

Finance & Performance Management

# Driving Value Through Strategic Planning and Budgeting

A Research Report from Cranfield School  
of Management and Accenture

The Accenture logo is displayed in white on a dark blue background. It features a stylized chevron symbol above the word "accenture" in a lowercase, sans-serif font.

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A substantial review of worldwide  
planning and budgeting practices.

# Executive Summary

In the first quarter of 2001, a team from the Centre for Business Performance at Cranfield School of Management and Accenture's Finance & Performance Management Service Line undertook a substantial review of worldwide planning and budgeting practices. The goals of this review were to establish what are considered as best practices in planning and budgeting and to identify any evidence of improving shareholder returns with enhanced planning and budgeting.

To achieve these goals, the research team reviewed some 100 academic and practitioner books and papers on the subject of planning and budgeting, and completed face-to-face interviews with executives from 15 different firms, including ABB, Bank of Scotland, Belron, Borealis, BP, Cisco Systems, Credit Lyonnais, DHL, Electrolux, Ford, SAS, Shell, Skandia, Svenska Handelsbanken and Volvo. These interviews were supplemented by discussions with more than 30 senior analysts from 6 different houses – Deutsche Bank, Morgan Stanley Dean Witter, Merrill Lynch, Prudential Securities, Standard & Poor's and William de Broë. The study also built on an earlier piece of research, completed by Accenture and Charles Schwab [31], which explored the planning and budgeting practices in 28 additional firms, including @Home, Ameren, AOL Time Warner, Aon Corp, Bank One, Chrysler Corp, Commonwealth Edison, Dell, Delta Airlines, Detroit Edison, Duke Power, Firemen's, H&R Block, Highmark, Hewlett Packard, Intel,

InterG, JP Morgan, Kaiser Permanente, Microsoft, Nat West (UK), Novartis, Phillip Morris, Safeco, Schlumberger, Sprint Canada, Sun Microsystems and Wellpoint. Based on this comprehensive review of the academic and practitioner literature and on the data we have gathered from executives in more than 40 firms we have concluded:

## Significant weaknesses exist in the traditional approaches to planning and budgeting

- The traditional approaches to planning and budgeting are widely criticized. This research identifies the 12 main criticisms as:
  - 1 Budgets are time consuming and costly to put together.
  - 2 Budgets constrain responsiveness and flexibility and are often a barrier to change.
  - 3 Budgets are rarely strategically focused and are often contradictory.

- 4 Budgets add little value, especially given the time required to prepare them.
- 5 Budgets concentrate on cost reduction and not on value creation.
- 6 Budgets strengthen vertical command and control.
- 7 Budgets do not reflect the emerging network structures that organizations are adopting.
- 8 Budgets encourage 'gaming' and perverse behaviors.
- 9 Budgets are developed and updated too infrequently, usually annually.
- 10 Budgets are based on unsupported assumptions and guess-work.
- 11 Budgets reinforce departmental barriers rather than encourage knowledge sharing.
- 12 Budgets make people feel under-valued.

### Organizations are adopting and evolving new processes for planning and budgeting

- All of the organizations involved in this research were actively seeking to improve their budgeting and planning systems, but for different reasons.
- Some wished to enhance the cost efficiency of the planning and budgeting process.
- Some wanted to improve their ability to forecast, and therefore manage financial market expectations.
- Some were seeking to use the planning and budgeting process to encourage their managers to think more strategically and to explore more fully the organization's value drivers.

### There is a link between planning and budgeting, and shareholder value

- The link between shareholder value and planning and budgeting can be demonstrated through a theoretical model, which involves 3 broad sets of factors – improved management, managing market expectations and improved performance.
- Underpinning each of these factors are inter-linked sub-factors:
  - Improved management is underpinned by better company forecasting, better strategy formulation and execution, and more cost efficient planning and budgeting.
  - Managing market expectations is strengthened by better communication with analysts (due to improved accuracy of management information) and increased management credibility.
  - Better company performance is underpinned by actual financial performance, performance against expectations and expected future performance.

### The future of planning and budgeting lies in planning for value

- Despite the literature's emphasis on the cost of putting budgets together as the major reason why organizations should re-engineer their planning and budgeting processes, it is our contention that the major value lies in aligning plans and budgets to strategies.
- The future of planning and budgeting lies not simply in becoming more efficient, but rather in planning for value.

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# 1.0 Introduction

The days of traditional budgeting appear to be numbered. The consensus opinion of business leaders in this research indicates that traditional budgeting no longer meets the evolving demands of today's businesses.

