

# Functional Budgeting

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## Introduction

In current economic climate every company tries to cut costs and most of them do it with downsizing human resources. Many economists believed that large companies are capable of handling economic recessions and be able to plan in long-terms and invest into research and innovation. Now all these companies are laying off people who had potential and could bring great values in future. Now there are no long-term objectives; now it is just bare fight for survival.

But every recession has an end and the big question is what happens after that. Would companies start re-hiring their own employees? Is it possible to buy back all the lost knowledge, skills and experience? Many employees loose their good opinion and belief in faith in their old employers and won't come back. Others start their own companies and offer same skills and experience but for much higher price. In short term it might be the solution, but is it worth it? Would such a company survive?

All these questions should be asked when CEO decides to do budget cuts and department heads make their decisions who should be on the list.

From my experience it is very often done by sorting employees according to the salary and start from the highest one.

This document should show another alternative: namely do the decision making according to the skills. As the previous approach doesn't guarantee that the department would be still operational or would not loose the skill potential to expand or perform future tasks.

## Functional requirements

Every department has its objectives and duties it needs to perform. A good department-head should make sure that he has all the resources necessary to perform them (human resources included).

Specifying the required personnel is the most commonly used technique, where a manager lists all the experts he needs. One major disadvantage is that people who have more skills in various fields of expertise would have their potential not utilized very well. Or another disadvantage that somebody in different position may know more or be better in performing the task than the expert hired for it.

Task	Person
Present the product	Marketing expert
Acquire customers	Salesman
Design solutions for customers	Consultant
Write Contracts and handle legal problems or questions	Lawyer
Perform accounting and bill customers	Accountant

Example1: Business department

Another approach is to list skills required to cover tasks and goals in the department and try to find people who have them. It is necessary to pay attention not to overbook the recommended 8 working hours a day.

Task	Skill
Present the product	Marketing
Acquire customers	Sales
Design solutions for customers	Design and consulting
Write Contracts and handle legal problems or questions	Business law expertise; contract writing
Perform accounting and bill customers	Accounting and billing

Example2: Business department

Although tables seem very similar in the second case it is possible that sales and consulting would be done by one person or billing and sales by another employee.

In order to do some qualitative assessment of the skill required there should be several categories used:

### **Priority**

There are tasks that have the top priority and require specific skills to be done. Also there are tasks that need to be done in order to support the top priority goals or tasks done on a routine basis although they are not important for company goals but for department performance. Distinguishing such tasks can be done in several classes:

1. Business critical (primary tasks assigned to the department)
2. Important (secondary tasks that department should perform to achieve business goals)
3. Less important (inner-departmental tasks required to perform the above or maintain the department operational)

### **Time**

Everybody knows the saying “time is money” and it actually is true. Timing the tasks to be performed is very important unless the company has the financial resources necessary to hire enough staff to perform any tasks even those unexpected ones. Now there are two variables here that should be noted:

- Starting point (now; tomorrow; next month; in far future)
- Length (10 minutes; one day; one year; not specified or permanent)

### **Experience**

Although different tasks may need the same skill, they may require different level of depth or experience level. While sales needs basic level of knowledge about the product, consulting needs very deep experience of the product. To distinguish the level of experience there may be following groups:

- Theoretical knowledge (just know what it does and how)
- Basic experience (experience with using it and how to operate it)
- Good experience (experience to implement and use the product in various environments)
- Deep experience (this level is required to develop a similar product on its own)

Most of the companies base their experience assessment according to years using the product, but this leads to false decisions as there is a difference between using the product in the same way for 10 years and implementing the product in various environments in 1 year. Failing to identify the experience level may lead to failure in designing the suitable solution for the customer and losing profit or even business.

## **Budget plan for human resources**

After having a list of tasks and skills to be performed lets start putting some numbers behind them. Valuation of each task is a very complex process with many ethical and political questions.

Lets evaluate the process of selling an existing product:

1. marketing the product
2. acquiring the customer
3. designing the solution/implementation for the customer
4. Writing a contract/ agreeing to the conditions
5. Billing the customer and accounting

Every point has a certain part on the profit gained by the whole process. It is very hard to decide how much is each point worth and therefore just suppose that each point is equal.

