

Beyond Budgeting: A Model for Performance Management and Controlling in the 21st Century?

by Jürgen H. Daum*

How much sense does the budgeting effort make if budgets are already out-of-date after a few weeks?

Traditional budgeting as an instrument of corporate management is increasingly seen as an obstacle to progress by managers. Typical statements are "too complex", "takes too long", "too inflexible, we cannot adapt quickly enough to the market", "does not motivate you to set yourself ambitious targets", or even "the budget is the bane of corporate America" (Jack Welch, General Electric), and "the budget is a tool of repression" (Bob Lutz, Chrysler). But controllers also complain "a lot of effort, no-one is really interested in it", "we mould the figures long enough until we are in agreement internally but that does not help us much on the market" – and the list goes on.

In contrast to that, the time managers and controllers spend creating the budget is enormous. According to a study by Hackett Benchmark, enterprises spend on average 25,000 person days on planning and performance measurement per US\$ 1 billion turnover. According to another study (by KPMG) the budgeting process takes up 20-30 percent of managers' and controllers' time. Consultants at Horvath & Partner in Germany estimate that controllers use at least 50 percent of their capacities for planning and budgeting. At the same time, budgets are quickly losing their relevance today and are outdated by reality, which makes them appear even more questionable. While the budget as the central element of the corporate management system until now, above all focuses managers and controllers on keeping budget targets and limits that were agreed once, in today's dynamic economic environment increasingly the opposite is expected of companies. By adapting operational plans and measures, managers and their companies should be able to react quickly to market changes.

Traditional budgeting has had its day – companies need new tools today

The highly dynamic environment for companies will continue to increase. Today's knowledge and service-oriented economy results in a dominating role for soft success factors, for intangible assets, and thus increases not only the dynamics on the macro level but also creates new challenges for companies internally: Company activities become more complex and internal dynamics also increase. If you consider that budgeting emerged as a management instrument in the 1920s of the last century, it becomes clear that there is a need for action. Compared with companies 30, 40, or even 50 years ago, the task of today's companies is no longer only to produce and sell products. Nowadays, companies must no longer compete successfully in a seller's market but in a buyer's market. To be successful

and remain so, they must keep bringing new products onto the market in shorter time intervals, form systematic long-term workable and profitable relationships with customers and business partners, constantly develop the company's human capital, and keep the good employees, and not least satisfy the more demanding investors with good financial results. Therefore, today they have to do very different things at the same time: Develop the right products (in the long-term), form good relationships with customers, employees, and business partners (medium-term), and operate profitably (short-term). This increases the "trade-offs" in the business system and results in the increased need for regular internal reconciliations. At the same time, change dynamics are increasing in the environment and force companies to balance their activities in shorter intervals with external developments. The traditional corporate management instruments budgeting and monthly target/actual comparison prove to be too inflexible and have therefore long since had their day as the only basis of the management system.

The introduction of new management instruments such as the Balanced Scorecard (focus: better internal coordination of strategic targets and their realization) and value based management (focus: better orientation of the company to external expectations – here of the investors) has created the framework for a more flexible performance management geared towards strategy and the capital market. Though what is often missing is a transition to flexible operational planning and measure management. The Beyond Budgeting model wants to fill exactly this gap. As a result, the planning and management process should be simplified and become more flexible, the effort should be reduced at the same time. Beyond Budgeting, partly taken very far as "managing and controlling without budgets", opens new possibilities for strategic enterprise management with the transition to flexible resource allocation.

Svenska Handelsbanken – A company that has been managed for over 30 years without budgets

Is it at all possible – managing without budgets? Svenska Handelsbanken, a Swedish bank with branches all over Northern Europe and in Great Britain, has shown that it is possible. They have had no budgets, no absolute targets, and no fixed plans since 1970. Nevertheless, it is one of the most successful banks in Europe and has outperformed all Scandinavian competitors with regard to the important performance measures such as return-on-equity, cost-to-income ratio and customer satisfaction – and this consistently over 30 years. Svenska Handelsbanken wrote in their annual report 2001 "It is possible to combine the highest profitability in the banking sector with the most

satisfied customer". This is achieved by every employee constantly examining all costs, and the loss of receivables outstanding are extremely low since credit decisions are only made on the spot where they know the customers.

