New Paths to Dramatically Improve Your Planning and Control Processes
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For many years, organizations have been dissatisfied with their existing planning and budgeting practices. While they have suffered the burden of the annual budgeting process, it is seldom in silence. Beginning in 1998, new hope was found through the efforts of the Beyond Budgeting Round Table (BBRT). The BBRT is a member based group of companies who sought more effective methods to plan and control their organizations. Building on case research of some true pioneers, the BBRT has identified a cohesive approach that dramatically improves planning and control.

The BBRT framework was first published to BBRT members in early 2000. Major portions of the framework have since been publicly disclosed in the landmark book Beyond Budgeting: How Managers can Break Free from the Annual Performance Trap, by Jeremy Hope and Robin Fraser (Harvard Business School Press, 2003). This book describes the initial BBRT research and identifies 12 key principles in the BBRT framework that create a dramatically more responsive approach to planning and control as contrasted with approaches taken by traditional budgeting practices. The purpose of these changes is to shift from a philosophy of "command and control" to one of "sense and respond." This change creates not only a more adaptive organization but also one with greater front-line empowerment and employees with greater motivation to optimize results.

As you can imagine, moving to beyond budgeting is a dramatic change in both the people and the organizational culture. Through additional case research, we have identified at least two key paths to making these changes – the approach can be either revolutionary or evolutionary. This article examines both in hopes of helping you select the path that will provide the greatest opportunity for success. The discussion begins with a quick recap of the typical problems organizations find with their traditional budgeting practices.

Typical Problems with Budgeting
The complaints against traditional budgeting are well documented. The most common complaints are:

1. Budgets **take too long** to prepare (often making them out of date when published)
2. Budgets **cost too much**
3. Budgeting is based on **assumptions that are nearly always wrong**
4. Budgeting **causes gaming** that erodes the ethical foundation of the company
5. Budgeting **triggers unnecessary spending**
6. Budgeting **gives the illusion of control** by robbing potential
7. In the words of Jack Welch, "It [Budgeting] **brings out the most unproductive behaviors in an organization."**[1]

Beyond Budgeting companies seek to move from a command and control approach focused on fixed targets and plans into a sense and respond approach that utilizes continuous planning and adaptive controls and utilizes relative targets and constant adaptation to changing condition. The key changes are summarized in Exhibit 1.

Exhibit 1

I. Principles of Beyond Budgeting Processes

1. Goals: Set stretch goals aimed at relative improvement (not focused on negotiating incremental numbers).
a. Enable local teams to set goals based on maximizing their performance potential. To encourage managers to go for "maximum stretch," goals should be disconnected from evaluations and rewards. (There must not be a "fixed performance contract.")
b. Base goals on medium-term (two- to five-year) outcomes, with action plans to support them.
c. Base goals on achieving better results than peers, competitors, or external benchmarks (i.e., being at the top of the league table).
d. Transfer ownership of goals to local teams and encourage the right (virtuous) behavior.

2. Rewards: Base evaluations and rewards on relative improvement contracts "with hindsight." (Don't relate incentives to a fixed performance contract.)
a. Base rewards on the relative success of teams against a mix of measures with the benefit of hindsight based on a known formula.
b. Base rewards on teams (e.g., whole company, business unit team, front-line team).
c. Base the bonus pool formula on a range of KPIs consistent with goals and strategy.
d. Adopt rewards that balance the need to encourage both short- and medium-term results.
e. Ensure that rewards are seen to be fair and motivate the right actions and behavior.

3. Planning: Make action planning a continuous, inclusive approach (not a top-down annual event).
a. Devolve strategy planning and decision-making to lower-level teams.
b. Involve the whole team in strategy discussions.
c. Base reviews on short- and medium-term performance management cycles (or continuous reviews). Reviews can be based on the calendar (e.g., quarterly) or triggered by events.
d. Focus teams on continuous value creation rather than negotiating numbers.
e. Derive key value drivers, action plans, and KPIs from goals and strategies.
f. Manage action plans as an integrated portfolio.

