High-Performance Bureaucracy™

MONITOR

Actually Doing More with Less:

Avoiding the Traps of Traditional Budget-Cutting

BY BRUCE CHEW, JOSH LEE, AND JESSICA WATSON

PRESSURE FOR REAL CHANGE

Agencies and departments at all levels of government, and the public sector more broadly, are facing unprecedented pressure to cut their budgets and tighten their belts. This time, the usual budget-cutting tactics—deferred expenditures, hiring freezes and creative accounting techniques—will not be sufficient to achieve the demanded cost savings.

Agency leadership is searching urgently for how best to cope with this stark reality. If leaders are to close the gap between revenues and expenditures without sacrificing their agency's mission, they are going to have to find a way to effectively do more with less. This is a daunting task and, in the absence of a compelling new approach to accomplishing that objective, many agencies are still clinging to three "wishful solutions" that offer false hope, based on flawed assumptions:

Wishful Solution No. 1: "They may not grow my budget, but they won't really cut it."

This belief has already been proven false at most city and state levels. It is unclear how much resolve there will be at the Federal level and which agencies will be most affected. But even without actual cuts in the budget, many—if not most—agencies will be forced to find ways to generate more value for every dollar spent.

In spite of all the complaining about government, demands placed on government services are rising. This is the result of increased activity; the FAA, for example, estimates that the number of annual airline passengers in the U.S. will rise from 713 million in 2010 to one billion by 2021. It is also the result of changing demographics. Demand on government services for the aging will almost certainly rise, as evidenced by the Census Bureau's prediction that the number of Americans over the age of 65 will nearly double from 37 million in 2006 to 72 million in the year 2030. At the same time, as citizens become accustomed to higher and faster levels of service in the private sector, their expectations for the quality of government service are rising as well.

In the face of these and other trends, for many agencies it is unlikely that current performance and satisfaction levels can be sustained at today's expenditure levels if "business as usual" remains the norm. *Agencies need to think more broadly and creatively about how to maintain high levels and higher volumes of service in the face of limited resources.*

Wishful Solution No. 2: "We can solve our budget problem by eliminating waste."

A 2009 Gallup poll found that, on average, Americans believe that 50 cents of every Federal dollar spent is wasted. This figure reflects cynicism more than economic analysis, but even if a significant portion of government spending is wasteful, much of that waste is beyond the ability of agency managers to influence. Waste can be attacked at the level of day-to-day activities, but experience suggests that such approaches only eliminate 5 to 10 percent of costs. Larger savings can be found by addressing the underlying drivers of costs, and even greater savings can be achieved at the level of policy and strategic decisions. For agency management, then, simply focusing on reducing waste in their "as-is" operations will not be enough to address shortfalls between funds sought and funds available.

Moreover, focusing on the elimination of waste—while politically popular—often distracts executives and managers from greater opportunities to save money and improve service delivery. *Agencies must pursue larger and more difficult opportunities above and beyond waste reduction to achieve meaningful savings.*

Wishful Solution No. 3: "We can fix our budget problems if we just act more like a business."

The truth is that many corporations struggle with the transformational changes needed to achieve major cost savings. Monitor Group's research shows that 60 percent of private sector cost reduction initiatives do not reach their targets, while 50 percent of corporations allow costs to rebound after a reduction initiative. Even worse, 30 percent of the cost reduction initiatives studied actually weakened the company by eliminating critical assets or undercutting vital development programs. [1]

While there are certainly lessons to be learned about cost management discipline in corporations, the private sector has not "cracked the code" on cost savings. *Government agencies should develop their own strategies for reducing costs while sustaining savings over the long term.*

RECOGNIZING THE BUDGET-MINDSET TRAP

The solutions won't be found by hoping and waiting. Government agencies must find a way to do more with less if they are to successfully pursue their missions in these turbulent times. But how can they find a solution that enables them to truly do more with fewer resources? The first and most crucial step sounds counterintuitive. It comes from recognizing that the answer to the budget problem cannot be found simply by looking harder at the budget.

