

Focus on Results: Using Budgeting for Results — To Deliver Results to Citizens and Customers At the Price They Are Willing to Pay

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"We're broke and we're going to stay that way so the new central focus has to be on delivering better value (as perceived by citizens and customers) without increasing the price charged."

In an era of continued belt-tightening and demands for greater fiscal responsibility, organizations need concrete solutions to get the results they need without increasing their revenue and to create budgets based on targeted results, not on estimated costs.

Outcome-based budgeting requires a significant change in mindset, a shift of focus from funding cost centers to funding targeted outcomes, a process that traditional budgeting practices do not address. This results-oriented process starts with:

- defining what is to be accomplished
- soliciting competitive proposals from everyone who has an interest in being funded
- using broad stakeholder input to prioritize desired results
- dividing funds based on the priorities
- cutting off (as opposed to reducing) funding for anything else.

The focus of this presentation is primarily governmental, but the concepts and applications hold true for private industry as well. It has been successfully used in the public sector and in Fortune 100 companies. With outcome-based budgeting, public sector organizations from Washington to South Carolina have reduced deficits, used revenue more effectively, and significantly increased taxpayer confidence.

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e complain though we might about the federal tax load, the rate at which the government collects revenues (as a percentage of Gross Domestic Product or GDP) has remained consistently at +- 18 percent since 1960, and is forecasted to remain at this same rate through the next 50 years. So why is government strapped for funds. Making a profound impact are three programs which, when coupled with the national debt, are eating us alive:

- Social Security has grown from +2 percent of GDP in 1960 to +4 percent today, and is expected to rise to +5.5 percent in about 2024, less than 20 years from now.
- Medicare didn't exist in 1960. It is now +3 percent of GDP, anticipated to grow to +7 percent by 2024.
- Medicaid, also nonexistent in 1960, will grow from current +1.5 percent to +2.5 percent

These three programs are usurping our federal revenues, especially when seen in a 20-year forecast, and because the future percent of taxes to GDP is highly likely to remain consistent, we have no choice but to give up other essential spending. (For those of us who may think 20 years in the future is a long way off, consider: 20 years ago, Ronald Reagan was in the White House; 20 years before that the Ford Mustang debuted and US involvement in Vietnam had just begun; and 20 years before that, World War II ended.)

State and local governments are broke, too. Going back to 1974 as a base point, spending for K-12 education has fallen slightly from +32 percent of local expenditures to +27 percent. Spending for human services, higher education and transportation has fallen slightly as well. But expenditures for safety (mostly prisons and jails) has risen from +8 percent to +13 percent of current expenditures and health has shot up from +11 percent to +19 percent, a rate of increase that nullifies reductions in other government expenses.

Lest we think that this is exclusively a government problem, note that businesses are also broke. Airlines, automobile manufacturing, groceries, retail, energy, technology and others are falling on the sword of the costs attendant to pensions and healthcare.

The math simply doesn't work out under traditional budgeting. We're losing our ability to lead and we have put ourselves in a permanent fiscal crisis; i.e., in a financial "perfect storm."

- costs are increasing, especially the cost to medicate
- obligations for pensions and healthcare are increasing as the populace ages
- governments, companies, organizations and families are carrying increased debt at increased debt service rates
- price sensitivity – hostility to price increases – makes it almost impossible to increase revenues.

Thus, in nearly every segment of our economy we are not fully accountable for future costs and we're in deep trouble. The systems we now use won't get us out of this mess.

"We will win only if we deliver the results that citizens and customers want at the price they are willing to pay."

To budget for outcomes effectively, we need to understand how factors shape the results.

Factors affecting health. Let's take a quick look at health and the factors that are influencing the cost of healthcare. The health of a population is driven by the availability of healthcare, by the environment (exposure to hazardous conditions, materials and diseases) and by risk factors (age, socio-economic status, genetics, gender, race and ethnicity). However, these contribute less than 50 percent overall. Behavior (diet, obesity, exercise, tobacco use, sexual behavior, self-protection, substance abuse, and non-receptivity to health care) drives the health of the population more than the first three factors combined. Individual choice is the single highest contributor to cost and can only be controlled at an individual level.