4. Resources: Make resources available as required. (Don't allocate them in advance.)
a. Use "fast-track" approvals for major projects with frequent reevaluation of priorities.
b. Devolve authority for smaller projects to local teams.
c. Provide an internal market for operational resources. Make central services available through an internal market at agreed-upon transfer prices.
d. Set KPI goals and controls to manage operational resources (e.g., cost-to-income ratio) within which units must operate.

5. Coordination: Coordinate cross-company actions with prevailing demand. (Don't rely on annual planning.)
a. Make periodic service-level agreements with other units for products/services.
b. Ensure that teams are seen as suppliers and customers within an internal market. Internal customers have needs that are subject to conditions of satisfaction.
c. Manage short-term capacity in real time by adjusting it to customer demand.
d. Manage customer profitability information by enabling front-line people to see and respond to the "net" profitability of customers.

e. Listen and respond to individual customers, and provide customized solutions.

6. Controls: Base controls on effective governance and on a range of KPIs (not just annual budgets).
a. Base internal controls on a clear governance framework.
b. Produce fast actual financials, and make information open to all.
c. Use trend analysis and moving averages.
d. Use rolling forecasts.
e. Use key performance indicators to set goals and controls.
f. Use league tables.
g. Use patterns and trends to manage by exception.

II. Principles for Front-Line Action

1. Governance: Provide a governance framework based on clear principles and boundaries (not on rules, regulations, and budgets). To enable local decision-making and safeguard stakeholders' interest, leaders should:
a. Provide clear principles and boundaries.
b. Bind people to a common purpose and shared values.
c. Adopt a "coach and support" leadership style.

2. Climate: Create a high-performance climate based on relative success (not on fixed performance contracts and fear of failure). To motivate people and ensure sustainable success, leaders should:
a. Champion relative performance.
b. Challenge ambition.
c. Balance internal cooperation and competition.

3. Freedom To Act: Give people freedom to make local decisions that are consistent with governance principles and the organization's goals (not with rules, central plans, and the narrow self-interest of departmental goals). To foster innovation and responsiveness, leaders should:
a. Challenge assumptions and risks.
b. Involve everyone in strategy.

4. Capability To Act: Place the responsibility for value-creating decisions on front-line teams (not on trying to exert control from the center). To increase adaptability and reduce waste, leaders should place the responsibility for value-creating decisions on front-line teams by:
a. Creating a network of small, customer-oriented teams.
b. Base recruitment on "fit with the team."

5. Responsibility: Make people accountable for customer outcomes (not for meeting functional plans and budgets). To satisfy customer needs profitably, leaders should:
a. Enable teams to respond to customer demand.
b. Encourage teams to share knowledge across the business.

6. Access to Information: Support open and ethical information systems that provide "one truth" throughout the organization (not on having middlemen filtering information and making it available on a need-to-know basis). To promote ethical behavior, leaders should:
a. Make information fast and open.
b. Set high ethical standards of information flow.

We often find that finance managers readily identify with most of these issues. Therefore we will limit the discussion here and move on to the approaches being used to overcome these limitations.

The Revolutionary Approach to Change

The early research of the BBRT was heavily influenced by examples of organizations that had dramatically different practices in the ways they planned and controlled their organizations. The most evolved organization studied was the Swedish bank Svenska Handelsbanken. Their transformation occurred when Dr. Jan Wallander took over as CEO in 1972. Having spent the first twenty years of his professional career as an economist, Wallender knew the difficulties in trying to predict the future. His conclusion was that it was virtually impossible to do. Therefore he concluded that it made little sense to base his management system - the way you plan and control your organization - on a system that requires you to predict the future.

Typical command and control systems are locked into assumptions that form the basis for their planned actions. Great difficulties arise when the future differs from these assumptions. In many cases, one of the greatest problems with traditional budgeting is that managers assume they are entitled to spend money because it's "in the budget." The problem occurs because the assumptions used to put the expenditures "in the budget" turn out to be wrong but the budgets remain fixed.