THE WRONG LENS

For agencies seeking to do more with less, the budget-centric mental model is a trap that inadvertently constrains innovative thinking about how to manage spending. Traditionally, budgets have been used quite effectively as tools for both political and administrative purposes. From a political standpoint, budgets provide a framework for politicians to debate the relative merits of various government activities. From an administrative perspective, budgets are useful tools for tracking and reporting expenditures.

But this tool, the budget, designed to bring into focus political or administrative issues, proves unhelpful when it becomes necessary for executives and managers to make decisions and take practical actions that will reduce costs while maintaining or even improving service levels. Budgets have three inherent limitations that prevent them from functioning as effective leadership tools:

> **Limitation No. 1:** Budgets treat all dollars equally and do not discriminate between core and non-core activities—between a dollar spent on a mission-critical strategic project, for example, and a dollar spent on the cafeteria. From a budget viewpoint, a dollar saved is a dollar saved, whether it comes from switching to different napkins in the cafeteria or shutting down an R&D initiative.
>
> **Limitation No. 2:** Budgets cannot distinguish between real and spurious savings. Budgets look at a single time period and therefore cannot accommodate inter-period dynamics. Because a budget is like a financial snapshot, it cannot take into account the fact that

"saving" a little money today by cutting down on maintenance might actually result in major future expenses down the road.

Limitation No. 3: Budgets look at expenditures, not at results. With no equivalent to the "revenue" part of a Profit & Loss statement, there is no guide for managers regarding the prospective return on specific investments of resources. Two investments, each amounting to one million dollars, may both be in the same budget line. They may both be good investments, in the sense that they are efficient uses of capital and are beneficial. But they may differ in that they provide radically different returns with regard to their impact against the agency's requirements or objectives.

To get at the root of their resourcing problems, managers must recognize that the budget is the wrong lens through which to bring long-term solutions into focus.

THE WRONG FOCAL POINT

It is natural for a leader faced with pressure on his or her agency's budget to focus on that budget in pursuit of a solution. But the budget is not just constrained in the way it deals with dollars. Budgets focus attention inward; they look only at what goes on within an agency's own four walls. This narrow focus is **too limited** in a time when external partnerships offer some of the most promising potential for cost savings. A recent Monitor Group High-Performance Bureaucracy™ survey of more than 100 government managers revealed that more than 70 percent saw their agency as being "Extremely Dependent" or "Very Dependent" on other organizations; fewer than 10 percent described their organization as being able to fulfill its mission independently. This co-dependence brings opportunities to deploy scarce resources more optimally. To pursue these opportunities, managers will have to lift their heads up from examining their own budgets and look to other agencies, private sector and not-for-profit partners, and even customers, as potential collaborators. The fact that budget-minded potential government partners are likely to turn inward when facing cost pressures only walls them off from potential paths to savings.

THE WRONG FORUM

Finally, the traditional budget process is often an **inappropriate forum** for dealing with and resolving the difficult issues that must be addressed in creating real economic change. Rather than encouraging true leadership behavior and new ways of coming together to discuss challenges and trade-offs at the agency-wide level, the budget process can foster an environment that encourages managers to act like "budgeteers," with managers playing shell games by shifting costs from one group to another; offering "peanut butter" solutions that seek to spread the pain "fairly" across departments, regardless of efficiency or value differentials within the group; and using brinksmanship negotiating tactics by threatening to cut essential services. Each of these tactics is, at best, short-sighted and, more often, destructive in times like the present when real and permanent change is called for.

THREE KEYS TO BREAKING OUT OF THE BUDGET-MINDSET TRAP

In a time when severe budget cuts are looming, managers need to escape the blinders and constraints that come with the conventional budget mindset and budgeting process. The following three keys offer alternative management approaches to traditional budget arguments. They hold the potential of unlocking new methods of delivering more valued services, while using fewer resources.