This means that the marketing skill required to perform the first point would be worth  $1/5$  of the profit. Well not really the  $1/5$  of the whole profit but the part reserved for employee salaries for that contract.

## Salary model

With so many companies on the market there are loads of salary models used. Each model has its own objective according to which it divides the financial resources. Factors needed for consideration in each case are different as some companies should value loyalty more others do performance.

As example in IT business it makes no sense to value loyalty when skills required to perform the business functions change almost every month; or in the sales field valuing skills instead of performance or contacts.

In order to consider the model mission there should be several factors to consider:

- Financial state of the company
- Dynamics of required staff skill-set
- Size of the company
- Average age of employees
- Required performance for success
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Here are some examples of mission statement for the model:

*“Salary model should promote gaining of new skills required to fulfill company’s objectives”*

This model should be used in dynamic companies with changing skills requirements and be small or medium size company with low profit (or no budget for new recruitment)

*“Salary model should ensure the stability of staff pool and offer the possibility to gain required skills by new recruitment”*

This model may be used more for middle or large sized companies with more stable skill-sets or sufficient budget for recruitment.

## Salary model design

After stating the mission of the model the actual work only begins.

There are two approaches for model design:

- **Top-down approach** (used when there is a fixed budget plan for staff)
- **Bottom-up approach** (used more in consulting where plans and expectations are used)

**Top-down approach** is done by splitting the budget in between the required skills and a fixed cost (minimum wage must be preserved according to law). Deciding upon the value of each skill depends on various factors ranging from its importance to the scarceness

**Bottom-up approach** bases the model of availability of the specified skills in the company and requirements from clients (internal or external). If the skill is required by clients very often and it's scarce in the current skill-pool it should be valued more than a common skill or skill not required by clients so often (considering the contract value).

### ***Salary model integration***

Very often people tend not to reveal their skills in hope that they won't get extra work or responsibility. More progressive model should remove this behavior from company, but the change must be handled with care. If the model structure is stated in public it would be often the case that people would have skills they can't perform in order to gain more financial benefits.

Another problem is timing and prioritization, as not many managers can assess the required time to perform the duty/task and set correct priority that would allow the employee completing the task.

Integration may have following steps:

1. acquire list of skills for each employee
2. identify each skill's importance and distribution among employees
3. calculate the progressive part of the salary

While gathering and identification was already mentioned the calculation is a bit more difficult as in some environments it is not possible to know the exact value of a task or project (fx. non budget oriented environments).

In product oriented environments it is easy to say how much time must an employee spend on creating a product (time of the production cycle) and difference between costs of material and the sales price is the actual price that can show how much a task is valued.

In service oriented environments (internal services or external services) it is a bit more difficult as timing of a task or service is much harder. In some environments a consultant is charged by hours spent on the customer site and in such environments it is not necessary or very hard to introduce this functional budgeting (only when hourly rates differ depending on the skills required). Other environments may have indicators showing the utilization of specific service or tasks which may help identify the expenses or time spent on performing such duties.

With projects it is much more interesting as there is clearly defined what skills are required and how often. Adding information about its criticality and including scarceness of the specified skill in the market would help to distribute the skill values efficiently.

### ***Salary model maintenance***

Even though it takes a lot of effort to design this model it has to be kept up-to-date to keep its motivation value.

Many people would be learning new skills and utilizing them on every possible occasion so the skills list has to be updated with cooperation of the superior.

Another point in maintenance process is re-identifying the importance of each skill. Every company has continually changing needs and objectives that often require new skills which might be valued higher than before.

## **Conclusion**

With all the downsizing and restructuring going on in every company many people think about the effectiveness of these processes and wonder whether they have chosen correctly (being either employee, investor or a manager). Maybe the companies that went bankrupt would still be in business when they have chosen a different approach for downsizing.

I hope this information would widen the list of alternatives of restructuring processes and save some of these “to be bankrupt” companies.

Also important is to educate all the future managers, investors or employees that restructuring can also be done in natural way of evolution (the most valuable employees keep the job).

Even the motivation of employees on learning new skills that company needs would increase and save even more resources removing the need to hire more people.

There are many positive sides that may help a manager to decide how to plan his budget and I hope this paper helped to widen the perspective how to make it better.