

**SAP® HUMAN RESOURCES UND
FINANCIALS KONGRESS**
10.-11. Dezember 2002, Karlsruhe



Successful Enterprise Management through Employee Empowerment and Financial Efficiency: “Beyond Budgeting”

Juergen H. Daum
SAP AG

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■ Agenda



- **Motivation for a New Management System**
- **Company Success Beyond Traditional Management and Budgeting: The Beyond Budgeting Model**
- **Case Studies**
- **Conclusions for HR, Financial, and IT Management**

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Challenges in the Field of the Leadership Model and of Organizational Development

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**Peter F. Drucker:
„Management Challenges for the 21st Century“**




**“The most important contribution management
needs to make in the 21st century is to
increase the productivity of knowledge work
and of the knowledge worker.**

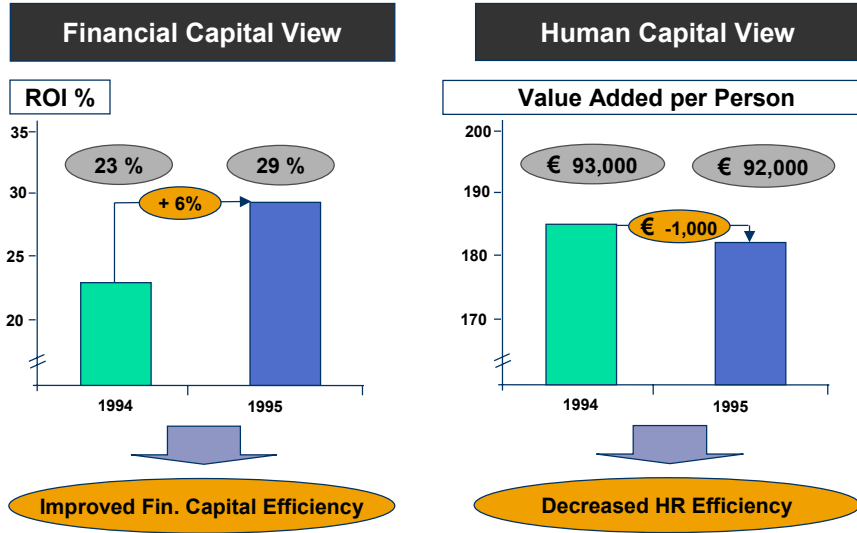
**The most valuable asset of a 21st-century
institution, whether business or nonbusiness,
will be its knowledge workers and their
productivity.”**

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The New Perspective: Efficiency of Human Capital Instead of Financial Capital - Case Study SAP*



*Source: Top Performer Study of The Boston Consulting Group

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Conclusions

- The most important resource and bottleneck factor for companies like SAP is not financial capital, but human capital
- Key figure systems that only measure the efficiency of financial capital (such as EVA) are consequently not sufficient means for steering and for measuring company performance in a human-capital-intensive business
- “Value added per person” represents a “symptom” in the financial perspective that cannot be optimized using classic finance-oriented controlling tools

“It is the quality of its structural capital that determines what a company is able to create from its human capital.”

Leif Edvinsson, pioneer in the field of Intellectual Capital Management*

In this way, the organizational and management systems become decisive productivity factors!

*Quote taken from an interview with Leif Edvinsson in Jürgen H. Daum's book "Intangible Assets and Value Creation", Chichester (Wiley) 2002

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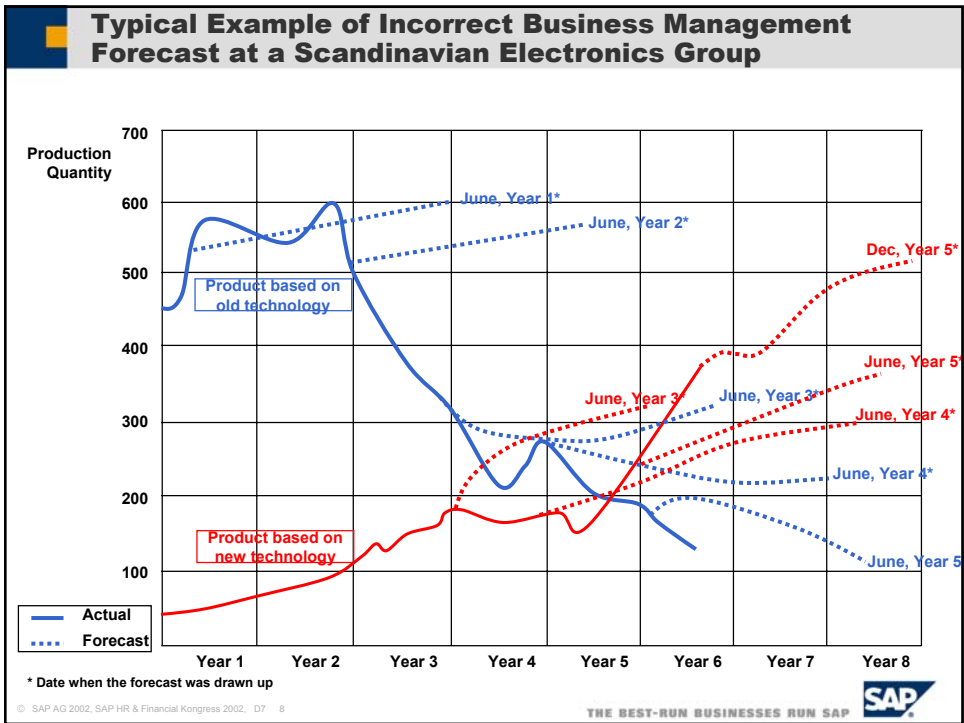