Key No. 1: Use a Different Lens to Identify Resource Classes, not Expenditures

At the heart of leading change is the ability to answer the question: "What would happen if we did X or Y?" The traditional budgeting process has no answers. To gain insights into the what-ifs of cost savings, leaders must recast their budget numbers by categorizing costs according to the role they play as opposed to the line-item to which they currently belong.

Costs need to be understood and managed as a diverse portfolio of resource expenditures that contribute in different ways to the pursuit of an agency's mission. As shown in Exhibit 1, expenditures differ in terms of the role they play in enabling the mission and thus the value they create, and in terms of the amount of value created relative to the resources they consume.

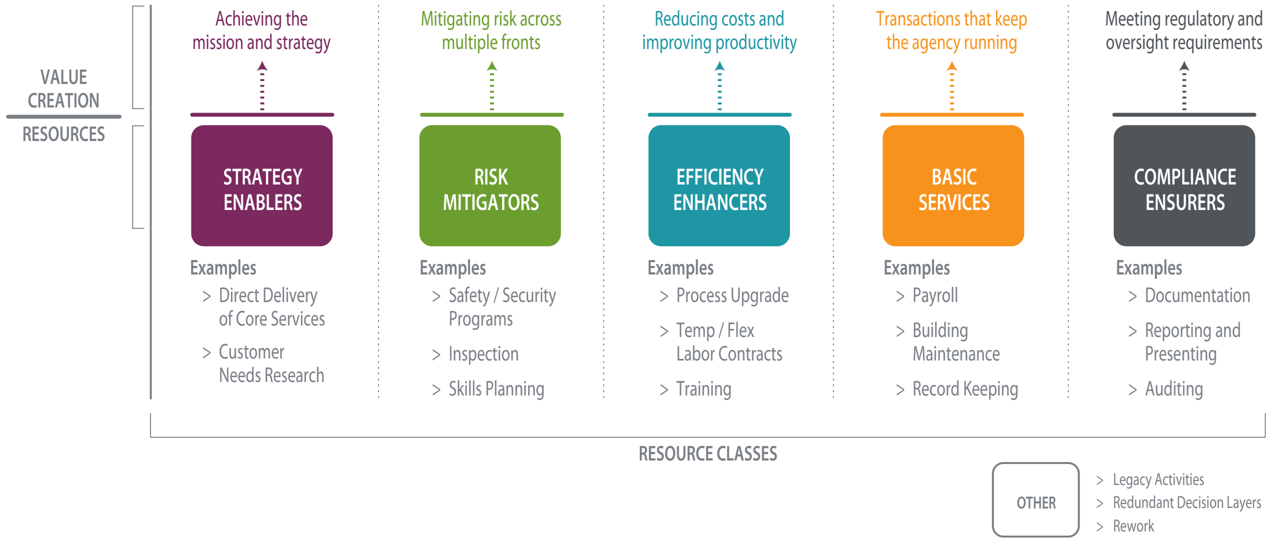
Managers need to recast their budgets in order to examine the resulting *value* generated by different costs; they do so by categorizing spending in terms of Resource Classes. Most costs will belong primarily to one of the following Resource Classes:

a. **Strategy Enablers:** These costs are directly tied to helping the organization achieve its mission or strategy, for example, by delivering core services or investing in certain talent development programs.

b. **Risk Mitigators:** These costs insulate the organization from avoidable risk, for example, by improving safety and security, maintaining infrastructure, and planning for crisis scenarios.

Exhibit 1. Recasting the Budget as a Portfolio of Resource Classes

This method enables agency managers to compare the implications of eliminating one expenditure versus another based on the value each resource dollar creates



c. **Efficiency Enhancers:** Money spent in this category is focused on reducing future costs and improving productivity, and ultimately making the organization more efficient. Examples in this category could include process upgrades or employee training programs.

d. **Basic Services:** As the name implies, these costs include all the daily functions involved with running an organization, such as payroll and record-keeping.

e. **Compliance Ensurers:** These costs include the documentation, meetings, and audits needed to ensure that the agency meets all oversight and regulatory requirements.

