Throw out the budget process, or at least radically alter it
( be part of the Beyond Budgeting Movement)


By David Parmenter (davidparmenter.com)

Companies in Asia, Europe, America and some in New Zealand are recognising that the existing budget process cannot continue. It has been with us, some say, since the Roman calendar was adopted by the western world. It is now seen by many that the budget process is a hindrance to management rather than a help. An international survey found that nearly 90% of chief financial officers (CFOs) were dissatisfied with their budget process and that there was often no link from the annual budget to strategy.

Jeremy Hope and Robin Fraser, the management gurus behind the “Beyond budgeting movement” have stated that not only is the budget process a time consuming, costly exercise generating little value, but also, and more importantly, a major limiting factor on how your organisation can perform. They have many examples of companies, following the philosophies they have expounded, which have broken free and achieved success well beyond their expectations. Here are three quotes which challenge the very concept of budgeting.

“So long as the budget dominates business planning a self-motivated workforce is a fantasy, however many cutting-edge techniques a company embraces”

“Modern companies reject centralisation, inflexible planning, and command and control. So why do they cling to a process that reinforces those things?”

“The same companies that vow to respond quickly to market shifts cling to budgeting – a process that slows the response to market developments until it is too late.”
Jeremy Hope and Robin Fraser, Harvard Business Review April 2003

Lets now look at why the budget process, as it currently stands, is a “no brainer”. A survey performed in 1998 by Hackett Benchmarking & Research, a US consulting firm, on CFOs came up with a frightening statistic. There were 25,000 person days invested in the budget process for every $1bn of revenue. The study also found:

- the average time for a budget process was 4 months.
- 66% of CFOs stated their budget was influenced more by politics than strategy
- nearly 90% of CFOs were dissatisfied with their budget process
- 60% of CFOs acknowledged that there was no link from their budgets to strategy

I can assure you this level of dissatisfaction is similarly among Boards, CEOs, general managers and budget holders. I have recently just finished two assignments, one with a public authority and another with a manufacturing operation, the findings were the same. Hope and Fraser state that companies that have adopted the “beyond budgeting management model”, the ‘spend or loose it’ philosophy that is at work in traditional
organisations has no meaning. Another writer talking about personal experiences commented the incessant game playing extended the budget round and limited the need for to stretch or seek breakthrough solutions. Does this sound familiar?

There is an answer, throw the budget process out, it takes too long, is not linked to strategic outcomes or "critical success factors" and is your major barrier to success.

The existing budget model cannot possibly be of any use for the following reasons:

- budgets do not help companies focus on the performance drivers of today’s organisations e.g. innovation rates, service levels, quality, and knowledge sharing etc. (these are clearly shown in a balanced scorecard)
- budgets have been turned into fixed performance contracts and have led to dysfunctional behaviour with dire circumstances - managers in a study were found to be inclined to either try and beat the system or felt pressured to achieve targets at any cost (the same behaviour that generated many of the recent "managed earnings" scandals)
- budgets treat all employees as costs, whereas a team’s talent, innovation and commitment are more important in determining performance than the “personnel costs” of the team
- the budget process builds silos, effectively compartmentalising a company into small units
- Hope and Fraser were the first to point out that the budget process limits the ability of organisations to make full use of new management philosophies such as economic value added (EVA), Balanced Scorecard, activity based management (ABM), customer relationship management (CRM) and rolling forecasts

There is now hope. European companies have joined the “beyond budgeting round table” to free themselves from the shackles of the budgetary process. There is one brilliant case study on a famous cider maker H P Bulmer, UK www.info-edge.com/samples/BI-3037sam.pdf. This case study sets out clearly the very doubts and concerns that already exist in your organisation and gives you a pathway forward. It will revolutionise your company if the eight page case study is read by the senior management team, budget holders, the finance team and the Board. I promise you.

Bulmer’s breakthrough all started with the CFO attending a “beyond budgeting round table” seminar. The CFO obtained permission from the Board to assess the implications and way forward. Their first steps were a series of in-depth workshops across the company to ascertain the net worth of the existing budget system. To their horror they didn’t find anybody who supported the present budgeting process. As the CFO said “we were absolutely overwhelmed by what we heard”. As in your organisation, the accountants had worked every weekend for two months to work on the budget. They had effectively sat at their desks until 10 o’clock at night to rework the budgets to find out that nobody uses it. It’s only use being the variance analysis that commonly states “this variance is due to a timing difference because………………” Does this sound familiar?

