

ANDERS OLESEN, BEYOND BUDGETING INSTITUTE:
“TRADITIONAL BUDGETING PREVENTS
COMPANIES FROM ACHIEVING THEIR
FULL POTENTIAL.”

Companies with a best practice in performance management have already known it for some time: traditional budgeting is typically a very time-consuming and innovation obstructive event, which actually creates a false sense of control. Together with likeminded and curious professionals, these companies have joined forces in the international ‘Beyond Budgeting Round Table’ network. We talk to Director Anders Olesen about the evolution in management models and the ongoing evolution within budgeting and forecasting processes.

■ **What is wrong with the “traditional” budget process that most companies use?**

ANDERS OLESEN: “The management models that are applied by most companies today were developed during the previous century. The budget model, for example, was developed almost 100 years ago. We, however, no longer live in the industrial era. Companies operate in environments characterized by significant uncertainty and exponential change. Knowledge and information is shared faster than ever before. Many companies are realizing that in order to prosper in the 21st century, management (i.e. how we lead and manage) must undergo fundamental change. Adaptable and empowered organisations will win over rigid and hierarchical organisations with strong centralised control. Science clearly shows that people perform best when there is purpose, autonomy and the possibility for personal development. Beyond Budgeting is a mindset that helps companies achieve their full potential by finding the right management model with the optimal balance between autonomy and control. The above mentioned aspects are often ignored in traditional budgeting and performance management models.”

■ **Does this mean that companies should just stop budgeting?**

ANDERS OLESEN: “Certainly not. Before making changes to the corporate budget process, careful consideration must be given to many aspects. First and foremost

the following questions must be answered: How do we maintain control without the budget? What targets shall we compare actual performance with? How do we control our costs? What will we do instead? Before an organisation stops budgeting, it must address these and many more issues and questions. However, we know that there are good answers and solutions to these questions and that it is possible to replace the old processes with ones that are both more effective and (even more important) enable the organisation to reach its performance potential in the long-term. To be clear, it is not that we oppose all kinds of budgets. In many cases, a budget (or a financial plan) is necessary; for example for managing projects. It is, however, always important to be very specific about the purpose of the budget (or: the plan) and how it is used. The type of budgeting that Beyond Budgeting is challenging is the traditional, annual, corporate budget built on *old school* management models that turn companies into bastions of hierarchy and rigidity that hinder performance instead of enabling it.”

■ **What should companies do to monitor their performance?**

ANDERS OLESEN: “To maintain control it is extremely important that companies monitor their performance closely; both at corporate and at local level. Understanding where you are and how you are doing is critical. We strongly encourage companies to continuously analyse its performance, to monitor trends, to compare with benchmarks etc. in order to know when and how to act when



“Companies that simply replace the budget with rolling forecasts risk performing the equivalent of the annual budget exercise twelve times per year. This naturally leads to even more work and tax on the entire organization.”

performance or conditions change. For example: We find that it makes more sense to compare actual performance with past performance and benchmarks than the classical monthly variance reporting against budgets. The latter method is very often how it is done in companies with traditional budget processes.

■ How does a company start the process of getting rid of the budget?

ANDERS OLESEN: “Although the actual implementation of the proposed “new” way of managing will vary significantly between organizations, we generally propose this three-step plan for the implementation of a new management model based on the Beyond Budgeting principles:

1) WHAT IS THE PURPOSE OF THE BUDGET?

Start by asking yourself what you want to achieve with the budget; what does it do for you? Many very important and relevant purposes will no doubt appear from such an exercise. The following are almost always mentioned: Setting targets, establishing a financial forecast and allocation of resources (costs, headcount, investments). There will usually be more depending on the individual company; a few examples are: Determining cost prices, coordination, tax planning, etc.

2) DEFINE NEW AND SPECIFIC PROCESSES FOR EACH OF THE PURPOSES

Hereafter, a separate and very specific process is designed for each of the above-mentioned purposes. When doing so, companies find that there are indeed much better ways of addressing each of the purposes than by having them forced together in the same uniform process. A few examples:

- Setting targets: Normally it is the purpose of targets to provide direction and they should be ambitious (yet realistic) so that every individual is inspired to do his/her best thus leading to the whole organisation reaching its full performance potential. Having established the purpose of target setting, then

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Founded in the UK in 1998, its purpose is to help organizations achieve sustained high performance, also under turbulent conditions, by developing their management models from **command & control** towards **empower & adapt**. For more information, see www.bbrt.org.