Research suggests that 80% of companies are dissatisfied with their planning and budgeting processes, and in a recent survey, financial directors ranked budgetary reform as their top priority [42]. Among the various drawbacks identified by the practitioner and academic communities are that the processes are too time consuming and costly. They are too slow and unresponsive for today's competitive and turbulent environment. They are usually affected by 'gaming,' corporate politics and horse-trading tactics. And overall, it all adds little value to organizations.

Data from The Hackett Group, the consultancy firm, suggests – the average company with annual sales of \$1 billion spends 25,000 person-days per year planning and measuring performance. Compare this with the upper quartile, which is 6,000 person-days per year, and the best, which is about 700 person-days. Clearly there is an opportunity for significant improvement in many organizations.

It is not only the value of the budgeting and planning processes that is being questioned, more and more people are also recognizing the costs involved. Ford, one of the companies involved in this study, estimated that their planning and budgeting process costs \$1.2 billion a year to run. Volvo, the Swedish car manufacturer, reported 20% of all management time was tied up in the group's budgeting and planning processes prior to their decision in 1996 to abolish budgets.

Jack Welch, CEO of GE, says: "The budget is the bane of corporate America. It never should have existed... Making a budget is an exercise in minimalization. You're always getting the lowest out of people, because everyone is negotiating to get the lowest number."

John Menzer, CFO of Wal-Mart, adds, "We weren't too big on planning or budgeting, because we figured, why tinker with success?"

Greg Vesey, Director of Business Systems at Texaco, believes "Planning is the most political of all processes that fall under the finance function."

Our research suggests that executives worldwide are recognizing these problems and re-engineering their planning and budgeting systems as a competitive advantage. They are looking for ways to make their organization's planning and budgeting processes far more efficient and effective. Some, such as Electrolux and Ford, are seeking to exploit the power of information technology. They are trying to establish integrated databases that contain accurate and valid information that can be accessed and updated in real-time. Ford, through its F@ST (Financials at the Speed of Thought) initiative is seeking to establish the capability to calculate the profitability of individual vehicles sold anywhere in the world and use this data in strategic decision-making. Electrolux, through its consolidation initiative, is seeking to develop an integrated planning and budgeting database that can replace all of the independent and ad hoc solutions being used by its 93,000 employees around the world.

Others, such as ABB and BP are seeking to use their budgeting processes to encourage more creative and strategic thinking in their businesses, by asking senior managers to explore more fully the cash flow and budget implications of their chosen strategies. Still others, such as Svenska Handelsbanken, one of the most profitable banks in Sweden, cut the Gordian knot years ago, by abolishing budgets in the 1970s.

These, and other themes emerged during a significant study of best practices in budgeting and planning. This white paper sets out the findings from this research. It is structured around 6 main sections, each of which explores 1 or more of the several different themes uncovered during the course of the research. Specific issues that are discussed include:

- Different approaches to planning and budgeting.
- Linking shareholder value and budgeting: the theory.
- Planning and budgeting: the practice.
- Planning and budgeting: the relationship with share price.
- The impact of planning and budgeting on shareholder value: conclusions and views on the future.

According to Dr Jan Wallander, Honorary President of Svenska Handelsbanken, the bank's philosophy is simple: "The budget gives you the wrong target. As soon as you introduce a budget, the aim becomes to beat the budget. But this is not the true aim. The true aim is to beat the competition."

# 2.0 Different Approaches to Planning and Budgeting

The first phase of the research involved an extensive review of the academic and practitioner literature on the subject of planning and budgeting.

This section draws on this material to explore 4 specific issues:

- The weaknesses of traditional planning and budgeting.
- Why organizations have not already overcome these weaknesses.
- How organizations are seeking now to overcome these weaknesses – 'better budgeting'.
- The attempts to replace budgeting with alternative approaches – the 'beyond budgeting' campaign.

## 2.1 The weaknesses of traditional planning and budgeting

The starting point of any review of current practice in planning and budgeting has to acknowledge the massive frustration with the traditional approaches. Interestingly, while all the literature reviewed discussed the drawbacks and occasionally the benefits of the 'traditional' planning and budgeting process, few actually defined it. For the purposes of this paper, 'traditional' planning and budgeting is viewed as the periodic process by which organizations tend to define their forward operational expenditures and forecasted incomes. In its 'traditional' sense, it is a top-down process, whereby budget packets go out from the corporate office to various divisions and operating units, accompanied by forms to be filled in and sales and operational forecasts to be completed. Once the necessary data has been entered these budget packs are returned 'bottom-up' to the corporate office. Subsequently, multiple iterations (which include the same path) are performed until final agreement is achieved. The resulting budget is usually produced weeks or months after the initial distribution of the budget forms,

and this sets the 'limits' to operate within and targets to be achieved, for the next budget period (usually 1 year). Typically, monthly variance reports are produced and discussed.