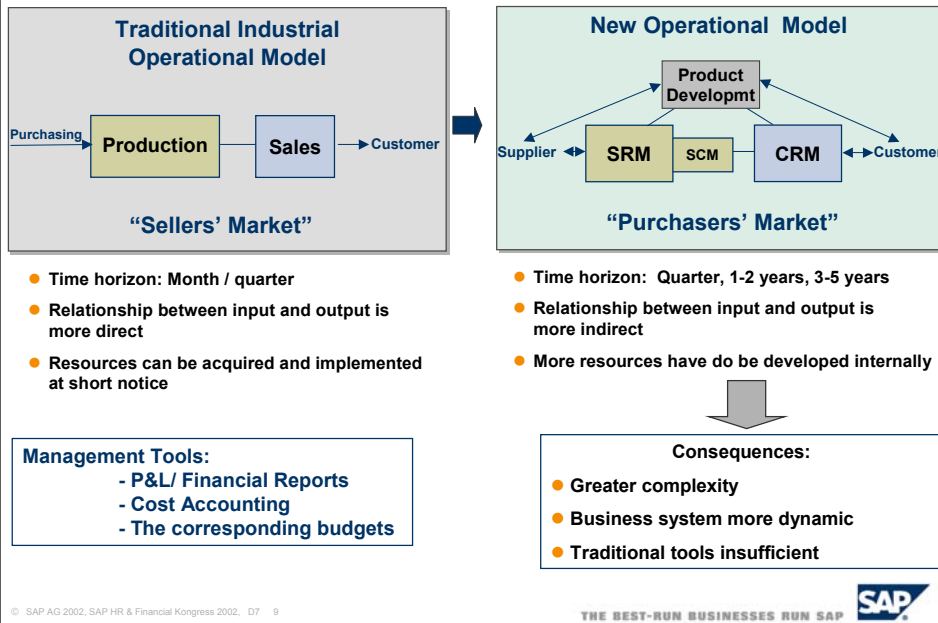
Challenges in the Field of Performance Management

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Companies Compelled to Develop Extended Operational Models due to New Competitive Factors



Consequences for enterprises

- Performance targets remain fixed over the planned fiscal year, but the world of business is ever changing: Companies are often unable to react quickly enough with adjustment measures
- In budgeting, the short-term perspective is in focus (time horizon: fiscal year). However, essential value-creating activities (concerning customer relations, product development projects, etc.) are tied to projects extending over several years
- Budget mentality prevents managers from surpassing themselves by setting truly ambitious targets. Really innovative ideas often fail to get past the first hurdle.

"The budget is the bane of Corporate America. [...] It is an exercise in minimalization. You always are getting the lowest out of people."

Jack Welch, former CEO, General Electric*

In this way, traditional budget-oriented performance management systems become obstacles to performance!

*Quote taken from an interview in *Fortune Magazine*, 1995

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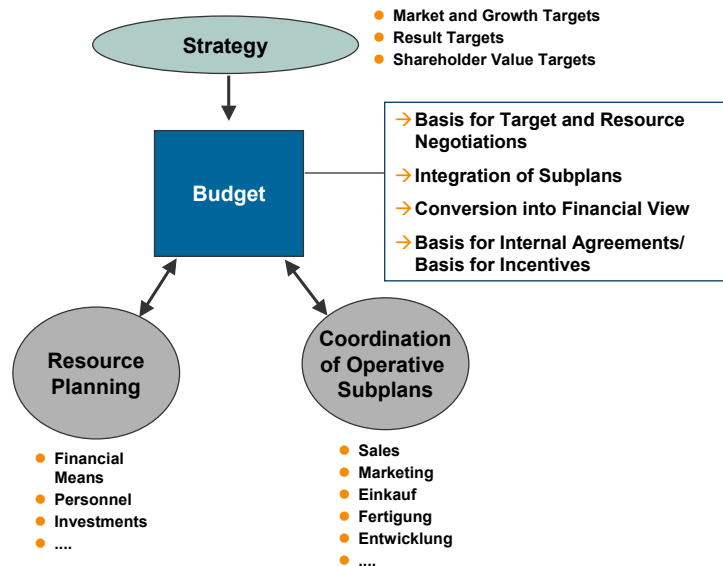
The Beyond Budgeting Management Model tackles these very issues

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Basic Principles of Traditional Budgeting



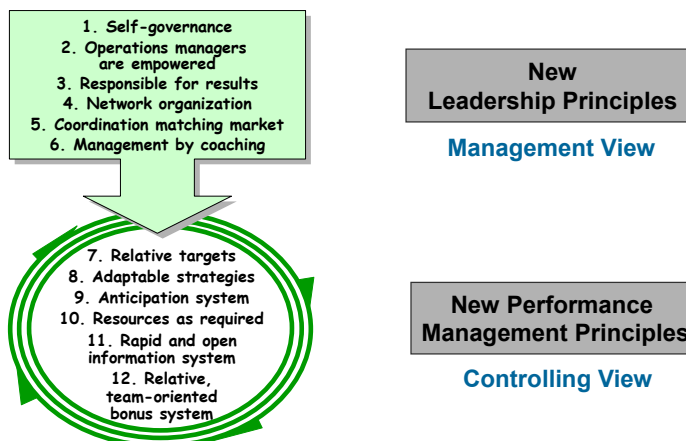
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Beyond Budgeting