Bucketing budget dollars into different resource classes is an essential step in building a richer framework that enables managers to see and discuss tradeoffs differently. Instead of "my dollars versus your dollars," the resource classes highlight considerations such as "dollars that enable strategy versus expenditures for basic services." By recasting their budget in more meaningful terms, managers are able to break out of the traditional budget mindset and make choices that enable innovative, durable cost reductions without sacrificing the core strategy enablers or taking on unnecessary risk.

Key No. 2: Look Outside Your Own Organization

Not only are contemporary budget shortfalls too large for individual agencies to tackle on their own, but it makes little sense to try to go it alone in a world where government agencies operate in a broad, interconnected ecosystem. Traditional efforts focused on an agency's relationship to its customers and other parties have emphasized clean and linear handoffs. This transactions-based approach may help facilitate clearer roles and accountabilities, but it obscures the more dynamic, relationship-based opportunities for breakthrough cost savings—and improved service—that are available through collaboration.

PURSUE COLLABORATIVE PARTNERS

As noted earlier, Monitor's recent survey found that more than 70 percent of the government managers interviewed found their agency "extremely" or "very" dependent on others to accomplish their mission. Yet despite the perceived necessity of collaborating with others, Monitor's survey also showed that only a small number (less than 20 percent) of the most collaboration-dependent organizations found their collaborators to be valuable partners. In fact, a significant number (34 percent) actually described their collaborators as *impeding* their own organization's efforts.

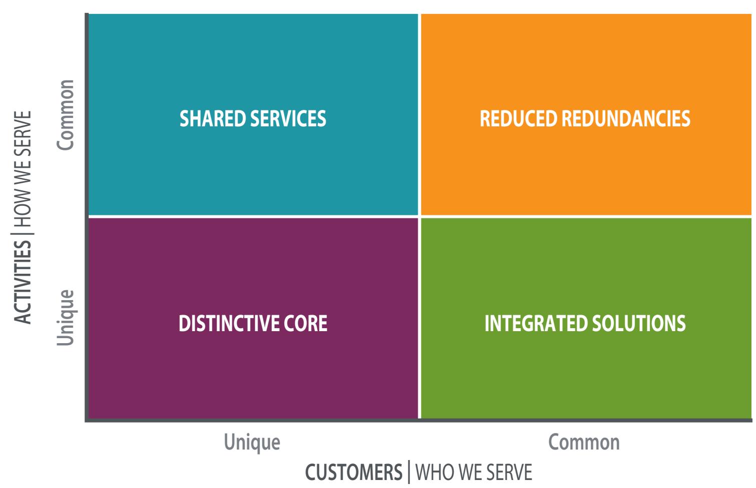
In the face of these dynamics, better interagency collaboration could go a long way toward helping agencies to cut costs by sharing services, developing more efficient workflows, improving communication, eliminating redundancies or uncovering untapped synergistic opportunities. When "agencies working together" is discussed, the dialogue most often focuses on shared services. The opportunity for savings through shared services can be quite large and they are, in many cases, being pursued. For example, the Office of Management and Budget and the Government's new Chief Information Officer are currently striving to consolidate many of the federal government's 2,100 data centers.

However when it comes to partnerships—either with other agencies or with NGOs and other external partners—executives and managers should consider collaboration options beyond shared services. Potential collaborative opportunities can be identified by exploring two dimensions: the degree to which the activities involved are common across organizations or are unique to the agency itself, and the degree to which the customers served are, likewise, common or unique. At the intersection of these two dimensions are four different situations, three of which can leverage collaboration to manage costs (see Exhibit 2 below):