The major theme in the literature (much of it practitioner-oriented) is an extensive criticism of the traditional approach to budgeting. The 12 most frequently cited criticisms in the literature are:

**1 Budgets are time consuming and costly to put together [19, 46, 49, 53, 55, 82, 96, 104].**

In many organizations the planning and budgeting process is said to consume between 20% and 30% of management's time [25].

**2 Budgets constrain responsiveness and flexibility and are often a barrier to change [25, 26, 40, 53, 55, 58, 84].**

Traditionally, attention is focused on achievement of the specific plan or budget. There is rarely an opportunity to amend budgets as circumstances change; and incentives to significantly out-perform budgets are effectively non-existent. Furthermore, traditional approaches to budgeting act as a barrier to continuous improvement and success, because the focus within the organization is constantly on how can we beat the budget, rather than how can we maximize our potential.

**3 Budgets are rarely strategically focused and are often contradictory [3, 53, 58, 70, 84].**

Accountants employed by listed companies argue that they are unable to think strategically because of the importance attached to current-year profits, compared to long-term business health. Budgets tend to be internally driven and do little to focus attention on the issues required to satisfy customers and generate value.

**4 Budgets add little value, especially given the time required to prepare them [14, 19, 46, 53, 96].**

A study, conducted by Trapp (1999), for example, found that more than half of the time spent by a finance department on the budget is consumed by putting data together, while only 27% of the time is spent on analysis [96]. Budgets tend to be bureaucratic and often focus on form filling, rather than creative thinking about how the organization is going to generate value.

**5 Budgets concentrate on cost reduction and not on value creation [3, 26, 52, 53, 55, 87, 100].**

Research reported in CFO magazine found that only 27% of companies integrate strategies with tactics and only 22% have forecasts, which include corrective action plans [70]. Budgets fail to measure, and can even stifle growth of intangible assets, which are now widely seen as key drivers of future cash-flows and shareholder value.

**6 Budgets strengthen vertical command and control [52, 53, 55].**

Budgets prescribe the conditions for activity within the company, which are generally dictated by senior management. The budgeting process provides a mechanism to ensure that these conditions are adhered to, controlling employees rather than encouraging them.

**7 Budgets do not reflect the emerging network structures that organizations are adopting [26, 53, 58].**

Increasingly, companies are decentralizing activities and taking advantage of alliances and partnerships to deliver customer service and create value. Budgets fail to reflect such approaches; instead they promote centralized control within the confines of the individual company.

**8 Budgets encourage 'gaming' and perverse behaviors [46, 58, 87].**

The majority of participants seek to minimize the level of commitment they have to make, and maximize

their personal gain during the process of setting budgets. This is especially the case when meeting the budget results with incentive payments to individuals and/or teams [51]. When this mentality and culture is pervasive throughout the organization, the drive to improve and develop is lost.

**9 Budgets are developed and updated too infrequently, usually annually [14, 26, 84].**

Budgets typically have an annual time horizon, and tend to remain unchanged in that 1 year period despite the fact that they are often out of date at the end of month-1 [55].

**10 Budgets are based on unsupported assumptions and guess-work [14, 19, 87].**

Typically traditional budgets include very limited justification of any assumptions on which they are based. Those preparing the budgets do not have to think rigorously about how they are going to deliver them. Indeed, if assumptions are not made explicit then the opportunity to truly analyze variances is limited. Often senior managers contribute to this process by arbitrarily cutting or increasing budgets by certain percentages.

**11 Budgets reinforce departmental barriers rather than encourage knowledge sharing [14, 55].**

As everyone strives to achieve their own budgets and targets there is little incentive to co-operate with others to achieve synergies.

**12 Budgets make people feel under-valued [55, 100].**

Traditional budgets prevent empowerment and the opportunity for employees to contribute to the achievement of strategic objectives. Often, they treat employees as costs to be minimized, rather than assets to be developed. Furthermore, it has been suggested that abandoning budgets can help attract good quality managers who value 'freedom and autonomy' and 'exciting challenges' when choosing a company to join [55].