In the early 1970s Handelsbanken was in trouble. Its board determined that a leadership change was required, and in evaluating possible moves they noted that one of their regional competitors had shown dramatic improvement even in a tough operating environment. The regional bank was run by Jan Wallander. When Wallander was offered the CEO job at Handelsbanken, he told their board he would only accept if they would allow him to operate without the traditional budget. The board agreed.

This change required the organization to adopt a dramatically different set of operating principles. Fortunately, Wallander had a good operating example in the system he had created for the regional bank. He very rapidly deployed it at Handelsbanken where they have continued to refine it for the last 34 years. It provides an excellent example for organizations investigating a fully developed model of the Beyond Budgeting principles.

Subsequent research has found other similar examples of companies operating without budgets. These include:

- Ahlsell, the Scandinavian building products distributor which has been budget-less since 1995 (Ahlsell's Finance Director Gunnar Haglund adopted a budget-less approach after reading Dr. Wallander's book explaining his philosophy[2]
- Borealis, the Danish petroleum refiner formed by joining the assets of two state-owned oil companies. After going through a painful first year budgeting process, Borealis knew their must be a better way. They analyzed their purposes in budgeting and determined that each of the four purposes could be achieved in a better way without the pain of traditional budgeting. As a result, they chose to eliminate budgets.[2]
- Guardian Industries, a flat glass manufacturer which operates in twenty-two countries around theglobe, Guardian is led by William Davidson who uses cash flow as his key performance indicator.
- SlimFast, as operated by Daniel Abramson (prior to its acquisition by Unilever in 2001) was able to grow a phenomenal 35% per year (in an industry where 4-6% is considered strong) without budgets.

The key to revolutionary adoption is visionary leadership.[3] Under this approach leadership rapidly identifies its true purposes in asking for budgets as well as identifying how well the traditional system meets both their needs and the needs of the front line managers. It is important to look to the front lines because that is where most customer contact occurs. In many cases budgets have become impediments to front line responsiveness. Once true purposes are defined, management can identify better ways to meet these objectives.

The advantage of the revolutionary approach is that it stops a cumbersome, time-consuming practice with the immediate benefit of creating internal capability to pursue alternatives. The potential disadvantage is the possible perception that the organization will spin out of control. This can be easily checked by tools like:

- Expense ratio management (used by SlimFast)
- League tables (used by Handelsbanken and Ahlsell) and cash flow control (used by Guardian).
- The most pervasive control in Beyond Budgeting companies is the front line leaders being trusted to run the business as if they were the owners (rather than being treated like people who can not be trusted to make decisions).

These mature examples are excellent for seeing how a Beyond Budgeting approach will promote a collaborative culture of front line empowerment. They provide a vision for what can be achieved and done very rapidly (typically the revolutionary approach can be achieved in six to 24 months).

For most financial executives, the revolutionary approach seems far faster than they the feel they can go. It also has a disadvantage in that a new visionary leader can reverse course (as what happened at Borealis in 2001 when John Taylor took over as CEO and was later joined by Clive Watson as finance chief. They reintroduced budgets later that year). While reversion is a risk, many organizations have completed the transition and remain budget-less. For example, in one five year span, Ahlsell changed CEOs twice and had three ownership changes but Finance Director Gunnar Haglund has been able to maintain a budget-less culture. As for Handelsbanken, Dr. Wallander has retired (and now is Chairman Emeritus) but Handelsbanken’s budget less culture remains firmly in operation.

The Evolutionary Approach to Change

A second path to adopting Beyond Budgeting principles has developed, particularly in North America. This path includes an organization’s move to adopt the Beyond Budgeting principles using a more gradual approach that seeks to try key parts of the Beyond Budgeting philosophy while continuing to utilize some form of traditional budgeting. Followers of this path agree with many of the points made by Beyond Budgeting advocates but lack the conviction, courage or required executive buy-in to make the immediate leap to a budget-less environment. The evolutionary approach clearly provides a safer path to achieving these benefits. Examples of companies taking this approach include American Express, Time Warner Telecom and Millipore.