1. **Reduced Redundancies:** When two organizations share customers and perform similar activities, it is likely that unnecessary duplication has arisen. Eliminating this duplication can offer opportunities for savings without reducing the services available to customers. For example, it has been noted that many government services for schools are duplicated across federal, state and local levels.
2. **Shared Services:** When a particular class of activity exists across a variety of agencies serving different customers, opportunities exist to create centers of excellence to provide shared services to a number of agencies. The backroom basic services of government are often common across agencies. A number of federal functional areas have been identified as opportunities for Shared Service Centers, including Information Technology Infrastructure which involves the data centers noted above.
3. **Integrated Solutions:** When two agencies serve the same customer in different ways, the possibility exists for powerful economic synergies. This is an exciting but often overlooked collaborative option. When opportunities are identified and acted on, the results can be impressive, as has been shown through examples like the Veterans Administration and the Department of Housing and Urban Development teaming up to combat homelessness among veterans.
4. **Distinctive Core:** Not everything offers opportunities for collaboration. Sometimes an agency's customers and the activities performed to serve them are both unique. This distinctive core may be why the agency was created. But leaders need to be careful. Sometimes their organizations are less unique than they appear. Breaking out of the blinders encouraged by discrete budgets may lead to a realization that there are significant, previously unnoticed commonalities with other agencies and/or organizations outside of government.

Exhibit 2. Opportunities for More Effective Collaboration

A variety of collaborative opportunities exists for managers willing to look beyond the walls of their own organizations



Once managers have determined areas for potential collaboration with other agencies based on the relationship between their respective customers and activities, they have a broad range of choices in picking the most suitable model for structuring the collaborative relationship. The collaboration service models can range from sharing best practices (for example, through virtual communities) to creating centers of expertise, sharing resources across operating units, or even jointly outsourcing certain functions. Methods may be developed for handling arms-length transfers of services between groups, or long-term dynamic relationships may emerge. But the question of how best to structure the relationship first requires the opportunity be identified. That identification, in turn, is dependent on agency managers' recognition that the solution to their internal budget problem may lie in working with another outside agency.

COLLABORATE WITH CUSTOMERS

In many cases, customers themselves represent the greatest potential for short-term cost improvements when looking for external partners, providing the agency can substitute a more nuanced customer-centric view than the "services-out" view typical of government services. Agencies accustomed to seeing customers purely as *recipients* of services may find it unusual to think of customers as *collaborators*. Executives and managers recognize that customer behaviors are a major driver of costs. What they often fail to realize is that those behaviors are not immutable; they can be influenced if and when agencies have a rich, multi-faceted understanding of their customers, whether they are citizens, small businesses, or other stakeholder groups.

This does not mean government should mandate customer behaviors so as to minimize government costs. But government can take some lessons from the field of marketing on how to shape customer behaviors. What leads an individual to consider availing themselves of an agency's services? Where do they gather information? What options do they consider? How do they choose? What preparation do they take? How do they interact with the agency? Insightful answers to these questions lay a foundation for the agency to answer two other key questions: What do I want the customer to do? Where and how do I intervene in the customer's choices and actions to move them toward the behavior I desire?

These are not questions government typically asks. More often government is asking "How do I deliver the services customers are currently asking for?" But the dollar implications of those two lines of questioning are dramatic. Online services provide a useful illustration. A fortune has been spent to enable government services to be performed online. Many customers find it more convenient and the cost savings for government are huge. The IRS, for example, estimated that e-filing saved over 90 percent of the cost of a paper return. Yet our Monitor Group survey found that, on average, agencies could support an 85 percent increase over current levels of online service activities. Without even looking too far, there are dramatic opportunities for savings if customers can be influenced to utilize more effective service channels.