Factors affecting the perceived cost of government. In government, the "cost of doing business" is set by all of the taxes, fees and charges paid by citizens for services. Unlike the private sector, it is very difficult to determine exactly how these funds are spent because they all go into one pot from which funds are subsequently disbursed. This lack of clarity makes taxpayers distrustful, dissatisfied and cynical:

- doubting systems and organizations and leaders
- reluctant to pay for things that have insufficient results
- not understanding about how public budgeting is done

Because governmental budgets are huge, complex, and allocated by cost, and the message is "give us more money," why should it surprise us when citizens perceive that we don't care about them?

In some ways, we've been trained for this point-of-view. Consider earlier government achievements: the interstate highway system, a much more advanced K-12 educational system, more accessible higher education, public infrastructures such as satellite communications, space travel, and the defeat of communism. These are the achievement levels we still long for at a time when Social Security, Medicare and Medicaid (and recently, Defense) costs are taking a huge percent of available revenues. (See previous page.)

Even though it goes against the street wisdom of both liberals and conservatives, it is inaccurate to say that government spending is out of control. The U.S. price of all governments (Federal, state and local) has remained remarkable stable over the past 50 years at approximately 36 percent of personal income. (This is substantially below the cost of government in Europe, but well above the cost of government in South America.) However, the way governmental monies are disbursed is significantly different than it was 50 years ago and this presents a dilemma: the public wants government to keep up with results or increase them, but is unwilling to pay more to get them. When the price is raised over what the public wants to pay, the public doesn't buy it.

The price of state government, state to state, hovers around 15 percent of personal income. California dropped several percentage points in 1976-1978 as a result of initiatives, but has climbed back to "average" because of fines and fees not covered by the tax code. Minnesota price of government remains +/- 2 percentage points above average. In Washington, Initiative 601 drove prices down; it is now average. Oregon has for years been above-average (in large part because of our peculiar tax system), but in the past three years has more closely matched the national norm. Curiously, Colorado recently passed a referendum to increase tax revenues, saying "we'll pay more, given the consequences of not paying more."

Of concern to all of us, personal saving as a percent of personal income has dropped precipitously from +/-11 percent in 1972 to approximately 4 percent today. This is dangerous. When over-extended, we have the fewest resources to fall back on and we have already committed the post-tax 64 percent of our income to new standards of living. Compared to 1950, today's average house is twice as big with three times as many bathrooms, but has only two-thirds the number of inhabitants. In 1950, one car was the norm per family and eating out was a rare circumstance. In 2005, we have more, but we are strapped financially and are saving

considerably less. Are we resistant to tax increases? You bet. Do we want more for our tax dollars? For sure.

Are we willing to give up some things of lesser value to gain things of higher value? Not willingly, yet therein lies our hope for a solid financial future.

Setting the price is the choice of the marketplace, public or private, and the key to gaining trust (a willing buyer) is to set the price so that it is acceptable (we are willing to pay it), adequate (to fund the desired outcome), and competitive (so we don't get "taken").

From the point of view of the citizens, desired government priorities (outcomes) don't change much:

- kids learning
- a strong economy
- citizens healthy
- people and goods moving reliably
- available cultural and recreational opportunities
- people working and earning
- people safe and secure
- a trustworthy government
- a clean environment
- keeping vulnerable people safe and self-sufficient

Citizens look for the results that matter the most to the most citizens; they want specific indicators and measures of success, not just good intentions, and are apt to turn a blind eye and a deaf ear to specific costs, activities, programs and organizations as long as the total cost is not exorbitant (as perceived) and specific outcomes are achieved.

The focus remains, how to deliver more results for the same price over the years. And the answer remains, we can't do it with traditional budgeting. Budget systems are largely inherited. Every year we expect a miracle to occur, but it doesn't. Hence, we need to change the way we think about budgeting, to find ways to get more results from the budget . . . or keep losing.