The Beyond Budgeting Model has two pillars

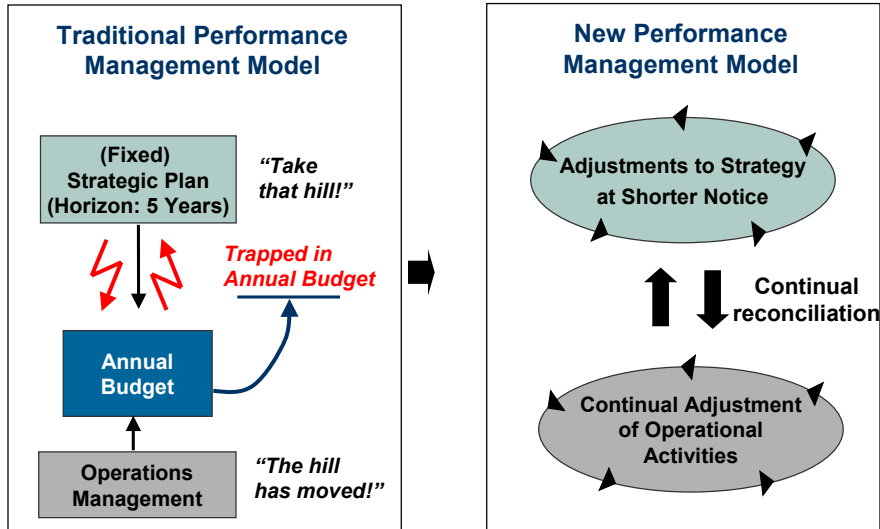


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The Underlying Philosophy of Beyond Budgeting – Aspect 1: Achieving Flexible Performance Management

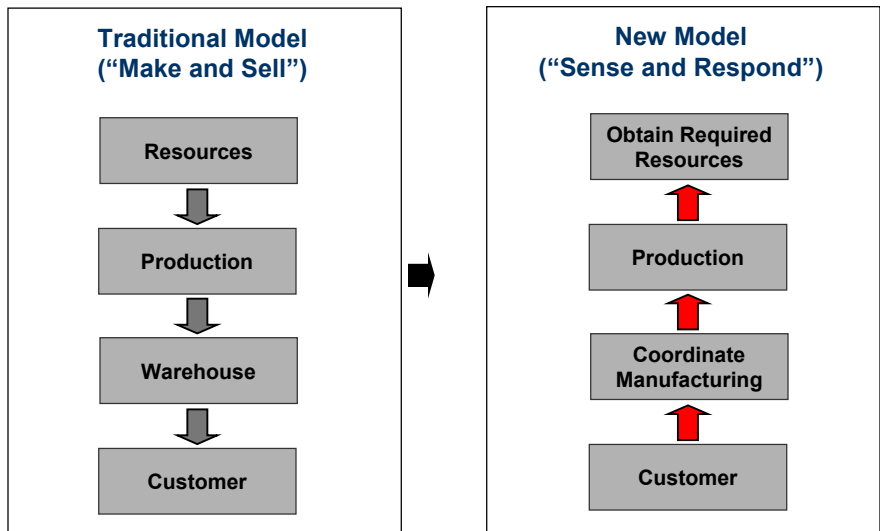


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Underlying Principle: Sense and Respond



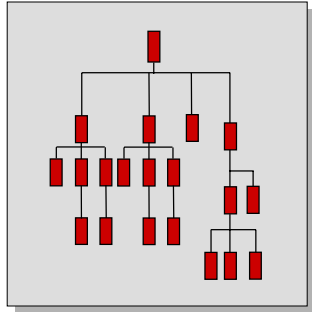
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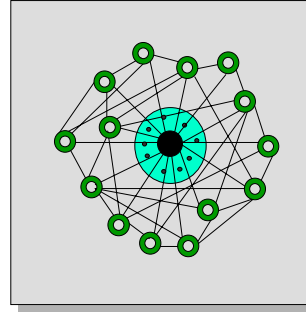
The Underlying Philosophy of Beyond Budgeting – Aspect 2: Empowerment and Self-Governance

Traditional Model (“Hierarchy”)



“command and control”

New Model (“Network”)



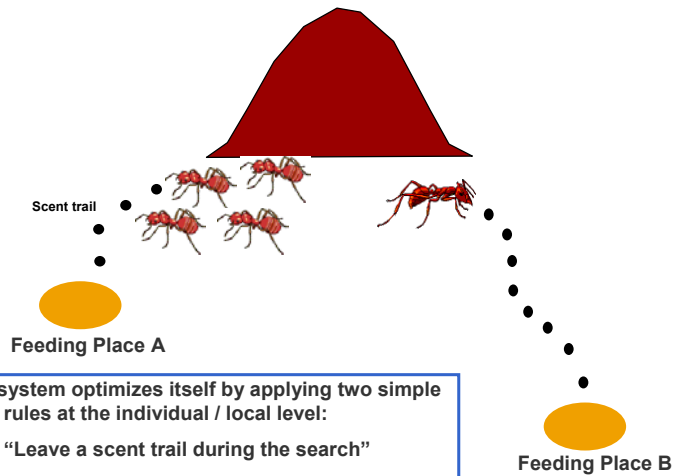
“Seeing for oneself, reaching joint agreements, and making one’s own decisions”

