IT Budgeting

by

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In a difficult economy, hospitality budgets, especially in the area of information technology (IT), are tight. This leads to increased scrutiny over requests for capital and the need for more rigor and disciplined approaches to evaluating how limited capital will be used and for what key projects or strategic initiatives. For an IT project to be approved, its business case must be rock solid and bullet-proof. The expected returns must be carefully and completely documented, and they must outweigh the project's costs and risks (both actual and perceived). Williamson (1997) suggests the following criteria when evaluating IT investment decisions for inclusion in the business case:

- Alignment with the Business Strategy – Consideration for how well the proposed IT project fits with the company's overall business strategy.

- Return on Investment (ROI) – The anticipated return on the IT investment.

- Risk – The ability to deliver the proposed project, fulfilling the requirements within a timely fashion. Assessments should be made to determine both technical and organizational risks.

- Business Readiness – The overall preparedness of the firm to adopt the new technology and make the necessary changes required to implement it.

- Regulatory or Mandated Changes – Changes that are required due to necessary changes in the business environment.

- Business Values – The anticipated changes brought on by the new IT application are consistent with the firm's corporate value system.

- Cost Assessment – The best estimate for the project's total cost.

- Sponsorship – The project has support from the user community and an overall product champion.

- Common Sense – Intuitively, the project makes sense.

Due to capital constraints, hospitality companies are making it more difficult to gain access to capital investment dollars. In the present environment, they are only likely to fund projects with assured outcomes. Unfortunately, this puts IT at a disadvantage. Institutional memory is high from many visible IT projects that have failed, and executives often consider IT investment as akin to putting money into a big black hole. They have invested in the past and been disappointed in the results. Furthermore, the general press frequently reports a rather large number of IT project failures across the entire business world. Thus, the deck is stacked against

IT, and any project going before a funding committee must be well defined, clearly articulated, and essential to achieving the strategic objectives of the firm.

The Strategic Importance of the Budgeting Process

Most people have come to loathe the budgeting process. The mere mention of the word budgeting is likely to elicit anxiety from even the most seasoned executives and managers. For better or for worse, budgeting is characterized by extremely onerous tasks, fierce debates, and enormous challenges for all but the most enlightened of organizations. In recent years, perhaps few have been more disillusioned by the budgeting process than those responsible for IT in the hospitality industry. In terms of IT, one of the reasons budgeting is difficult is that IT professionals maintain some misconceptions about budgeting. Oftentimes, they are unwilling or unable to effectively participate in a decision-making process that can make, or break, the effectiveness of their department's annual spending. Another contributing factor to IT budgeting hardship is the failure to assign ownership of IT projects to the business units that will realize the benefits of a successful implementation and maintenance.

The negative factors notwithstanding, the budgeting process is one of the most important processes on which a company can embark. Budget preparation should involve every level of an organization, as every functional area must prepare and submit requests to finance routine and non-routine projects. It is important to understand that, in this process, IT is just one more functional area asking and competing for money.

In the Appraisal Institute's *Dictionary of Real Estate Appraisal*, Third Edition, "capital expenditure" is defined as follows:

> "Investments of cash or the creation of liability to acquire or improve an asset, e.g., land, buildings, building additions, site improvements, machinery, equipment; as distinguished from cash outflows for expense items that are normally considered part of the current period's operations."

The principal focus of the budgeting process is the allocation of the firm's limited (and, therefore, precious) resources. It, thus, plays a critical role in the execution of strategy, and it is a necessary step in answering the perennial question of any organization, "How to create value?" When done well, the budgeting process will select the firm's top strategic priorities, ensuring that there is alignment between the strategic/business objectives of the firm, the initiatives to be undertaken for the budgeted period, and how resources (namely, people, capital, and equipment) are to be used. This alignment is increasingly becoming the focus of corporate strategists because of its high correlation with competitive advantage and firm performance and because of an increased pressure to create value.

IT Budgeting Trends

As a result of a tough economy, hospitality companies are looking inwardly for cost reduction opportunities. IT budgets in most hospitality organizations are either flat or down slightly from previous years. Getting more from existing systems by investing in maintenance, support, and upgrades and improving systems integration are top agenda items for hospitality executives in

the immediate term. This is consistent with the conservative approach hotel executives have taken with respect to IT during this difficult economic downturn to extend the useful life of existing systems, protect and reap more from their prior investments, and minimize large capital outlays until after an economic turnaround. This may also be a function of aging systems and infrastructures that need to be prolonged due to a lack of perceived suitable replacement systems or technologies. Clearly, the focus is more on operational alignment than on strategic alignment. It seems that industry executives are more concerned with tactical issues and short-term gains rather than strategic issues and a long-term vision. The basic premise is survivability or riding out the economic storm. Unfortunately, this is not likely to change any time soon. The industry has always been slow to change and respond to shifts in the business environment. As history suggests, the hospitality industry is evolutionary, not revolutionary.