American Express followed this approach in their planning transformation. Their initial steps were to adopt a five quarter rolling forecast with the objective of speeding investment optimization decisions. In doing so, they modified typical variance explanations to always discuss differences from the prior year and differences from the latest forecast. While annual budgets were still prepared, the focus was shifted to the latest forecasts. This approach had the advantage of making the latest forecasts always the most current estimates.

By fall of 2005, both field and corporate organizations began to question the need for an annual budget exercise. They concluded that it was no longer required. Senior management quickly agreed and the budgets were eliminated. This “quite passing” of the budget was accomplished because management had been able to see how operating on rolling forecasts would work in their environment. Planning Transformation Leader Jamie Croake noted that their culture had changed to a much more forward-looking approach to driving their business.

At Time Warner Telecom, Planning Leader Nevine White had a similar experience. Their approach to rolling forecasts was somewhat different in that field level forecasts only go out six months. This short approach is taken because it best reflects the field organizations belief on what visibility they have. From this operational view of plans, corporate expands to create financial forecasts and to integrate with capital plans, and they have reported continued progress.

Likewise, Millipore eliminated budgets turning to their balanced scorecard as the key to adaptive management. In addition to the balanced scorecard, Millipore has implemented an Office of Strategy Management to help align their project initiatives and ensure consistent execution. The scorecard approach has been used similar to the approach taken by Borealis.

Many organizations see the advantages to changing to more adaptive planning practices. The evolutionary approach allows them to rapidly move forward while continuing to also perform their annual budgeting process. While this is extra work, it provides a comfort level to make sure changes can be successfully implemented. Once in place, firms can then examine the need for continuing their traditional budgeting practices.

Companies following the evolutionary approach must be cautious, however, to make sure the combination of approaches they use remain coherent in order to avoid one part of their management system conflicting with another. A common example of this problem is when organizations try to follow a stretch budgeting process while still linking incentive compensation to achieving budget targets. Stretch requires trust and transparency to have managers openly discuss what might be achieved. However, many managers are reluctant to do so when that conversation is used to set incentive targets, and this conflict usually inhibits these discussions.

Another example of lack of coherency is found in many implementation of the Balanced Scorecard. From a philosophical standpoint, the Balanced Scorecard tries to create a system of front line empowerment where everyone knows what to do because the firm's strategy is explicitly mapped to the actions needed to execute the strategy. It seeks clear cause-and-effect linkages. Yet most companies implementing the Balanced Scorecard continue to follow traditional budgeting practices which reflect a command-and-control approach. When managers look to the scorecard for guidance in how to respond to opportunities or defend against threats, they often find their actions limited because the resources needed to take action are "not in the budget." If they act anyway, they will receive monthly visits from their management accountants asking for variance explanations and action plans to bring the organization back to budget. Managers quickly learn that the scorecard may be nice, but the budget still controls everything (particularly when bonuses are tied to meeting budgets). This is a major contributing factor to why the majority of Balanced Scorecard implementation results in failure.

The same lack of coherence happens to organizations attempting to become lean enterprises. When implementing lean, the organization is driven by customer demand. The lean enterprise focuses on eliminating waste, delays and unevenness in meeting that demand as efficiently as possible. Customer demand is the trigger to the pull system.

Yet when you overlay a traditional budget, you quickly see that it is a push system in that it sets financial targets then plans how the organization will push all its parts to reach those targets. In earlier times, when buyers were plentiful and supply constrained (such as just after World War II), reaching those targets was fairly easy. However, today's business environment is characterized by global competitors and shrinking barriers to competition. The customer has numerous choices making it more difficult to push products through them. Lean enterprises respond to these challenges. But simply stated, your organization can never become a true lean enterprise if it continues to use a traditional push budgeting system. There is an inherent conflict because your management system will lack coherence.