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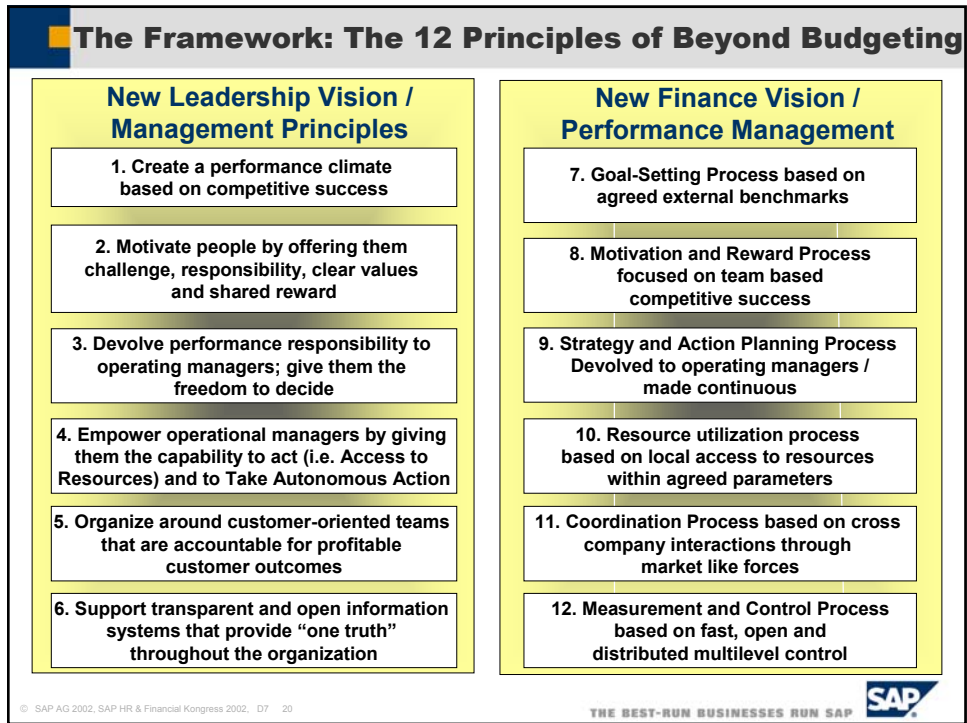
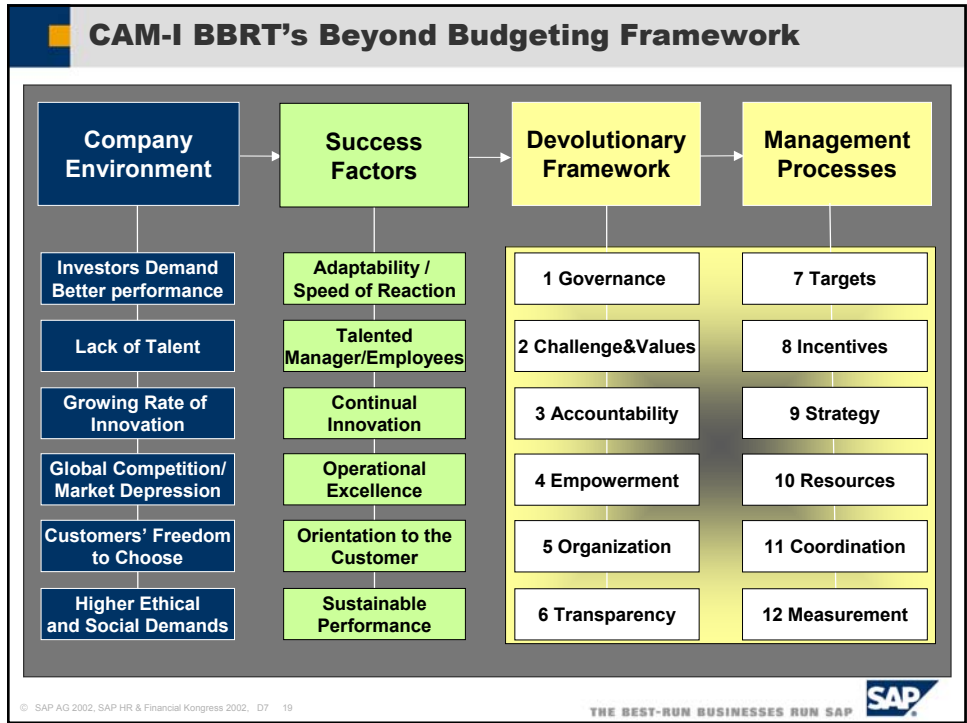
Underlying Principle: System Self-Optimization Through Local Autonomy

Example of a Self-Optimizing Organization Model:
Anthill Social Organization



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Case Study: Svenska Handelsbanken



- No budgets (since 1970)
- No absolute targets
- No fixed plans
- No central marketing
- No product orientation
- No individual incentives
- Virtually no hierarchies...