Given the practice of capitalizing hospitality IT investments over a period of time, it is even more difficult to determine the true annual IT expenditure of most hospitality organizations. However, it is known that spending on IT in the hospitality industry has never equaled that of other industries like airlines, retail, banking, financial, real estate, entertainment, and insurance. At the recent CIO Summit, held in September 2003 in Lansdowne, Virginia, the general consensus among industry technology leaders was that the majority of the hospitality industry spends less than 1% of total revenues on IT. IT spending lags considerably when compared as a percentage of revenues and when looking at IT spending per employee (see Figure 1) across other industries. An information worker is defined as an employee who spends more than 75% of his/her time at a computer workstation. In the context of hospitality, an information worker would most likely include positions like reservation and guest service agents, controllers, sales managers, etc.

Figure 1

Comparison of IT Spending for Selected Industries

Industry	IT Spending as % of Revenue	IT Spending Per Employee	IT Spending Per Information Worker
Retail	3.5	$5,689	$13,155
Financial Services	3.3	$8,500	$12,312
Real Estate	2.9	$9,070	$16,338
Entertainment	2.9	$5,202	$11,749
Hospitality	2.8	$2,245	$10,291

Sources: IT Industry Benchmark Summary
ValueIT Peer Comparison Tool, available at www.Alinean.com

It is important to understand the limitations of the above metrics. Alinean's Peer Comparison tool draws from a database of more than 20,000 publicly held companies, in more than 400 different industry segmentations. Investments in IT by publicly-held hospitality companies, which include the larger brands/franchising organizations, are not necessarily representative of

those made by individual property owners with franchise affiliations, small privately held owner-operator groups, or independent properties. Nonetheless, the above summary illustrates that hospitality industry indeed spends less than related industries, and, if anything, the numbers presented for hospitality are skewed in favor of the big chains—meaning that the situation is likely to be even graver than what is depicted here. IT spending in other industries slowed for a time but is now starting to rise again. Unfortunately, no similar trend has been witnessed in hospitality—meaning the IT spending gap is widening.

With growing security concerns and risks of viruses and hacking, companies need to increase their expenditures on protecting and securing their systems. These initiatives are necessary and unavoidable; yet, they do little to add new customer services or amenities. Because these initiatives are often viewed as insurance policies to protect against something that may never occur, because of their behind-the-scenes nature, and because they are not well understood by many executives, their importance is not always clear. Consequently, they often fall low on the list of priorities. However, in today's era of cyber threats, one cannot be so quick to discount these initiatives. While the payback may not be easy to calculate, the threats of hacked systems and compromised customer or employee data are very real and can be quite costly—in terms of monetary impact, lost credibility, and a tarnished brand image. Thus, hospitality executives would be wise to develop a security strategy and to make investment in this area a priority.

Changes to the Budgeting Process

On the surface, IT investment decisions seem straightforward. All projects should be accepted that add value to the firm. In reality, however, the process is much more complex due to the difficulties in defining and measuring value and the expected and actual contributions provided by IT. It does not help that in many hospitality firms, spending on IT is viewed as discretionary and, therefore, among the first to be reduced during times of capital rationing (Antonucci and Tucker, 1998). The decision-making process is further complicated by subsequent issues such as build versus buy (or hybrid) decisions for software and lease versus buy decisions for hardware, which add to the dimensions of the analysis. Investment in IT is important to nearly every aspect of an organization since it impacts customer service, transaction processing capabilities, employee performance, etc. Surprisingly, however, many executives are ill prepared to make sound decisions regarding IT investment and strategy (Weill and Broadbent, 1998).

With the role of IT changing from one of support or utility to one of strategic importance, the evaluation and decision-making process regarding which projects to accept and which ones to reject become more perplexing. The budgeting process is never easy. In many companies, it is an arduous, tedious, and time-consuming task. It is often politically motivated and wrought with inequities. Yet, one must look beyond these negative attributes, separate them from the process, and concentrate on taking a disciplined approach to ensure proper outcomes, ones that will lead the business to where it needs to be to remain competitive and prosperous.

Many companies are taking a closer look at how their budgeting process works and adopting some new approaches or applying practices used in other disciplines to improve the process and projected outcomes so that only value-adding initiatives get funded. Some of the changes being

embraced include the use of steering committees and application of finance practices such as portfolio theory and options.

Multi-disciplinary steering committees are being formed to help evaluate and prioritize the various budgetary requests. Through rigorous debate and group consensus-building approaches, the steering committee is able to take a holistic or enterprise-wide view of the needs and issues surrounding the firm; surface the top problems, needs or opportunities; and make decisions based on their overall impact and their alignment with the firm's strategic goals. Steering committees provide a shared governance role, taking many IT decisions out of the IT department and putting them in the hands of the heads of business. This gives the heads of business a vested interest in the outcome of IT projects and forces them to take a more active role in defining how to use IT for business advantage.