Support for the most frequently cited criticisms, namely the time-consuming nature of planning and budgeting and the costs involved comes from The Hackett Group, the US-based research consultancy, which has gathered data on the budgeting and planning practices of firms worldwide. Their data suggests that the best firms in the world are able to develop budgets and plans twice as fast as the worst.

Table 1 – Planning and Budgeting Data from The Hackett Group<sup>1</sup>

	Upper Quartile	Mean	Lower Quartile
Person days per billion \$ sales	6,077	25,000	28,592
Months to develop strategic plans	3	5	6
Months to develop financial plans	3	4	6
Reporting resource (person-days)	6.1	11.2	28.6
Line items in financial plan	40	90	250

Interestingly, while much of the literature focuses on the costs associated with budgeting and planning, there is clearly a growing recognition of the need to link them to strategy and value creation. It is our contention that budgets have to be aligned with strategies, and effective strategic planning and management processes have to be introduced. These processes must be value-based, consequential and continuous. To be effective, they will focus on identifying and managing the true drivers of shareholder value (value-based). They will make explicit the links between these value drivers (consequential). And they will involve a continuous process of questioning and challenging the assumptions inherent in the strategy (continuous). Unfortunately, the traditional budgeting and planning processes fail to meet any of these criteria [63] and therefore promote an inward-looking culture that focuses on achieving a budget figure rather than creating shareholder value over the medium- to long-term.

Overall, the predominant theme in the literature is that planning and budgeting processes traditionally used in many organizations are failing to deliver results. Fundamentally the problem is that they add limited value to the

management of businesses. They are too time consuming and costly to undertake and they encourage political behavior and game playing rather than driving business performance.

## 2.2 Why organizations have not already overcome these weaknesses

The budgeting and planning systems used in many firms today were developed many years ago for an industrial age, which was relatively static and simple to understand. Today's economy is much more turbulent, and attempts to develop long-term, fixed plans based on this old business model are naïve. Underlying this theme is the recognition that since its inception in the 19th Century, cost management has gradually changed to cost accounting. Originally the aim was to provide a method of analysis that delivered valuable insights into how the business was performing, and why. Now, in many organizations, cost accounting has become so routine and pervasive that it is effectively a mechanistic procedure that managers feel they have to perform. The impact of this has been that traditional management accounting, and the associated budgeting and planning processes, have lost their relevance to business and decision-making since the figures they contain are widely known to be of questionable validity and hence, dubious value [60].

As the world in which organizations compete changes, so must budgeting systems to support strategic objectives and competitive priorities [40]. Despite this, and the general recognition of the short-comings of traditional budgeting systems, 70% of companies have not updated their budgeting process in the last 5 years [82]. The literature identifies a number of reasons why organizations fail to change their planning and budgeting processes:

- The cost of overhauling the budgeting system can be very high (up to \$40 million is quoted) [19].

<sup>1</sup> The Hackett Group data is based on a wide range of companies, 60% of whom are service and 40% manufacturing. These companies have between 200 and 600,000 employees and achieve annual sales between \$15 million and \$150 billion.

- The benefits of changing budgeting systems are less quantifiable than they are for other systems such as information systems [15].
- Analysts estimate that as many as half of organizations that embark on such an overhaul become overwhelmed and decide to give up [19].
- Traditional budgeting processes are difficult to discard, because they remain a centrally coordinated activity (often the only one) within the business. It is usually the only process that covers all areas of organizational activity [84].

The literature shows the cost and effort of overhauling planning and budgeting systems are key factors in preventing their change. Companies also struggle with managing the scope of projects and understanding what the key barriers are to implementing change successfully. To address this issue, it would appear necessary for organizations to take a proactive approach of continual modification of planning and budgeting systems. Then, they can continually reflect the requirements of the organization and they won't entirely lose their relevance, requiring a complete redesign. In order to achieve this continual change and updating of the planning and budgeting system, a process for actively managing the evolution of the budgeting system has to be established. This process should also prompt reflection on the overall relevance of the budgeting systems as the organization's circumstances change, so they can be amended as appropriate. The key theme is that we have to manage the evolution of budgeting systems proactively, rather than reactively in the future.

## 2.3 Overcoming these weaknesses – 'better budgeting'

In response to these criticisms, authors and commentators from both Europe and the United States have offered a variety of proposed methods for 'better budgeting'. These improvements range from Hope and Fraser's call to abandon budgets (the 'beyond budgeting' model) [55], to Kaplan and Norton's suggestion that strategic as well as tactical budgets should be developed to ensure that the resources needed are devoted to strategy execution [64].