You can probably guess from the description that the enterprise management system at Svenska Handelsbanken works in a completely different way to how it typically is in many companies today: At the bank, controlling is not done by the controllers but by the managers and employees on the spot. More than 50% of Handelsbanken staff has some form of lending authority. The business responsibility is decentralized to a great extent in the branches that are managed as profit centers. The targets for the profit centers are defined relatively, as relative targets to the market. Performance measurement takes place using benchmarking with the competitors. Profit center managers have free access (within certain agreed performance parameters based on the cost-to-income ratio) to resources ad-hoc when they are needed. Internal service areas must "sell" their services competitively to the operational units, there is no "political" pricing. Therefore, the focus at Svenska Handelsbanken is on the market or beating the competitor, and producing the necessary flexibility for this - not on meeting a budget agreed on in the past. Of course there is also a central controlling department at Svenska Handelsbanken, but its task is only to monitor the portfolio of the branches regarding a few performance indicators. If a branch exceeds the defined acceptable bandwidth of variation of certain KPIs, the branch is informed and they are offered support with analysis and measure planning. But the branch still makes the decision about the measures.

Two elements are of considerable importance that create the prerequisite for the high level of freedom of operational managers and employees: The management culture in the company and the availability of a cleverly devised information system as the basis for performance management processes. This system determines the total performance of the branches on the basis of a few KPIs and makes this information available to all managers at the same time. In addition, customer behavior is recorded and analyzed in detail and customer profitability is monitored regularly. As a result, it is always possible for every manager to make a direct comparison with colleagues. The company uses this to encourage sporting, internal competition with performance league tables.

The Beyond Budgeting concept – the principles

In addition to Svenska Handelsbanken, which is the most extensive example, the Beyond Budgeting Round Table (BBRT) of the Consortium for Advanced Manufacturing International (CAM-I) founded in 1998 in London, has analyzed 13 other companies that operate completely or almost without budgets. The results are the 12 Beyond Budgeting principles that not only describe performance management and controlling processes that support a

management concept "Beyond Budgeting" but also the required new leadership principles:

The Leadership Principles:

1. Creation of a performance management climate that measures success against the competition and not against an internally focused budget
2. Motivation through challenges and transferring responsibility within clearly defined enterprise values
3. Delegation of responsibility to operational managers, who can make decisions themselves
4. Empowerment of operational managers by giving them the means to act independently (access to resources)
5. Organization based on customer-oriented teams, who are responsible for satisfied and profitable customers
6. Creation of a single "truth" in the organization with open and transparent information systems

The Performance Management Principles:

7. The target setting process is based on the agreement of external benchmarks
8. The motivation and reward process is based on the success of the team compared to the competition
9. Strategy and action planning is delegated to operational managers and takes place continuously
10. The resource utilization process is based on direct local access to resources (within agreed parameters)
11. The coordination process coordinates the use of resources on the basis of internal markets
12. The measurement and controlling process provides quick and open performance information for multilevel control

Therefore, the two fundamental elements of the Beyond Budgeting model are new leadership principles based on the principle of the empowerment of managers and employees, and new more adaptive management processes. The new leadership principles should unlock the full potential of managers and employees in order to enable the organization to react in an appropriate way and as quickly as possible to new chances and risks in the market environment. The CAM-I BBRT also calls this "devolution". Adaptive management processes are not based on fixed targets and resource plans like under the budgeting model. Instead, they enable an organization for a high degree of flexibility (see diagram 1).

Is Beyond Budgeting practicable?

Thus, the CAM-I BBRT Beyond Budgeting Model goes much further than a pure controlling perspective, it is much more a management concept. Rolling forecasts, flexible operational plans, continuous performance monitoring are the controller's tools to support this. Thus, Beyond Budgeting presents a radical approach, the implementation of which requires the commitment and backing of the whole management team. If you want to be successful, the project team must be made up of

