handling and buy-out of any surplus equipment. Then they allow for any credits together with all costs related to hardware, software, services, installation, training, maintenance and such like to be included in a new agreement.

Leasing

There is also a full suite of standard lease finance options. For some time, the two major accounting standards setting bodies have been deliberating over the next version of the rules which govern leasing. But most technology leases continue to be recorded as off-balance sheet operating leases. This means that they are expensed rather than capitalized.

There are many ways of structuring leases. At times the payment profile will be flat throughout the term of the lease, but on occasion they can move in increasing or decreasing steps if that fits a need. The overall length of the contract can also vary, although typically they are set-up to last between three and five years. Sometimes, leases can include all manner of installation costs, a combination of existing and upgraded hardware, and maybe software licenses and certain services.

Partnering

Adapting to the current pressure on budgets means that everyone involved in the development and delivery of technology solutions has to flex their offer in some way. That may be the technology itself, but increasingly, it's also about the ways in which technology is sourced and financed.

Working in partnership with a carefully selected vendor is the best way of building the creativity and flexibility required to meet the challenges of today's budgetary constraints. It's also necessary to recognize that technology and financing decisions are now inextricably entwined. So the need to partner with suppliers which offer flexibility in both technology and financing has never been greater.

Fujitsu Financial Services Solutions

Financing is the key component of your IT investment decision!

Fujitsu Financial Services offers a complete portfolio of financial solutions enabling the planning, transitioning, acquiring, managing, and retiring of your dynamic IT infrastructure. Our strong global presence allows us to provide financial solutions in all key international markets through our presence in over 50 countries. We cooperate with select leading global IT financing partners to offer custom solutions based on customer, local, and regional requirements.

Contact Us

For more information about the products and services available from Financial Services, please contact:
Email: ffs@au.fujitsu.com
Web: fujitsu.com/au/services/ffs