North American companies greatly favor the evolutionary approach to BBRT implementation. They find it is a safer way to reach their expected benefits. Following the lead of publicly held companies such as American Express and Millipore, they are finding ways to get started using multi-quarter rolling forecast, league tables, and revised incentive compensation plans. Dynamic resource allocation through the use of shared services is easier to comprehend since shared services have been in use for many years.

Common Keys to Success
What ever approach is taken, we find many success factors remain the same:

1) A move to continuous planning and adaptive controls requires enlightened leadership. Most senior managers reached their current position by being able to play the traditional budgeting games. It takes an enlighten leader to understand the problems those systems created and then move to overcome them (even though they rose to success by being able to play the old game). Those making these changes often realize that what happened in the past does not secure success in the future.

2) The second common trait is a commitment to change culture and behaviors as well as processes. Particularly in North America, we find managers very interested in how the planning and control processes change – the use of league tables to create relative targets versus the traditional fixed target, linking incentives to actual results rather that negotiated budgets, making resources available on demand, control with expense ratios rather than negotiated amounts, etc. But the key to success is beyond the process mechanics and on to how the process changes create a change in culture and behavior. Managers experience a higher degree of trust as performance becomes transparent and opportunities and risks are more openly discussed. Over time, the hording mentality of traditional budgeting will fall away as managers come to understand that resources are available as the marketplace allows and the front line supervisor becomes more empowered to optimize the business and serve the customer.

3) A final common trait is that virtually all Beyond Budgeting companies utilize fast, open information systems. These systems enable corporate managers to empower the field as they know they have the information needed to run the business. They also can readily see how the organization is changing. For instance, Handelsbanken reports monthly league tables that compare each branch to all the other branches in the region and the company. Regional managers can quickly see which branches are moving up and which are dropping down. Lower performing units can see who the top performers are and can readily call for advice on what practices are working. Information is readily shared.

Organizations looking to evaluate the Beyond Budgeting principles can take a free diagnostic survey found at www.BBRT.org. This survey report evaluates your organization's case for change from both a process and leadership point of view. Readers are also invited to join the BBRT – a member-based consortium of organizations seeking to improve their planning and control processes. The BBRT members create a peer-to-peer network of the leaders of planning, budgeting, and forecasting practitioners. The BBRT has round tables operating in North America, South America, Australia, Europe (with a special sub-section for German speaking counties), and the Middle East. For more information you can also contact the author – Steve Player by email at Steve@theplayergroup.com.

Side Bars
Exhibit 1 - Twelve principles from the BBRT Framework

Footnotes:
1. Winning, Jack and Suzy Welch, Ch. 12
2. Swedish businesses had an early advantage adopting beyond budgeting approaches as Handelsbanken in his book Budgeten – en onodigt ont (bugeting – an unnecessary evil. Sec.ed SNS 1995, ISBN 91-7150-615-2 which was only published in Swedish. An executive summary of this work was made available to BBRT members. Dr. Wallander has subsequently written further in Decentralization – Why and How to Make It Work: The

Handelsbanken Way, published by SNS Forlag, in 2003 which was also published in English.

3. Even with visionary leadership, it may take time to convert all elements. The BBRT case studies note that while Dr. Wallander was able t immediately change the practices of the bank's operating management, it took nine years before the board accepted that they did not need a formal budget at the group level. It was discontinued in 1979.

About the Beyond Budgeting Round Table

The Beyond Budgeting Round Table (BBRT) is a supported network of member organizations with a common interest in improving planning, forecasting and control, thereby improving overall performance. BBRT is helping organizations look at world-wide best practice and showing them how to develop dramatically improved solutions to some of the constraints of the traditional approaches to budgeting. The BBRT has activities in Europe, North America and Australia. For further information go to www.bbrt.org

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