... and nevertheless one of the most successful banks in Europe. Moreover, for the past 30 years, it has repeatedly beaten all Scandinavian competitors in terms of all essential performance measurements (ROE*, TSR*, EPS*, cost/income, and customer satisfaction).

Svenska Handelbanken is the most cost-efficient bank in Europe. Reasons:

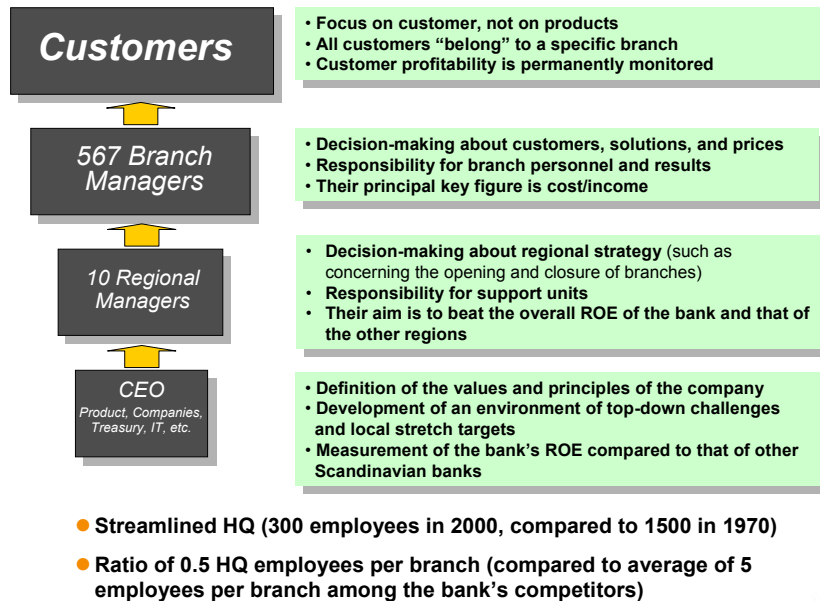
- Costs constantly examined by all employees, and
- Exceptionally low losses on receivables because credit decisions are only made at local level where the customer is known

*ROE= return on equity, TSR = total shareholder return, EPS = earnings per share

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The Organizational Structure



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The Management and Controlling System at Svenska Handelsbanken

- No formal strategy process
- No year plan or budgets
- Budgeting replaced by an accounting and information system

1. Clear values form the framework

2. Management process on informal basis: Top managers meet in monthly meetings without an agenda, discussions are based on the profit center figures. Aim: To exchange information and ideas and to discuss possible measures to correct negative trends

3. Performance measurement and incentive system: Performance is always measured in relation to the competition. Measurement involves few key figures: ROE (group), ROE + cost / income (region), cost / income + result per employee (branch). Annual competition at regional level for the branch with best results. Capital is allocated to the regions annually on the basis of the performance of each region. Branch performance constantly monitored, involving all employees. Bonuses are not awarded to individual employees, but are determined instead on the basis of group performance.

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Case Study: Boots

Case Study: Boots (Boots Healthcare International)*



- No fixed budgets
- Continuous reforecasting
- No fixed planning

“... the highly flexible performance management at Boots makes it easier to meet the group’s overall targets ”

* Based on a presentation by Matthias Steinke, Head of Accounting and Controlling for BHI (Boots Healthcare International) and Hermal Kurt Hermann GmbH&Co OHG, held at the “Beyond Budgeting” seminar for the Management Circle AG, chaired by the speaker on 07/31/2002 in Cologne.

The Management and Controlling System at Boots Healthcare International

- No fixed budget for the fiscal year
- Constant forecasts to assess goal achievement / results on ad hoc basis
- Continuous adjustment of plans for the entire region of operations

1. Fixed Performance Contract with the Boots Group

(based on few KPIs: Sales / Profit / Cash Flow / Economic Profit / Value for the following 5 years, updated annually, bottom-up annual budgets are drawn up once and are then overridden by the forecasts)

2. Management and controlling process is oriented towards these jointly-determined targets but still remains very flexible: Continuous assessment of goal achievement, continuous adjustment and coordination of measures right across the region (using format of regular management meetings between SPC managers from the region and the global category managers → “trade-off process”)

3. Continuous forecasts form basis for controlling: Each opportunity or threat to business at the local level generates a new forecast (Poland spared wave of flu, new health policies implemented in Germany, and so on)

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Points to Consider When Implementing “Beyond Budgeting”

- There is no out-of-the-box Beyond Budgeting solution that companies can implement
- For the implementation, focus needs to be on individual Beyond Budgeting principles, dependent on the individual success factors specific to a company
- Management models are more difficult to change and it takes longer than making improvements in the area of Performance Management. However, the effect is longer-lasting
- Applying Beyond Budgeting to the performance management system is easier, especially if it is done through a step-by-step approach to making the performance management processes and procedures (in the enterprise management system) more flexible