Ownership (and, hence, accountability, responsibility, and authority) are shifting from the IT department to the business units or functional disciplines that stand to gain from the IT investment. The hospitality industry has historically categorized any item with a technical component as an IT expense item, perhaps unfairly inflating the IT manager's departmental budget. In recent years, some leading companies have reformed budget practices with respect to IT expense. The practice of linking ownership of (and financial responsibility for) information systems to the departments or business units that benefit from them, is on the rise. In a simplified example, a new sales and catering system should be itemized on the sales department's budget, rather than the IT budget. Likewise a point-of-sale upgrade should belong to the food and beverage department.

Borrowing from the field of finance, a portfolio approach allows firms to diversify and spread out risk by taking on a variety of complementary projects at any given point in time. A firm's IT should be treated as any financial investment portfolio; that is, as a collection of assets that, when managed well, will generate suitable returns on investment (Weill and Broadbent, 1998). As with any financial portfolio, one must balance both short- and long-term needs of all stakeholders as well as risk and return while maintaining appropriate levels of investment to achieve a firm's objectives. The project mix must take into account factors like project size, scope, complexity, budget, and risk. It may include both large and small, complex and simple projects geared to make the most effective use of resources and maximize the likelihood of success. Using this approach assures that not too many resource-intensive projects or high risk projects are taken on concurrently. Different types of project initiatives may include strategic, transactional systems, informational, maintenance and support, and infrastructural (Weill and Broadbent, 1998). Like a financial portfolio, an IT portfolio requires on-going monitoring, management, and investment, making adjustments where necessary to ensure the strategic objectives of the firm are being met.

Another practice borrowed from the area of finance is the options approach. This allows firms to hedge their bets and apply a "test-and-invest" strategy. They try incrementally funding initiatives high in potential yet high in perceived risk or uncertain outcomes as pilot projects. Once initial measures are collected and reported as indicators of likely success, executives can review the results and make decisions to proceed or abort a project.

Finally, companies are beginning to apply a composite set of measures, both quantitative and qualitative, to evaluate IT rather than rely simply on financial measures alone. Because no single metric can adequately measure or capture the contributions of IT, assessing the impact of IT should use multiple measures to provide a more holistic, richer assessment and evaluate benefits from the various stakeholder perspectives. Bacon (1992) and Farbey et al. (1992) postulate that the criteria used in evaluating and making IT investment decisions are important because they determine which projects are accepted and the level of funding and resources they receive. Ultimately, they become instrumental in determining and measuring the overall success and effectiveness of the decisions—a means to assess performance. The assumption is that the criteria used will ensure that only the *right* projects (and mix of projects) are accepted, while all others are rejected or deferred until a more appropriate time.

Tools

Budget periods on average run between four and five months. It is not uncommon in many companies for an entire quarter to be devoted to budgeting activities. This process usually involves many people and commands considerable time from executives' and managers' schedules. If one were to place a cost on the annual planning and budgeting process, the number would be astonishing.

Many new software applications combine budgeting, forecasting, analytics, business intelligence, and collaboration capabilities. Web-enabled systems are designed to help companies radically speed up the planning process, even as they allow many more people to participate. They keep managers apprised of who has filed their budgets and who has not, and throughout the year, they help monitor variances among departmental budgets.

Despite the availability and adoption of these tools in many industries, most hospitality companies continue to plan and manage financial performance using the standard spreadsheet. Most companies rely on some combination of Excel, electronic mail, and paper for budgeting. This makes the process especially slow, rigid, and complex.

Concluding Remarks

Given the difficult economic conditions of the hospitality industry and uncertainty as to when the turnaround will actually hit, hospitality companies have assumed a conservative posture and deferred many strategic investments (those necessary for growth and long-term competitiveness) in favor of short-term needs and basic survivability. In many cases, IT has fallen to the bottom of the priority list. Consequently, the hospitality industry continues to lag behind other industries with respect to its technology position and posture, and the disparity is growing at an alarming rate. Looking back, hospitality companies deferred important projects due to the need to focus on making systems Year 2000 compliant. After that major ordeal, companies began focusing on the backlog of projects, only to again suffer setbacks due to the dot.com implosion and a faltering economy. All the while, the hospitality industry suffers with legacy systems becoming further obsolete, unable to meet changing business requirements, and falling further behind the technology curve. As a result of technological advances, customer needs are growing and becoming more demanding of technology amenities in hospitality. Yet, the industry's short-

sightedness and lack of emphasis on technology is making it difficult to keep up and meet these growing needs, not to mention maintain technological sophistication and parity with other industries.

While it is understandable that an economic turnaround is still many months off, it is important not to be too quick to discount the need for spending on IT, especially given the lead time required to develop and implement IT solutions. It can actually be a good time to invest in IT, for many technology suppliers are offering favorable pricing and financing terms in hopes of winning business and maintaining market share, not to mention finding ways to cope and weather the economic storm themselves. If one looks hard enough and is a shrewd negotiator, he/she can find some great deals. Moreover, because the competition is gun shy, it is possible to pick up some competitive advantage—catching the competition off guard while waiting for an economic recovery. Innovation in the industry and the ability to stay current with consumer demands depend on continued investment in IT.

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