

A Top-10 Integrated Utility Achieves Cost Reduction through Risk-Informed Budgeting

BACKGROUND

As part of an overall effort to inject more rigor into the development of their Operations & Maintenance (O&M) budget, a top-10 integrated utility in the Southwest sought to engage a firm with extensive experience in providing consulting services in zero base budgeting (ZBB) for utilities. The integrated utility's desire was to implement a sustainable methodology to provide visibility into cost drivers, incorporate risk valuation, maximize each budget dollar, and help management ensure credible budget targets for the future.

Prior to the initiative to implement ZBB, new budgets were created based on the previous year's budget plus or minus any major events. This approach left the utility unsure of just how much they spent by necessity versus how much was spent out of precedence. With installed information systems, detailed analyses of budgets and actuals were difficult if not impossible to conduct.

A bid was issued in the form of an RFP seeking the most capable implementer of ZBB for the budget cycle, as well as institutionalizing a complete ZBB product incorporating a training program, desktop instructions, templates, processes, etc. After a highly-competitive process, including in-person presentations, MCR emerged as the clear choice to implement ZBB for this large utility.

SOLUTION

MCR used its proven Risk-Informed Budgeting (RIB) process, originating from our approach to zero base budgeting, to help our client reach its spending goals. At its core, zero base budgeting requires budget owners to justify all budget requests from a baseline of zero. In a sense, it is the antithesis of the more traditional incremental budgeting process, which embeds a continuation of the past without rigorous spending scrutiny. The risk-informed approach considers the risk of not funding each individual line item.

The MCR team worked directly with our client's management team and budget analysts, guiding them through our RIB process steps:

- Develop a budget item classification framework relating spending levels to specific safety, regulatory and reliability risk factors
- Discuss each budget line item and assign to the risk classification framework
- Facilitate a structured review process guiding senior managers towards a risk-based ranking of all their budget line items
- Facilitate a final ranking process forcing the delineation between line items above and below the target budget funding line

MCR facilitated sessions with every budget owner and their finance representatives to explore spending paradigms for every budget line item. Working with the client team, we challenged every proposed expenditure in terms of risk and controllability. In these discussions, when identifying the true drivers of cost, hearsay was not admissible. Documented facts with clear references were often necessary to break the paradigms of exactly what influence our client had on spending.

The ZBB process brought to light budget items driving our business which were previously not understood.—Finance Manager

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RESULTS

Given the proper budget line-item risk classifications, MCR and the client management team identified opportunities to save \$80 million (25%) from the O&M request and \$19 million (7%) from the previous year's budget. These identified reduction opportunities enabled our client to meet their cost targets. In addition to the expense reductions identified by the RIB process, MCR also identified opportunities for improvements, including:

Operations

- For Power Generation, the complete discovery of reliability issues with low influence in scheduling indicates long-term budget restrictions addressing reliability risk. Strategic decisions will balance the required investment to maintain reliability vs. the desired longevity of assets
- A review of various industry standard metrics in relation to T&D costs per mile, per customer, per kWh transmitted, etc. all seem to indicate the client has room for improvement

Financial & Treasury

- Current financial systems and processes will benefit from significant upgrades
- Changes to analyses and reporting will reduce significant labor constraints in this area
- Knowledge sharing would alleviate issues of considerable expertise residing in a few senior employees

Security, Safety & Fleet

- Security tech outsourcing for aging equipment maintenance needs to be balanced with asset management
- Enterprise fleet key performance indicators need to include more cost-based measures
- Steps should be taken to lower the \$/FTE training requests from Security, Safety & Fleet to better align them with the company and peer averages

Information Technology

- The core ERP system is overdue for an upgrade and re-implementation
- Technology is owned by many organizations outside of IT, leading to conflict with the IT strategy; this issue could be remedied by bringing technology ownership under the IT umbrella

This exercise was very valuable in helping us document and prioritize reliability issues. —Finance Manager

MCR can help you with your RIB needs

We reduce and control O&M costs by working with budget owners to justify all budget expenditures from a baseline of zero. Our "challenge process" uses a peer review method to assess the risk associated with each budget line item and determine the ability to adjust the amount and timing of each expenditure within the executive team's risk tolerance.

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