The company now works on a 12 week cycle. They focus on sales growth targets, comparing sales against last year’s actuals. They focus on the brands that have the potential to perform and investment is targeted to enable this capability. Costs are managed by measuring against a set of key performance measures e.g. the manufacturing function’s performance is measured against the KPI of cost per hectolitre rather than a fixed budget. Manufacturing now plans its timetable on a rolling
12-week basis so it can be more responsive to product mix changes. As the CFO stated “it is pointless having a fixed budget when you do not know exactly how much is going to be manufactured.”

The change proposed by the “beyond budgeting management model” are challenging. Throwing out a process that has been around for centuries is a difficult quantum leap. The beauty is that all you need to do is research these exciting changes and get on board the change bus. You will be surprised to find that the Board, the SMT et al will all be rushing to jump on once they have read the Bulmer case study.

New Zealand organisations will now have the opportunity to meet Jeremy Hope in a seminar or workshop in Wellington (4 & 5 Nov) and in Auckland (6 Nov).

There are examples of this breakthrough on our shores, mainly through local offices of European multinationals.

A major telecommunications giant has replaced yearly budgets with four quarter rolling forecasts. The word budget does not exist. The new process gives them forewarning of events that they expect to take place, and that in turn allows them to take corrective action at an appropriate point in time.

A multinational company involved in innovation for a long time have been using quarterly forecasts, six quarters out this way. I remember interviewing a manager from this company and he said to me back in 1995, “we do not have a budget we have a six quarter out rolling forecast. The significance of what he said did not fully sunk in, they were, in fact, one of the early pioneers in “beyond budgeting”.

This new process has enabled leading companies to finalise numbers for the next three months while giving flexibility to management providing they are operating within key benchmarks and complying to existing strategy. This development is a huge breakthrough, just as the balanced scorecard is. As I write, I myself am discovering about the implementation issues. I would welcome reader’s experiences in this area.

When an annual budget is a legal requirement (in the public sector or when you are a subsidiary of a multinational run by the old school)

In some organisations it is a legal requirement to have an annual figure. In this case, an annual plan can be set in a quick two week process. This annual plan however should not be broken down into monthly budgets. Instead, establish a quarterly forecasting regime where management set out their required expenditure for the next eighteen months and seek approval for expenditure for the next three months. See diagram below.

Each quarter, before approving these estimates, management see the bigger picture six quarters out. They also can keep an eye on the new annual forecast. I often use the analogy based around rugby. The annual plan fixes the goal posts (sets the ranges) and the new forecast is meant to pass through the posts as long as the assumptions have not changed. Hope and Fraser point out the necessity to ensure honesty with forecasts. It is important to give the best estimates no matter how unsavoury they maybe. It is simply a waste of time forecasting a number that the SMT and Board want to see which is miles away from reality.
You can use your G/L for this exercise by using the revised budget field. Renaming it of course to something appropriate, forecast, target, expected etc. You then create reports from the G/L comparing actual against this forecast. The major benefit is that this forecast is at the most only three months old.

Hope and Fraser have many interesting case studies on how quarterly rolling forecasts have revolutionised organisations, and these will be covered in the November seminars and workshops. The case study on sight savers international is one to inspire public and “not for profit” sector organisation into action. See the recent Observer article on 20 July 20 July (www.breakingfree.co.nz)

Diagram of how the rolling forecast works

Replace budgeting with a bottom up forecasting regime and benchmarking

In my view there is no room for a top down forecast. They simply exist because we are still using Excel, a totally, inappropriate tool to do our forecast and budget.

In order to do a bottom up forecast, every quarter we need a bolted down system, some have successfully used an intranet based interface with their G/L while others use some enterprise planning software like Advisor or Adaytum. Whatever you chose it will be better than Excel which on this type of exercise is like a house built of playing cards. It is not if it will collapse but when!!

Benchmarking becomes more important as progress is now compared against “best in class”, both internally and externally for teams and divisions.