In the literature reviewed during the course of this investigation, the following major variations and/or alternatives were identified. These we have grouped together under the generic heading 'better budgeting'.

- 1 **Activity Based Budgeting (ABB)** – the origins of this approach relate to well-established theories in Activity Based Costing (ABC) and Activity Based Management (ABM). ABM involves structuring the organization's activities and business processes, so that they better meet customer and external needs. ABB builds on this and seeks to ensure that any resource and capital allocation decisions that are made are consistent with the ABM analysis. Effectively ABB involves planning and controlling along the lines of value-adding activities and processes. Advocates of this approach claim that it can result in cost savings of between 10% and 20% through the implementation of better methods of working and the elimination of bureaucracy [25].

## 2 Zero-Base Budgeting (ZBB) –

rather than basing budgets on previous years or periods, expenditures must be re-justified during each budgeting cycle. Many see Zero-Base Budgeting as the best attempt of the last 30 years to overcome the weaknesses of traditional budgeting, because it avoids building on the inefficiencies and inaccuracies of previous years [55]. The problem, however, is that it is too time consuming to repeat every year, since it requires you to build budgets from scratch. This is simply unnecessary in a stable business environment, and in fact is unlikely to deliver significant value on a continuous basis. That's because constantly challenging assumptions in a stable operating environment is unlikely to result in new insights. Indeed, you can only get this sort of a step-change once every 3 to 5 years.

More importantly, both ABB and ZBB do not really address the endemic shortcomings of traditional budgeting identified in section 2.1. Certainly, they provide alternative approaches to budgeting, but they are still time consuming, still result in game playing and add limited value after their first application.

## 3 Rolling Budgets and Forecasts –

one of the main improvements proposed relates to the need to make budgeting and forecasting more frequent to keep pace with changing circumstances. Methodologies in this area include rolling budgets, perpetual planning and rolling forecasts. These approaches are seen as more responsive to changing circumstances because they solve the problems associated with infrequent budgeting and hence result in more accurate forecasts [48, 84, 104]. They are also designed to overcome the problems associated with budgeting to a fixed point in time – i.e., the year end and the often dubious practices that such cut-offs encourage. A disadvantage of the rolling budget approach is that it

can result in greater cost to the organization because budgets have to be put together more frequently. Rolling forecasts, however, overcome this problem because they are often developed based on business models, which in turn incorporate specific assumptions about the drivers of income and expenditure.

## 4 Value-Based Management –

while not an explicit replacement for budgeting and planning, value-based management provides a formal and systematic approach for managing the creation of shareholder value over time<sup>2</sup>. It has 3 elements: beliefs, principles and processes.

The main approach is that all expenditure plans should be evaluated as project appraisals and assessed in terms of the shareholder value that they will create. Proponents of the approach note its ability to link strategy and shareholder value to planning and budgeting. However, there are few demonstrated detailed techniques for implementation, so much of the discussion on the topic appears to be of a conceptual nature [27]. In fact, some commentators have gone as far as suggesting that too many organizations have become focused on value measurement, rather than value management, which in turn limits the focus on value creation [68].

## 5 Profit Planning –

the profit wheel model for planning future financial cash flows of profit centers by assessing whether an organization or unit generates sufficient cash, creates economic value and attracts sufficient financial resources for investment. In theory this approach ensures consideration of an organization's short- and long-term prosperity when preparing its financial plans. However, once again, there are few examples of its practical application [94].

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<sup>2</sup> See, for example, Rappaport, A. (1986) *Creating Shareholder Value*, The Free Press, New York and Knight, J. A. (1998) *Value Based Management – Developing a Systematic Approach to Creating Shareholder Value*, McGraw-Hill, US.

The advocates of these approaches all claim benefits in organizations that have applied them. Case studies suggest that these benefits vary from marginal to substantial improvements, in terms of cost, time, communication and control. However, critics argue that each of the approaches effectively only involve re-engineering the traditional budgeting and planning processes and do not address fundamental problems. Moreover, there is evidence to show that while some of these approaches have a solid theory, they are not being well implemented or well received by the organization.

A recent research study, published in CFO magazine, for example, found that [70]:

- Most respondents were dissatisfied with their current planning and budgeting processes, even when they had re-engineered them.
- Most respondents believed there was plenty of room for improvement with their organizations' budgeting and planning processes.
- There were huge gaps between how well finance executives applied approaches such as ABB, ZBB and rolling forecasts, and how well they thought they should be able to apply them.
- A full 66% of respondents thought that their budgeting processes were more influenced by planning than by strategy.