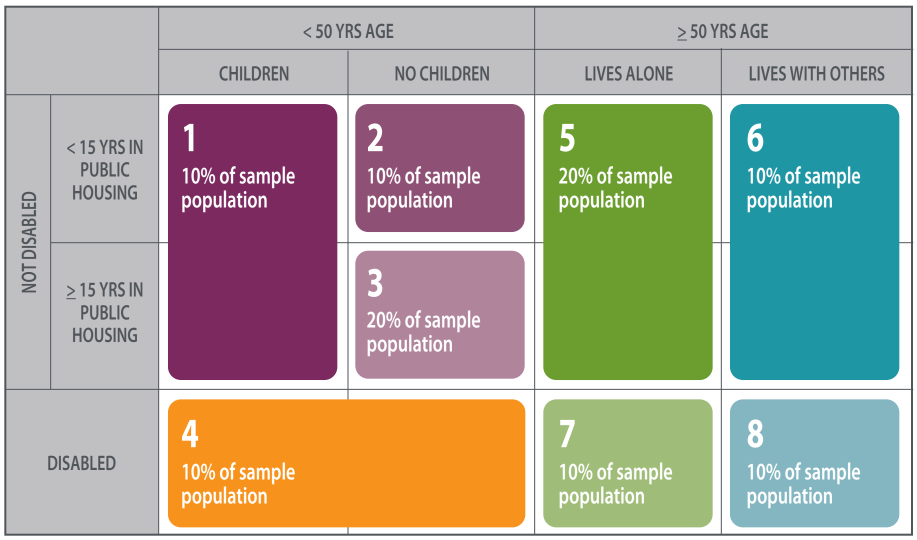
Of course, it can be misleading to talk about "how customers behave" or "how customers choose" in the singular. Different customers have very different needs in very different situations. If an agency wishes to align its service offerings more effectively with customer behaviors, it is essential to understand the differences between customer groups. In other words, it is useful to segment the customer base.

A good example of the power of customer insights is in health care. A wide range of public and private organizations including hospitals, insurers, employers and government agencies have struggled mightily and often with little success in the battle to control rising health care costs. Now a number of innovators across the country are experimenting with models that seem to lower overall costs by focusing resources where they are most needed. In some instances, the results have been impressive. One medical group in Camden, New Jersey, managed to reduce hospital and emergency room visits by 46 percent among its target community of 37 chronically ill patients, consequently lowering their hospital bills by 56 percent. They did this by giving the sickest and thereby most expensive patients more focused levels of high-contact care and support. These efforts might not seem to matter much, except for the fact that just 1 percent of Camden's population represents one-third of the city's total medical costs. Lower costs among this sickest 1 percent by treating them differently than the rest of the population and Camden's overall medical costs should plummet.[2]

Customer segmentation is an area where government agencies might indeed learn valuable lessons from the private sector, which has long used segmentation to move beyond one-size-fits-all solutions to deliver products and services tailored to specific targeted customer segments.

Exhibit 3. Segmenting the Customer Population

Segmentation enables a more tailored approach to delivering services with the potential to raise satisfaction and/or lower costs



Note: Example from work with a public housing agency; Data disguised

Consider the example of a public housing authority that was offering job training services to all of its residents. A Monitor study showed that these services were highly valued by the 10 percent of the population under the age of 50 who had children (Segment 1 in Exhibit 3) and the 10 percent under 50 who were disabled (Segment 4), who hoped the training would enable them to move their families out of public housing as time moved on. On the other hand, the 30 percent of the population over 50 years old who lived alone (segments 6 and 7) were generally highly satisfied with their current housing situation and showed little or no interest in the existing training programs.

The findings had major implications for the housing organization's strategic plans and resource deployment. First, it meant that the "resident satisfaction index" they had been reporting on was influenced as much by changing demographics as by management action. More concretely, the segmentation told them that they should focus their training programs on the younger parents and disabled residents. Cutting training programs for the older residents could save money while eliminating a service that those customers claimed not to value. Perhaps other programs could be developed that better met their interests or needs. The findings could also help the organization do a better job of predicting turnover rates and related costs across its buildings by looking at the demographic mix within those buildings. If it wanted to do so for efficiency reasons, the agency could even use the data to create a low-turnover building populated with those customer segments most satisfied with public housing who showed the least interest in leaving.

Government agencies have traditionally seen themselves as providing a single bundle of services (such as housing and job training) to all customers, but the value and attractiveness of those services can vary widely from one customer segment to the next. The most important point here is that while government agencies may not be able to choose *which* customers they serve, they can still move beyond treating all customers as indistinguishable. With customer segmentation data in hand, managers can apply scenario planning techniques to predict how each proposed action will affect different customer segments. Managers may be surprised to find that cost-cutting actions can actually have win-win benefits for certain customer segments, while other customers may need help dealing with the changes.