Some typical problems with traditional budgets (the complete list is much longer):

- Budgets are typically extremely **detailed**. Ask if the degree of depth is relevant and if it adds value. Most budgets are irrelevant a few months into the fiscal year due to inevitable changes in assumptions, so a lot of work is a waste of time.
- Budgets are typically extremely **time-consuming** to prepare. From the typical strategy session in the spring, to the overall target setting, the preparation of the budget manual, fixing assumptions, collecting data, consolidating data, negotiations, multiple versions... that ping-pong throughout the organization is extremely heavy and distracts the entire organisation from the truly value adding work.
- Traditional budget processes lead to **undesired behaviour** such as asking for more resources than needed, low-balling sales expectations, hiding reserves, postponing both good and bad news, overspending to maintain cost budgets, etc.
- Traditional budget mentality can lead to the **postponement and sometimes abandonment of the right decisions**. Threats and opportunities not foreseen in the budget will always appear. In some organisations, it is a cumbersome procedure to be allowed to deviate from the budget. This leads to the right decisions being made only “when I have a budget for it; maybe next year.”

“A target should express what you *want* to achieve, while a forecast should be the best guess of what is *expected* to happen. When these two very different purposes are unclear to the organisation, you can get into all sorts of undesirable situations.”

BIO: ANDERS OLESEN

Anders Olesen is Director of the Beyond Budgeting Institute. He is from Denmark and started his career at Arthur Andersen. He has since held various financial positions; among these was 8 years with Borealis half of which were in its operations in Belgium from 1997 to 2001. Since 2009, Anders has worked as a consultant advising organizations on performance management related issues; heavily inspired by the Beyond Budgeting principles.

ask yourself how this is best achieved. Must new targets be set every year? How many details are needed? Does the target have to coincide with the next fiscal year? Does it make sense to set a nominal target or does it make more sense to set relative targets? Can the target be expressed more as a direction than a specific and measurable goal?

- Forecasting can be very useful, but only if it is done for the right purpose, with the right frequency and at the right level. The period over which to predict, should follow the business cycle. This does not necessarily coincide with the 12-month accounting period.
- Allocation of resources: Does the allocation of all resources in advance of the planning period make sense? To increase the quality of the decision about what and how much to spend, it is usually wiser to delay decisions as late as possible. It may sometimes be better to monitor the use of resources based on certain criteria, for example: you may spend as long as the fixed costs do not exceed a certain percentage of sales.

3) CONTINUOUSLY IMPROVE THE NEW PROCESSES

When new specific processes are implemented these can be further developed independent of each other, since they are no longer part of the same big annual exercise.

After a successful switch of mindset and the implementation of the new processes, you can safely stop the old budget process.

■ How can you be sure that you do not lose control? What are the risks of switching to this philosophy?

ANDERS OLESEN: “The fear of losing control is indeed the main concern that we encounter. Proper planning and good communication, however, can overcome this. It is important to emphasize that Beyond Budgeting is about building empowered and adaptive organizations *without* losing control, as described in our book: “The Leader’s Dilemma”. A safe way to move ahead is to implement the new processes step-by-step and ensure that these are working before removing the budget. I have yet to come across a company that has lost control after abandoning the budget.”

■ How does rolling forecasting fit the concept of Beyond Budgeting?

ANDERS OLESEN: “Rolling forecasting fits very well with Beyond Budgeting. Rolling forecasts with a time horizon that matches the business cycle, with only enough details to serve its purpose, and that are free from bias are great. When asked, we often recommend organizations to start their Beyond Budgeting journey with the forecasting process. There are, however, also examples of companies that have simply replaced the annual budget with 12 rolling forecasts in an almost identical, albeit must faster, process. This naturally leads to much more work for the entire organization and hardly creates any value in itself. Moreover, it is unfortunately very common to treat forecasts as targets which can lead to serious problems. In my mind, the forecast should provide an unbiased view of what is the most likely outcome given the current performance and the expected impact of decisions taken. A forecast should be like a radar on a ship that warns the helmsman about dangers ahead so that he can adjust in good time. For this to work properly the radar must cover a sufficient area for the helmsman to be able to react; hence the need for a fixed time horizon this is long enough for the organization to adjust to the new conditions (threats or opportunities).”

■ Is there also an IT component associated with this way of working? Do most ERP applications support this way of working?

ANDERS OLESEN: “Today, many IT tools support different budgeting techniques such as rolling forecasts, but they are often very detailed and with fixed time periods. Software companies are developing more suitable models for dynamic planning. Many companies have used Excel when starting to work with rolling forecast and this can certainly work in many situations. It is definitely easy and inexpensive.” ■