Although each development in 'better budgeting' has been crafted to overcome specific shortcomings in traditional budgeting processes, they often require additional effort and management resource on top of that required for the traditional process. This may be justified in specific circumstances, such as special reviews, 'make or buy' outsourcing decisions, and for consolidations after acquisitions. But effort and resource requirements are not sustainable on a regular basis and benefits achieved through repeated applications of techniques such as ABB and ZBB are

limited. The literature clearly suggests that companies are looking to plan and budget more quickly, to respond to a faster changing external environment, and to use less resources – thereby freeing up management time. For some of the better budgeting techniques, most notably ABB and ZBB, it is questionable whether they deliver against these needs. For others, such as value-based management and profit planning, the challenge is how to implement the technique. Of the "better budgeting" techniques discussed, it appears that rolling forecasts have the most potential.

## 2.4 Eliminating budgets – 'beyond budgeting'

It is not surprising that there has been growing interest and support for the argument that budgeting as a concept is fundamentally flawed, and should be eliminated. For example, a budget is a single number. Yet, how can a single number provide both a stretching target and an accurate forecast? How can a single number be used both to motivate and control? One option would be to separate the control process from the motivational process within organizations. The implication would be to use the traditional budgeting and planning processes as a means of controlling expense and managing the delivery of financial results against a forecast. True, some modifications would have to be made to the approach. Annual budgets, and hence annual forecasts, are almost meaningless in today's turbulent environment. So, a greater forecasting frequency would have to be introduced. Then separately, the organization's performance measurement and management system could be used as a motivational device. The measures, and associated targets, could be aligned to strategy and used as an inspirational and motivation device.

Jeremy Hope and Robin Fraser, through their work with CAM-I (Computer Aided Manufacturing-International) are leading the call to abandon budgets. They argue that traditional budgeting processes are a barrier to change, and that techniques such as ABB and ZBB will not bring the expected benefits, if they do not fit with management structure and style. They assert that the underlying sources of future cash flows are the organization's intellectual assets and their management. Hence the role of the senior management team should be to maximize the value of the organization's intellectual capital, rather than seek to minimize the organization's cost base. Furthermore, they argue that it is almost impossible for organizations to achieve speed, customer focus, innovation and integration 'if the traditional planning and budgeting processes remain in place' [55]. Underpinning this argument is the notion that financial management should play the following roles in organizations:

- Forecasting and resource allocation, through rolling plans used for cash forecasting, rather than cost control.
- Measurement and control based not on 'actual versus budget' reports, but on progress against strategic milestones and relative measures.
- Cost management by creating a culture of thrift and continuous improvement, reinforced by long-term reward systems.

In essence, this new model is primarily 'behavior based', as opposed to the 'numbers-oriented' model that most companies use today. The validation for these ideas and the new model came from several case studies in major organizations that have fully or partially abandoned the traditional budgeting and planning processes. Hope and Fraser claim that a number of companies are striving to adopt a 'beyond budgeting' approach based on the following 12 principles [57]:

- 1 **Governance** – identify clear organizational values and boundaries that provide a basis for action, mission statements and plans.
- 2 **Performance responsibility** – make managers responsible for competitive results, not for meeting the budget.
- 3 **Delegation** – give people the freedom and responsibility to act, don't control and constrain them.
- 4 **Structure** – organize around networks and processes, not functions and departments.
- 5 **Coordination** – coordinate cross-company interactions through process design and fast information systems, not detailed actions through budgets.
- 6 **Leadership** – challenge and coach people, don't command and control them.
- 7 **Goal setting** – beat the competition, not the budgets.
- 8 **Strategy process** – make the strategy process a continuous and inclusive process – a top-down annual event.
- 9 **Anticipatory management** – use anticipatory systems for managing strategy, not for making short-term corrections to keep on track.
- 10 **Resource management** – make resources available to operating units when required at a fair cost, don't allocate them from the center.
- 11 **Measurement and control** – use a few key indicators to control the business, not a mass of detailed reports.
- 12 **Motivations and rewards** – base rewards on a company and unit-level competitive performance, not predetermined targets.

The only documented example of a truly 'beyond budgeting' company is Handelsbanken<sup>3</sup>, and indeed it is clear from the writing of Hope and Fraser that the bank has been extremely influential in shaping the authors' thinking on the subject. Under the guidance of former CEO Dr. Jan Wallander, Handelsbanken abandoned budgets and forecasts in favor of league tables to compare the performance of branches. Profitability per employee is measured on a monthly basis at a branch level and widely communicated throughout the organization. Effectively, the league tables are the motivational device that the bank uses to manage its 500-plus branches in Sweden and its network of branches in some 50 other locations inside and outside the Nordic region. "The aim for every branch is to beat the competition," says Dr. Wallander, "no matter whether the competition is internal or external".

