Budget Fundamentals

New IT Managers Institute
October 2019

Agenda

1. Review basic budget terminology
2. Learn budget fallacies to avoid...
3. Learn frameworks for creating a narrative for non-IT constituencies about IT funding needs
Q1: At what type of institution do you work?

Where do funds come from?

- State General Revenue Fund (for publics)
- Direct revenue (tuition and fees)
- Income from endowments
- Gifts, grants, and contracts
- Agency (self-supporting)
- Borrowing (issuing bonds)
Where do funds go?

- Personnel (on average, about 75%)
- Operating costs
- Capital purchases and projects
- Financial aid
- Debt servicing

1. Budget Terminology
Budgeting

Fundamentally a *planning* process
- Annual budgets planned and approved months before a new fiscal year starts
- Requires that you anticipate program needs many months in advance

Incremental Budgeting

- Most common form in higher education
- Based on slight changes to a previous budget.
- Provides stability and simplicity
Accounting

The process of *tracking expenditures* in a system of record keeping and reporting the results.

Cost Center

A department or other unit within an organization to which *costs are charged* for accounting purposes.
Discretionary Budget

Actual budget – Encumbrances = Discretionary budget

Operational vs Capital

- Operational expenditures (OpEx)
  - Typically provided on an annual basis
  - Covers all expenditures, including personnel
- Capital expenditures (CapEx)
  - Long-term investments typically for construction or expensive equipment. These assets can be depreciated over years.
- IT has capital and operating expenses
Permanent vs Temporary

- Permanent money (on-going; hard) is in the base operating budget
- *Temporary* money (one-time; soft) is non-recurring
  - Grants, gifts, one-time appropriations

Budget Dust

- Operating dollars unspent and unencumbered near the end of the fiscal year
2. Budgeting Fallacies!

Beware three common pitfalls

- Planning Fallacy
- Hidden Cost Fallacy
- Sunk Cost Fallacy
The planning fallacy is that you make a plan, which is usually a best-case scenario. Then you assume the outcome will follow your plan, even when you should know better.

--Daniel Kahneman

“The hidden-cost fallacy occurs when you ignore relevant costs. A common hidden-cost fallacy is to ignore the opportunity cost of labor when choosing to produce software in-house.”

- Froeb and McCann, Managerial Economics
Total Cost of Ownership

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<th>Services</th>
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The sunk-cost fallacy is when you tell yourself that you can’t quit because of all that time or money you spent.

--Stephen J. Dubner
3. Creating a Narrative
Communicating

Figuring out the numbers is only one part of budgeting.

The real task is learning to communicate with decision makers and stakeholders.

Mission-Driven Organizations

For almost all of Higher Education, profit is neither a goal nor a reality.

Success is defined by furthering the mission.
Benchmarking

- Higher education leaders tend to keep track of peer schools
- Nobody wants to be well behind the curve...
- Evidence of what is typical at similar schools can be persuasive
- Get to know your counterparts at your peer schools.

Focus: Return on Investment (ROI)

ROI is the *tangible* result of an investment

A *measurable* improvement in, e.g., productivity, costs, revenue, enrollments, retention, graduation rates, etc.
Focus: Value of Investment (VOI)

VOI points to the *intangible* benefits of an investment
Loyalty to the institution, student and faculty satisfaction, reputation effect...

Run — Grow — Transform

A model that facilitates better discussions with financial administrators and other decision makers.
Run

Run – Activities for ongoing operations

Grow

Grow – Activities that make incremental improvements
Run – Grow – Transform

Transform – Activities that aim to make transformative change

Why Run – Grow – Transform?

- Connects IT spending to the strategic objectives of the institution
- Focuses on outcomes, not just inputs
- Clearly identifies partners and beneficiaries
- Used to analyze multi-year budget plans
Audience poll 2

We’re showing you several different institutional profiles of Run–Grow–Transform splits.

In your estimation, which one looks like how IT investments are allocated at your institution?

Forming a narrative

- Benchmarks
- ROI
- VOI
- Run-Grow-Transform
Next Steps

- Ask your supervisor about how the budgeting process works at your institution
- Create a list of potential funding needs for your unit in the next 1-3 years
- Identify a product or service that is a candidate for reduction or elimination. Consider whether sunk cost fallacy has influenced thinking about this service...
- Identify your peer schools for benchmarking data. Get to know your counterparts at these institutions.

Q & A
Thanks!

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