Other benefits of throwing out the budget process and it’s associated annual performance trap

Many readers will have wondered why the introduction of sound new management tools have not worked in their organisation. Hope and Fraser have found the culprit, the budget process Let me explain.

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<th>Model</th>
<th>How the budget undermines the model</th>
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<tbody>
<tr>
<td>Economic value added (EVA)</td>
<td>The “silo based” budgeting approach is not compatible with a process view of the organisation which is required for EVA.</td>
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<tr>
<td>Benchmarking</td>
<td>The extent of under performance against best-in-class standards loses its visibility as the short term budget (fixed performance contract) dominates thought and action.</td>
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<td>Balanced scorecard BSC</td>
<td>It is easy to turn the BSC with its financial and non financial measures into yet another fixed performance contract with the same dysfunctional behaviour. The silo approach to budgets again</td>
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Activity based management models

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<td>The budget process does not focus on cost drivers or critical success factors but instead forces management to sail a course that was set many months earlier which may have no relevance to prevailing conditions.</td>
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Customer relationship management (CRM)

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<td>The inside-out budget process is at odds with the outside-in CRM strategies. Sales staff are too frequently hell bent on meeting internal goals rather than customer satisfaction and customer profitability.</td>
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Please see chapter nine of “Beyond budgeting” by Jeremy Hope and Robin Fraser to fully understand these issues.¹

**The beyond budgeting vision - the golfer!**

The beyond budgeting success stories all have built a strong corporate culture based on each individual taking personal responsibility both for their own individual performance and for that of the team. Hope and Fraser use an analogy that I particularly like, one of turning you staff into golfers.

“Golfers keep their own score. There is a transparency, everybody knows each others score. No one cheats on the course or misrepresents their score. To do so would bring disgrace and an abrupt end to their membership. Nor do golfers need anyone telling them what score to aim for. They already know their ranking whether it be a club or international competition. They know their handicap and what they have to do to improve relative to their peers. Their performance is continuously measured after each event and their aim is continuous improvement.”

**The first steps to take**

- read the Bulmer cider case study and distribute to the SMT
- obtain Hope and Fraser’s Harvard business review paper and book
- select a cross functional team and ensure that they attend a Hope and Fraser seminar workshop either in New Zealand or Abroad
- join the Beyond Budgeting round table
- select an advisor who can work with the in-house team
- commence your scoping exercise as set out in the Bulmer case study
- commence an education process of the Board, the SMT, management and staff
- turn your organisation into a golf club!

**Writer’s biography**

¹ Beyond budgeting: how managers can break free from the annual performance trap by Jeremy Hope and Robin Fraser ISBN 1-57851-866-0
David Parmenter is the CEO of waymark solutions. David specialises in assisting organisations measure, report and improve performance. waymark helps organisations streamline their: month-end reporting and annual planning processes, implement quarterly rolling forecasts, adopt the principles of beyond budgeting, develop decision based reports, and adopt performance measures that will improve performance. He has had speaking engagements in 2007 in Wellington, Auckland, Christchurch, Sydney, Melbourne, Brisbane, Canberra, Adelaide, Perth, Kuala Lumpur, Singapore, Dublin, Edinburgh, Glasgow and London.

John Wiley & Sons Inc are publishing two of his books in 2007 “Key performance indicators – developing, implementing and using winning KPIs” (January 07) and “Pareto's 80/20 Rule for the Corporate Accountant” – better practices from winning finance teams (April 07).

David has an in-depth understanding of better practices of corporate accountants across all sectors. David has also worked for Ernst & Young, BP Oil Ltd, Arthur Andersen, and Price Waterhouse. David is a fellow of the Institute of Chartered Accountants of England and Wales.

He has written over 30 articles for the accounting and management Journals in Australia, Malaysia, Ireland, England and New Zealand. His articles published include: “quarterly rolling planning - removing the barriers to success”, “Throw away the annual budget”, “Maybe its time to look at your KPIs”, “seven time wasters”, and “quick month end reporting”, “Beware corporate mergers”, “Implementing a Balanced Scorecard in 16 weeks not 16 months”, “Convert your monthly reporting to a management tool”, “Smash through the performance barrier”, “Is your board reporting process out of control?”

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