To date, there has been very little criticism of the 'beyond budgeting' approach, partly because it is not yet that well known in the public domain, and the theory has not yet reached implementation stage. Yet the Handelsbanken case raises a number of important questions that remain when it comes to "beyond budgeting".

Does the structure of the bank make it more amenable to the 'beyond budgeting' approach? Are the notions of internal competition, league tables and benchmarking easier to introduce in organizations that are homogenous in nature? It is far easier to implement league table in a branch network, consisting of a set of operating entities that are essentially doing the same thing, than in than a diverse set of business units.

Is intense internal competition appropriate in every setting? There are numerous examples of sub-optimal behavior and performance that result from intense competition between entities within the same business.

How do organizations manage the transition from producing forecasts to the 'beyond budgeting' position? The analysts are willing to accept Handelsbanken's approach because they have a track record of delivery. As Alwin Greder of Standard & Poor's points out, however, this is the exception rather than the norm. "Generally the reliability with which banks predict their future performance has a strong impact on the outlook provided by the analyst. Clearly this is not the case with Handelsbanken... The management of the company is well known to Standard & Poor's, and has been for some time. Its credibility is a key determinant of the positive opinion of the company. They have strong and consistent management and a track record of regularly delivering good results".

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<sup>3</sup> For a detailed description of the Handelsbanken approach see Appendix A.

# 3.0 Linking Shareholder Value and Budgeting: The Theory

The first phase of this research involved a review of some 100 papers and books on planning and budgeting.

Here, using the literature review as a basis, we explore one of the fundamental questions that we set out to address – the link between planning and budgeting and shareholder value. We have taken share price as a proxy for shareholder value: so what, according to the literature, are the factors that affect share prices?

## 3.1 The factors that affect share price

The factors that affect a company's share price are varied and complex. They range from external factors, such as the economic climate, through to organizational performance details, such as strategy, products and markets, and on to management's credibility. Indeed, the question 'how are stocks evaluated?' is one that numerous authors have attempted to address over the years [24, 28, 29, 30, 45, 66]. Summarizing these works, however, enables us to identify 3 specific factors directly related to company activities that appear to influence share prices<sup>4</sup>. These are:

- Actual financial performance.
- Actual financial performance against stock market expectations.
- Long-term stock market expectations.

Underpinning these primary factors are 3 contributory factors:

- Management credibility.
- Communication with investors.
- Strategy formulation and execution.

## The 3 Primary Factors

### Primary Factor 1 – Actual Financial Performance

Studies suggest that a significant determinant of share price performance is company financial performance. Views on which dimensions of financial performance matter most are divergent, but it is clear from the research evidence that analysts care about earnings per share<sup>5</sup> [97] and economic profit, which is actually better correlated with share price than traditional accounting measures [3]. Some researchers, such as Campbell and Shiller (1988), present evidence that stock returns are predictable from fundamental variables such as dividend yields. Others, such as Keim and Staubaugh (1986), report that stock returns are predictable from a common set of stock market variables and the term structure of interest rates. Still others, such as Bradley (1989), argue that the stock market adjusts in response to new dividend information (the efficient market hypothesis)<sup>6</sup>. There are also an increasing number of authors who argue that analysts emphasize the long-term over the short-term, despite the general perception to the contrary [32].

### Primary Factor 2 – Actual Financial Performance Against Stock Market Expectations

While actual financial performance is important, it is also clear that unless financial performance is in line with stock market expectations share prices can be adversely affected. Dell, Matalan and Nortel are just 3 companies who, for example, have reported increased profits, but have then seen their share price fall as they failed to meet the results expected by the market. Part of the reason is the stock market's interest in risk, as well as return. Risk averse

<sup>4</sup> Clearly there are other factors that affect share price performance which are outside the direct control of companies. These include those concerned with economic and market sector issues. For the purpose of this analysis, however, such factors have been omitted as they fall outside the direct control of management. The primary and contributory factors discussed represent a summary of the key factors affecting share price: they do not constitute an exhaustive list.