Citizens see results as effects, not nouns; i.e., smooth roads, clear air, getting home on time, being healthy, being employed. In getting to work, is the driving time reasonable considering the mileage? Does each trip take about the same amount of time? These matter and they are the stick by which citizens measure government spending.

And the Good News Is, Success is Possible

Outcome-based budgeting gives us the edge we need to do more with the money we have and to regain public trust:

Step 1 – The Agent (the Buyer) for Citizens and Customers initially:

- sets the overall price. How much money is available?
- establishes priorities. What are the results that need to be achieved?
- sets the price of each priority.
- plans on purchasing what works or matters most by soliciting Requests for Results from the Sellers.

Step 2 – The Departments, Agencies, Suppliers (the Sellers):

- respond to requests for results and compete to deliver the highest priorities for the least money.

Step 3 – The Agent (the Buyer) for Citizens and Customer then:

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Outcome-Based Budgeting: doing more while spending less

- Initially funds the results that deliver what the citizens/customers want at the price they are willing to pay.
- Remains open until a set date for resubmissions from those initially funded as well as those not funded.
- Makes final decisions, and then stands firm in not funding anything that wasn't important enough to be "bought."

Graphically, the result of budgeting for outcomes looks like this:



The only way to move up (to get in the funded area) is to convince the buyer that the assessment was wrong, or do a better job of proposing. This promotes rewriting proposals with a sharper pencil and the best ideas, making the proposals more creative.

By getting the budget from the field and having them sign off on it, it is reasonable to hold them to it. This alters the relationship as well as the way people behave. Budgeting for outcomes establishes a deal between seller (government, company, organization) and the buyer (citizen, customer). It changes the action from a service delivery strategy to a business strategy. Think of it as a planning, soliciting, responding, deciding and implementing process. Higher priorities receive adequate funding. Lower priorities receive no funding at all. "We will buy until we run out of money. Then we will stop buying."

At first glance, this methodology would seem to fuel negative competition between managers. Experience has shown that the reverse is more often the case. The managers typically collaborate and cooperate, often reducing or restructuring their own interests in an effort to gain the most desired overall results. In Multnomah County, for example, over 85 percent of all budget requests were resubmitted during the resubmission time frame. Many fully funded departments found ways to cut expenses without cutting services, and subsequently reduced their requests thereby helping fund the requests of other departments.

Said another way, the methodology is about keeping, not cutting; about buying until the money runs out, and then stopping. It's about spending the money wisely. It's about results. Our leadership challenge is to figure out the factors that produce the results and then do what we can to influence them positively. This changes the process we go through to make a difference. If The Way We've Always Done It (TWWADI) is the answer, we've got it all wrong.

It is important to distinguish between good management and good leadership. Good management (the traditional way to budget) is about solving the math problems. This is mostly subtraction and addition, and is trivial insofar as it affects outcomes. Good leadership is delivering more on the dollar; i.e., adding greater value to the people served. This is hard work because it includes improving services, earning trust, balancing the budget, and solving the value-for-money problem.

The State of Washington did this via reverse engineering, looking first at results and then backing into the budget those items that would achieve the most desired results; i.e., treating budget requests as proposals or offers, and asking which of these could achieve the result at what cost and in what time frame. The State, in effect, considered today's value rather than TWWADI by:

1. treating budget submissions as offers to deliver results at a price. This was a results architecture, not cost reduction.
2. measuring each offer against the results that were most important to citizens. What were their priorities? This step established performance agreements.
3. Buying those offers that contributed most to the desired key results and then leaving the rest unfunded.

"The impossible task of cutting \$2 billion from state spending has been made possible. . . The usual, political way to handle a projected deficit is to take last year's budget and cut. It is like taking last year's family car and reducing its weight with a blowtorch and shears. But cutting \$2 billion from this vehicle does not make it a compact; it makes it a wreck. What is wanted is a budget designed from the ground up." Seattle Times 11/18/02

Implementing Outcome-Based Budgeting

Shifting to outcome-based budgeting requires redefining the process.