Key No. 3: Create a Different Forum

A new lens and focal point set the stage for doing more with less. But what's needed to fully escape the trap of the budget mindset is a third critical component: agencies will need to create a different and more effective forum for weighing tradeoffs and making tough financial decisions. To be successful, this forum requires five components:

1. **The Right Data:** An appropriate amount of strategically relevant data, at an appropriate level of detail and presented in a useful format such as the Resource Classes taxonomy (Exhibit 1).
2. **The Right Methods:** Frameworks and tools that enable decision-makers to effectively organize, analyze, and extract insight from the assembled data sets. Exhibits 2 and 3 are examples of the kinds of tools that have proven effective.
3. **The Right People:** A "council" that is both separate from and linked to the Budget Process. This group should involve a diverse set of relevant constituencies, including a broad range of executives, managers, employees and outside partners.

4. **The Right Decision Rights:** Clearly articulated and allocated roles, responsibilities and authority that permit the members of the Council to make clear and actionable decisions.
5. **The Right Dialogue:** Transparent, fact-based and effective communication dynamics that enable the decision-makers on the Council to address difficult questions around priorities and tradeoffs inherent in scenario planning.

These five requirements of the new forum are all essential to success, and they operate as an integrated system. The right people without the right data and the right methods will be unable to make informed choices and decisions, no matter how dedicated, aligned, and well-intentioned they might be. The right data, methods and people will not be able to address past assumptions and discover new solutions without the open discussion and healthy debate of the right dialogue. Finally, if all the other four are in place but the right decision rights are absent, the discussions will ultimately break down. A new cast of characters being asked to give input for the first time will assume they are also being given a say in making the final decision, unless explicitly told otherwise. This is likely to lead to inertia as the chances of full consensus in the face of difficult choices are prohibitively small.

But with the right data, methods, people, decision rights and dialogue, agencies can create the forum they need to produce a set of cost-cutting options with the potential to help the agency become more efficient, more effective and more creative than ever before at doing more with less.

THE KEYS TO ACCOMPLISHING MORE WITH LESS

Cutting costs is never easy, and it can seem particularly daunting given the magnitude of the reductions that many agencies are being asked to make. But more aggressive cost targets *are* attainable—just not by the same old budgeteering tactics that have failed to make significant lasting progress in the past.

It is not possible to say in advance where the critical cost savings will be found in a given agency. Each agency faces its own mission, challenges and problems. But it is possible to say something about *how* those savings will be found. They will not be found by the Budget Committee working even harder on the budget. They will be found, instead, by escaping the limits of the budget mindset. They will be found by recasting the budget numbers so that they are more useful to decision-makers and action takers. They will be found by looking beyond past practices and beyond the walls of the agency. And they will be found by a team supplemented by new members engaged in a dialogue of discovery.

Those will be the keys that will unlock government's ability to accomplish more with less. •

ENDNOTES

1 In the private sector, Monitor has used an approach called Adaptive Cost Management (ACM) to help companies achieve cost-reduction targets and subsequently keep costs under control without causing harm to core competencies. To learn more about ACM, see "Shifting the Curve of Cost and Value" by Josh Lee, part of the Monitor thought leadership series *Taking Advantage of Tumultuous Times*.

2 "The Hot Spotters" by Atul Gawande, *The New Yorker*, January 24, 2011.

About Monitor

Monitor is an international consulting firm that works with the world's leading corporations, governments, and social sector organizations to drive growth. Monitor offers a range of services—Strategy and Uncertainty, Innovation, Leadership and Organization, Marketing, Pricing and Sales, Economic Development, and Social Action—to deliver sustainable results.

Monitor's High-Performance Bureaucracy™ practice works with leaders of government and public service organizations across the globe to identify precise mechanisms for these leaders to drive real change and improve the performance of their organizations—and ultimately, to have a greater positive impact on the constituents they serve.

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