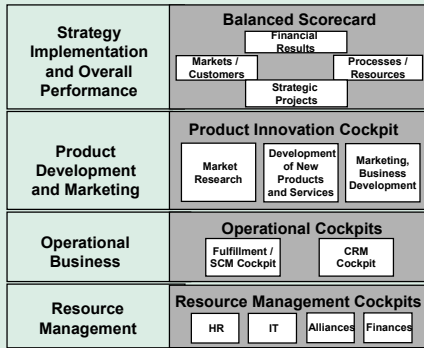


System for Performance Management, Business Controlling, and Strategy Management



Elements of the New Enterprise Management System*

Extended Performance Measurement for "Multi-Level Control"

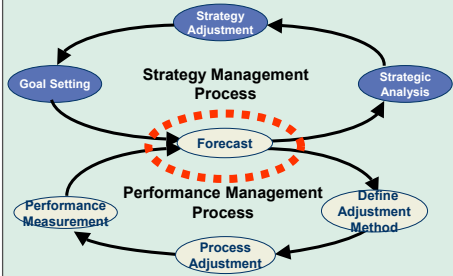


Creation of a balanced and highly focussed view of all strategic and operational success factors

*see: Jürgen Daum: "Intangible Assets and Value Creation", Chichester (Wiley) 2002

Continual Management Processes for Dynamic Adaptability

Creation of Value (of Potential for the Future) and of Long-Term Competitive Advantages



Achievement of Short-Term Performance Targets and Realization of Generated Values

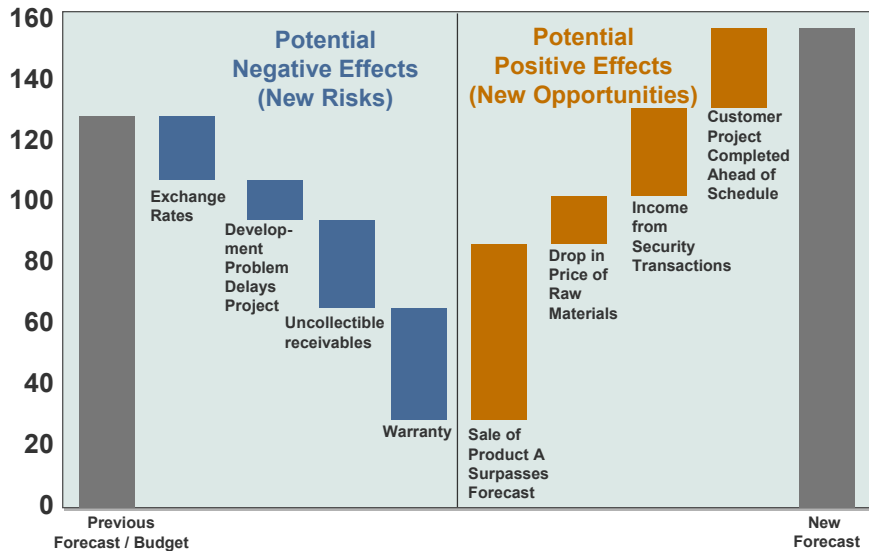
Integrated, rolling management processes enable strategies to be linked to the business processes and daily operations

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Rolling Forecasts and the Continuous and Systematic Analysis of New, Emerging Opportunities and Risks

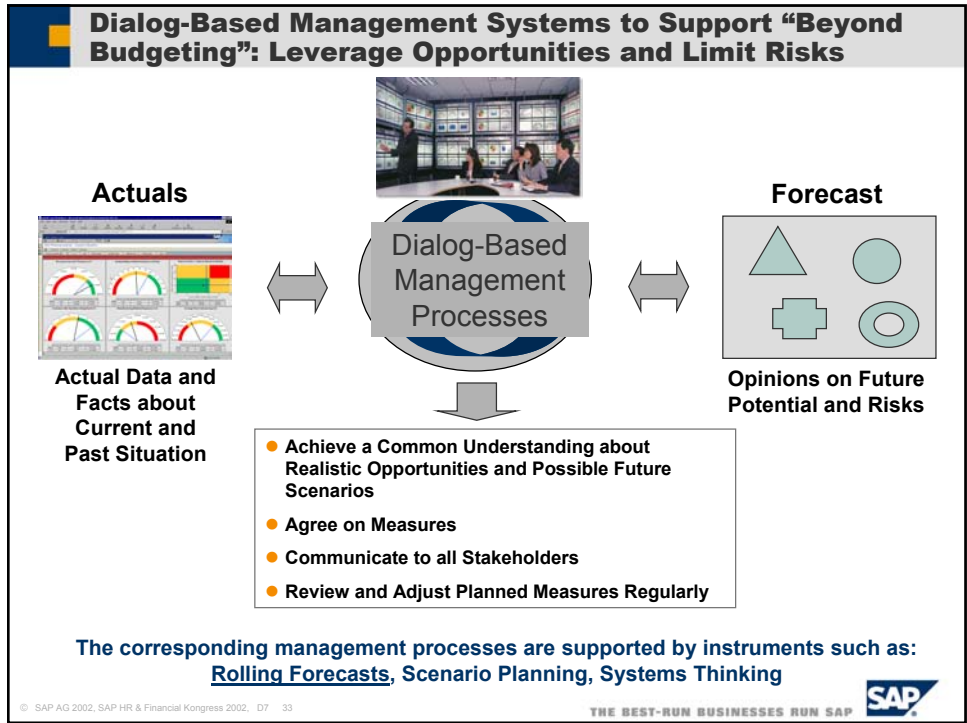


Source: Jürgen Daum: "Intangible Assets and Value Creation", Chichester (Wiley) 2002