- 1. Get a grip on fiscal facts by thinking simple and long, but not too long.** Consider looking five years out, not ten, and paying attention to the five key components of any budget:

	2005	2006	2007	2008	2009
Beginning Reserves					
Revenues					
Expenses					
Balance or Deficit					
Ending Reserves					

- 2. Abandon the Old Budget Game in which we budget by status quo (TWWADI).** The TWWADI question that starts most budgeting is "How much would it cost to keep doing exactly what you have been doing in the way you have always done it?" Status quo is guaranteed to cost more because changes in costs, cases and complexity are strong expense drivers. Under the Old Budget Game, the only choices are to pay more to get what we've always got, or to pay the same and get less.

Cutting is a game for losers because cutting always inspires blame. A new governor, eager to trim a \$4.5B deficit, chose as his initial cut the elimination of the Highway Helper trucks that gave aid to stranded or disable motorists. Schooled in the old budget game, he knew of no other way. The public outcry was instant and loud since this very visible, highly popular program cost only \$1M per year, less than 1/4 of one-percent of the deficit.

Other time-honored "tricks of the trade" – clouding the issues, playing hide-and-seek and operating in an environment of all cuts, all blame, all the time – need to dropped, too. Do any of these look familiar?

- stealing funds from other accounts, calling them "transfers."
- lying through accounting gimmicks. In the private world, this is called creative accounting. In the government world, it's done by moving the recognition of spending or revenue from one fiscal year to the next.
- borrowing to pay tomorrow for today's costs. The most devastating tomorrow-borrow is deferred maintenance for people, equipment, processes and real estate. These are

simply not accounted for. In current U.S. state governments, California holds the record for taking money from future generations to pay for today's services and expenses. In private industry, this may take the form of booking real estate on the day it goes on the market, not on the day it is sold.

- making something up and screwing around with assumptions so that the budget "looks" balanced.
- "thinning the soup" by using the flawed mantra that "any good manager can handle a 3-percent cut" to mandate across-the-board cuts so that no one gets blamed. A seasoned manager, aware of this possibility, will build "spam" or "slack" into her budget so that across-the-board cuts won't affect her operation. On the public side, managers often rush to spend their entire budgets at the end of the fiscal cycle, knowing that any unspent money will be deducted from their next year's budget. It bears noting that this is seldom done because of ill intent; it's done because that's what is needed to survive in The Old Budget Game.

3. Forever dump TWWADI in favor of changing the questions.

- What is the price our citizens/customers are willing to pay? (**Revenue**)
- What results matter most? (**Priorities**)
- How much should we pay to achieve each result? (**Cost**)
- How can we best deliver the results that citizens/customers expect? (**Results**)

4. Change the game in a radical way by budgeting to get the most result for the money.

This is not unlike how we budget our personal incomes. Income less expenses = balance. When our personal expenses exceed our personal income – when the balance is negative – we cut or eliminate where it hurts least, perhaps eating out less or curbing other discretionary spending. It makes no sense to cut every expense across the board. What would your mortgage company say if you told them that – because your expenses are exceeding your income – you will, starting today, send them only 93% of your monthly payment?

Always measure the intended result first, and then fund accordingly by continually asking what results you will get for the money:

- What is the best road to take to get the results I want?
- What factors most influence the result?
- What can my organization do to enhance the results?

You'll be using a new set of assumptions:

- A balanced budget starts and ends with the money you've got.
- This is a new game with new rules that alters the way people think about budgets.
- The focus is on the 'keeps' not the 'cuts'.
- You are budgeting to buy results not costs.
- Performance accountability is built around getting a specific result at a specific price.
- Continuous reform and improvement are part of the process.
- So is establishing communications that make sense.

In determining what to fund and what to cut, there is no substitute for focus groups, surveys and other inquiries. Have the citizens/customers determine the priorities and get their jurisdiction to think about things (results) the way they think about them, thereby creating incentives rather than

penalties. Gain their buy-in by involving them in the process rather than by marketing to them after the fact.