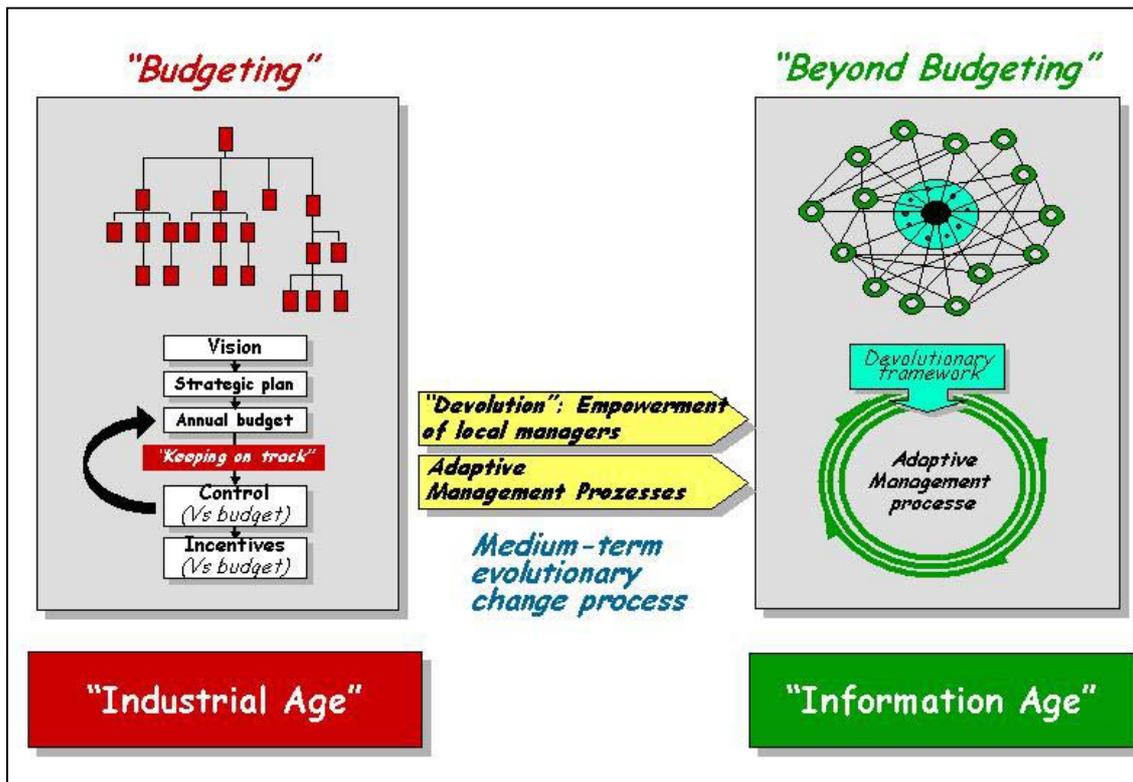


Diagram 1: The CAM-I BBRT Mission

controlling specialists, as well as human resources management, change management, and IT experts. Not every company is able and prepared to get such a project under way. Therefore, at my last meeting with CAM-I BBRT it was conceded that there could also be a possible interim step that presents a more evolutionary approach and is the responsibility of controlling: "Better Budgeting" or "Advanced Budgeting". The objectives of Better Budgeting are more efficient controlling processes, speeding up planning and (still existing) budgeting or operational planning processes, and the transition to rolling processes in comparison to a one-off annual budgeting action. Already as a result, the adaptability of the company would clearly increase, as internal reconciliation and a comparison with external market developments would take place regularly. The whole organization is then always "on track" and managers and controllers must not familiarize themselves with the planning task again when the new annual planning is on the agenda. The following measures or improvements are possible to support Better Budgeting:

- Reduction of the level of detail of planning / level of detail dependent on the planning area and the situation
- Continuous rolling forecasting instead of only annual planning
- Rolling strategic planning that can lead also to mid-year strategic plan adjustments if required
- Non-financial performance measures (output-oriented) flow into the operational plan / budget, which are geared to relative (external) targets

- Changes in the operational business or of strategic targets lead to mid-year plan/budget adjustments
- All operative areas are taken into account, as a result trade-offs within a company's business system, such as between short term profit targets and long term innovation objectives, become transparent early enough in order to be managed actively
- Clear top-down targets, but decentralized, operational planning
- Use of software-based planning and performance management systems

You can find more information Beyond Budgeting at <http://www.juergendaum.com/bb.htm>, and on the New Performance Management System in the author's forthcoming book "Intangible Assets and Value Creation" (Chichester: John Wiley Ltd., 2002, ISBN 0470845120).

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