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Information Systems

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Focus of IT Support for a “Beyond Budgeting” Concept for Enterprise Management

“Fast Actuals”

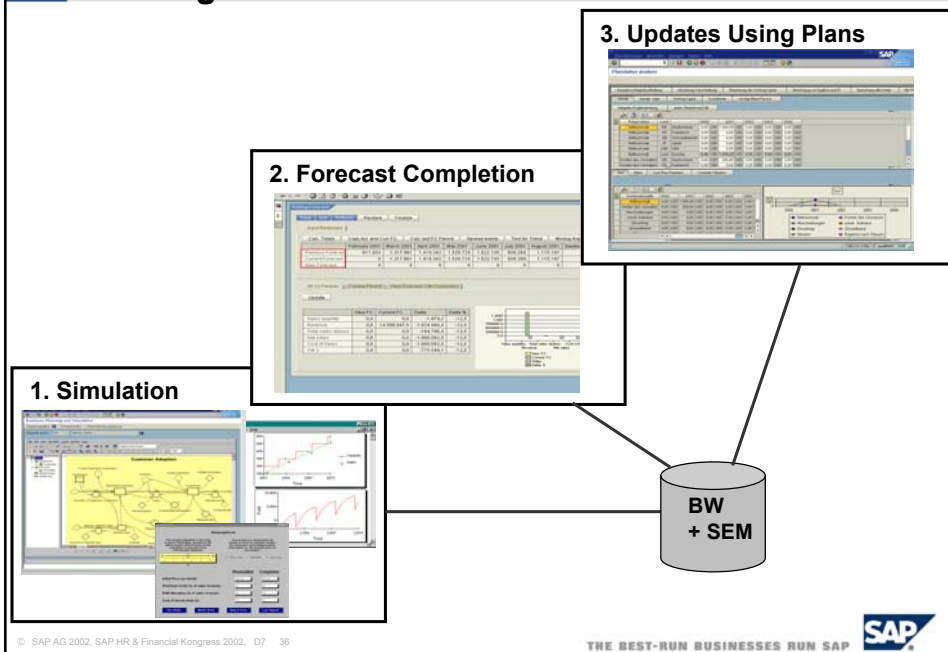
- Rapid delivery of reliable and relevant key figures concerning:
 - ◆ Overall success (such as Profit, EVA, ROE ...)
 - ◆ Important value-creation activities / value drivers (such as customer acquisition / customer churn rate / customer profitability, risk profile of customer base, asset management result, employee productivity ...)
- Also encompasses “Fast Close”

Flexible, ad hoc forecasting with immediate transparency for all areas of the company

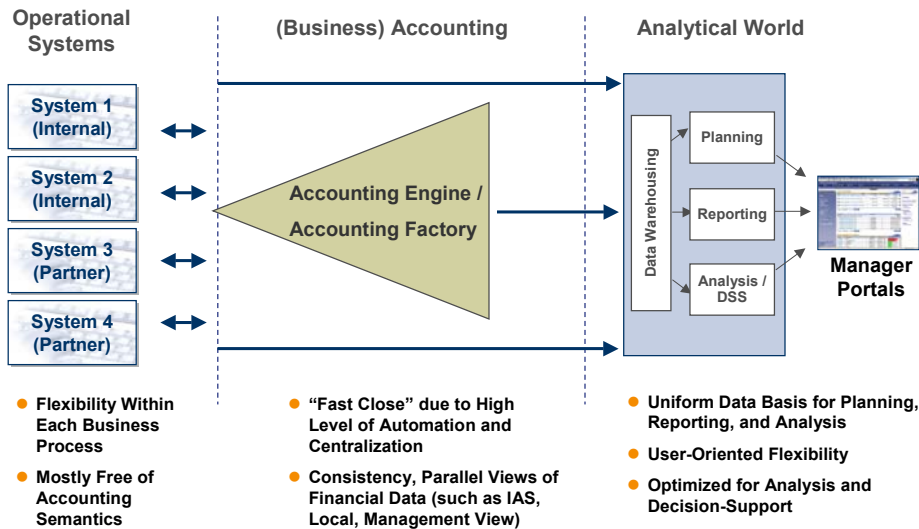
- A company-wide planning database accessible for all managers and controllers
- As far as possible, any additional calculations are performed in the same system and are based on a uniform dataset
- The “base case” that is usually interlinked with potential or already implemented additional measures, will remain transparent (precondition for flexibility!)
- Storage of structured and unstructured information (comments, documents, links to Web pages, and so forth)



SEM/BA: Efficient Forecasting Process Using Uniform Planning Procedure and a Consistent Data Basis