Note that few people really want to change the status quo. Everyone is for change, but not necessarily for themselves, so breaking the language of 'cuts', firmly entrenched in processes and history, is incredibly hard.

But asking what matters or works is liberating, too. It makes the budget understandable in its entirety, not just the parts, and easier to communicate because the focus is on the bigger stuff, organization wide, not the cubicles. It's hard work because it's so difficult, and it's good work because people love the result.

If you decide to go down this road, you need better information about results and costs. Not the details of cost codes, but the overall results and costs. (Curiously, we know the cost of transporting a child to school, but not the cost of teaching her how to read.) Here, the focus is on organization-wide results for citizens and customers, away from traditional agency/department silos. For instance, if public safety isn't focusing on helping fix healthcare costs, it isn't focusing on public safety because healthcare is gobbling up the funds that could otherwise be spent on public safety.

Outcome-based budgeting is a good policy that produces good politics.

Delivering Outcomes: Tools for Success

1. **Smarter Budgeting** (see the preceding pages)

2. **Smarter sizing:** it does matter.

- Divest to invest: "If we had \$5 million, what would we do with it? Now what are we going to divest to pay for it?" Balance and improve.
- Consolidate. Regular consolidation rarely works because people get torqued about reportability, work environment, work styles, etc. Make smart mergers such as backroom operational consolidations, a single web site, a single 800 number.
- Right-size. Do the right work (produce the value justified by the price), do the work right (deliver the results), and use the right people and technology.

3. **Smarter spending:** buy value, not cost.

- Buy competitively, but don't take bids for granted. Get benchmarks and create the challenge to meet the best examples.
- Reward performance, not intentions. Make performance consequential. It's not about performance reviews; it's about performance outcomes.
- Put customers in the driver's seat. Give them choice and control, don't waste their time, and don't buy mistrust. Win compliance.
- If people complain about the metrics, have them (not you) provide better metrics. "If Plan A doesn't work, Plan B is to make Plan A work."

(Note: Most of our systems are driven by the idea that we can't trust people. Consider expense reports, for example, with their attendant receipts. These systems are carryovers from a time when trust wasn't automatic. Did you know that in government, one-third of all money is spent checking out the spending of the other two-thirds?)

4. **Smarter management:** rethink relationships and reform the inside to improve outside performance.

- Tie greater flexibility to better results. Use flexibility to get accountability. The focus is on better outcomes.
- Make administrative systems allies, not enemies. Most of our systems are against us. Their design frustrates creativity and productivity. They create data yet no information about how to do things better. Find and implement the systems that support outcomes.
- Use smarter work processes. TQM, Process re-engineering, et al are only good if they increase favorable outcomes.

5. Smarter leadership: the aim is to make the main thing the main thing.

- Make your purpose clear. Relentlessly pursue the things that matter.
- Frame everything in results terms.
- Focus on the core, not the peripherals.
- Always keep your customers in sight.
- Be open to changing anything except the organization's values.
- Expect leadership everywhere. "What did you do today to make things better?"

"A leader is someone who goes out and changes things to make things better."

Summary: Implications and Key Principles

1. Budgeting for outcomes leads organizations to:
 - Focus on their core purpose and priorities
 - Be accountable to their customers for results and price
 - Experience their performance as consequential
 - Use control as a tool not a weapon
 - Operate in a culture of performance (results) not bureaucracy (systems).
2. When we succeed in doing this, we will be successful as well as ethical to our charter.
3. Fiscal problems are not going away. Government and private industry will always have challenges between cost and price.
4. Change the budget game, or remain broke and broken.
5. Budget for outcomes:
 - set the price
 - define the priorities, the results that matter most to the citizens or customers
 - set the price of each priority result
 - plan to purchase what works or matters most

Outcome-Based Budgeting: doing more while spending less

- make sellers compete to deliver value for the money
- buy results that deliver what the citizens and customers want at the price they are willing to pay