Architecture of the Information Supply System

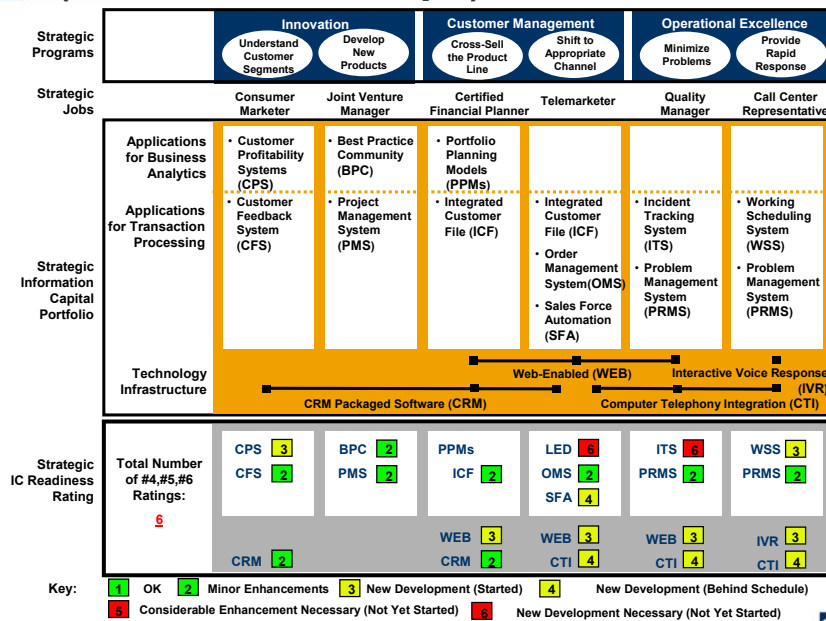


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Strategic Information Capital Readiness Map (Consumer Bank Example)



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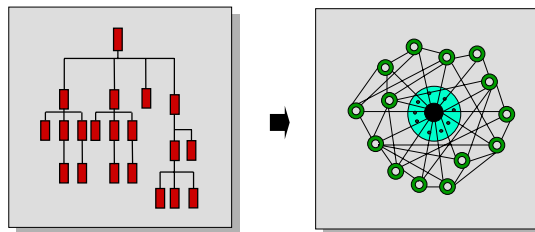
Personnel Management

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Creating the Right Environment to make People really productive

- Empowerment motivates, but only if it can be lived out for real
- A management style entailing a careful balance between coaching and setting challenges helps employees to realize their full potential
- Hiring employees who can be trusted with responsibilities and who enjoy having them, and who are not trapped in the classical hierarchy mindset
- Prioritize internal resources for filling management positions?



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Human Capital Development Program

- Which competencies and skills do we need in future?
- Do the employees lend their full support to the company's goals?
- Is team spirit sufficiently present?

Human Capital Readiness Map		
Human Capital Category	Aim	Target Value
Strategic Competencies	• Reduce Strategic Talent Gap	• < 10%
	• Reduce Fluctuation	• < 5%
Management	• Manager Competence • Acceptance Among Employees	• Rating based on Job Requirements • Rating in Peer Group
Alignment / Motivation	• Employees Actively Support Company Goals	• Employee Survey • Ratings by Other Stakeholders
Integration Energy / Team Spirit	• Sharing Knowledge, Experts, etc.	• Employee Survey • Manager Survey



Human Capital Development Program		
HR Function	Measures	Target
Recruiting		
Training & Development		
Leadership Development		
Communications / Change Management		
Knowledge Management		

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Decentralization of Responsibility Calls for a Strong Company Charter

Example: Supplier in Automobile Industry with Decentralized Structures

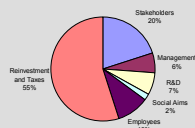
Company Charter

Employee Charter:

- Fairness
- Job Security
- Competitive Salaries
- Employee own a share in the company's stock
- Communication and Information
- Personal Hotline Support

Underlying Principles:

- Values and Basic Rules (What We Do and Don't Do)
- Mission: What We Are About
- Target Distribution Key for Company Profit



Incentive System:

- Employee Profit-Sharing (50% Cash / 50% Stocks)
- Incentives Linked to Continual Improvement Process
- Incentives for Middle Management based on Annual Target Agreements
- Top Management: 3-Year Share in Company Stocks with Obligatory Period of Retention – Use of Resources: Employee Involvement in Assessment Process

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Closing Thoughts

- **For Controlling:**
 - Relevance beats completeness, speed beats accuracy!
 - How should a people-oriented controlling concept look?
 - Consequences for the organization of a company's controlling area:
Should we perhaps be thinking about a more interdisciplinary approach beyond a pure financial view?
- **For IT Management:**
 - "Disciplining the enduser" vs. "personal productivity"
 - IT as a specialist or a generalist discipline?
 - How to bridge the gap between "Strategic Readiness" and "Operational Efficiency"?
- **For Personnel Management:**
 - Personnel manager = Administrator or productivity manager?
 - From personnel manager to specialist for structural capital / organization?
 - How do you gain the necessary influence on the business? What is your strategy? (Can you learn something from the controllers?)



**Thank you for your attention
and your interest!**



More Information about Beyond Budgeting

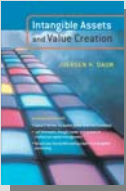
Links

- ◆ <http://www.cam-i.org/bb.html>
- ◆ <http://www.juergendaum.com/bb.htm>

Background Information on the New Enterprise Management System:

- ◆ Jürgen Daum's Website at
 - <http://www.juergendaum.com/>

- ◆ Jürgen Daum's book:

	<p>Intangible Assets and Value Creation</p> <p>by Juergen H. Daum</p> <p>John Wiley & Sons, Chichester, 2002 ISBN 04708455120 (available 19 December 2002)</p> <p>More information at: http://www.juergendaum.com/mybook.htm</p>
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