<sup>5</sup> Study by Chugh and Meador and the Boston Security Analysts Society, Inc. – [32]

<sup>6</sup> Research that provides evidence that short- and long-term stock returns are predictable from fundamental variables such as dividend yields include: Campbell, J. and Shiller, R. (1988) *The Dividend-Price Ratio and Expectations of Future Dividends and Discount Factors*, *The Review of Financial Studies*, 1, 195-228; Campbell, J. and Shiller, R. (1988) *Stock Prices, Earnings and Expected Dividends*, *The Journal of Finance*, x1iii, 3, July; Fama, E. F. and French, K. R. (1988) *Dividends Yields and Expected Stock Returns*, *Journal of Financial Economics*, 22, 3-25. Research that provides evidence that stock returns are predictable from a common set of stock market variables and the term structure of interest rates includes: Campbell, J. (1987) *Stock Returns and the Term Structure*, *Journal of Financial Economics*, 18, 373-379; Keim, D. B. and Staubaugh, R. F. (1986) *Predicting Returns in Stock and Bonds Markets*, *Journal of Financial Economics*, 17, 357-390. Research that provides evidence that the stock market adjusts in response to new dividend information (the efficient market hypothesis) is provided by: Bradley, R. A. (1989) *Does Dividend Policy Matter*, *The Revolution in Corporate Finance*, Edited by J. M. Stern and D. H. Chew.

investors not only want growth in earnings, they also want predictability of earnings – particularly as it is recognized that share prices are affected by analysts' expectations of future discounted cash flows. This, in turn, has led to increased interest in the practitioner and academic literature about how managers can track and predict future cash flows [38].

Closely related to this issue is the question of forecast accuracy, for without accurate forecasts it is impossible either to predict future cash flows or for companies to manage delivery against expectations. Recent surveys indicate that consistency is valuable, with investors prepared to pay a premium for reduced earnings volatility and ambiguity [79]. In some theoretical research, Mentzer (1999) presented a model that demonstrated the impact of improved operational forecasting accuracy on shareholder value. Using a case example of an anonymous company, he showed how improvement in forecasting accuracy improved shareholder value. In the example, forecasting accuracy turns into improved execution of operational plans, which in turn results in improved service to customers. The improvement in execution of operational plans results in lower costs per dollar of sales. At the same time, the improvement in customer service results in an increase in sales and cash flows.

In a separate piece of work, intended to shed some light on best practice in forecasting, a survey was undertaken to determine benchmarks for sales forecast accuracy. The data revealed that those companies most satisfied with their sales forecasting process have the following characteristics [61]:

- They actively measure forecast accuracy and/or error.
- They use a consensus approach when developing sales forecasts.
- They recognize the sales forecasting department as a separate entity, responsible for all forecasting accuracy.

- They hold the forecasting department accountable for accuracy.
- They ensure that the forecasting department has high credibility.

In the manufacturing arena, there is also research evidence showing that forecast accuracy is impacted by [103]:

- Establishing accountability for forecasts.
- Ensuring that the forecaster has a thorough knowledge of all areas affecting the forecast.
- Documenting all assumptions regarding the forecast and reviewing them as conditions change and variances occur.
- Involving multiple stakeholders in the development of forecasts.
- Reconciling forecasts with actual demand (i.e., measuring forecast accuracy) and ensuring that the resultant feedback is built into future forecasts.

While these studies do not relate specifically to financial forecasts, there is no reason why many of the findings would not apply equally to financial forecasts, especially when bearing in mind the similarities between the findings for sales forecast accuracy and manufacturing forecast accuracy.

### **Primary Factor 3 – Long-Term Stock Market Expectations**

Short-term financial performance is clearly not the only thing that matters to the stock market, for there are numerous studies that provide evidence that analysts are interested in the long term as well [32]. A significant reason is that analysts want to understand future cash flows and the general growth and development prospects for specific sectors and economies [32, 72, 97].

### **The 3 Contributory Factors**

As already discussed, underpinning the 3 primary factors that appear to affect share prices are 3 contributory factors – management credibility, communication with investors, and strategy formulation

and execution. Management credibility and communication with investors both affect stock market expectations of the future performance of the company.

Strategy formulation is an input to the communication process – does this company have a robust and valid strategy? Strategy execution affects management's long-term credibility and, of course, actual performance – can this management team deliver and execute the strategy it promised?

### **Contributory Factor 1 – Management Credibility**

The performance record of management has been found to be of particular importance to analysts [32].

Management's ability to meet the expectations of the market and deliver promised strategy and results is a major determinant of analyst opinion. The ability to consistently deliver to the market's expectations will also have a significant impact on a company's management credibility. Specific studies related to management credibility found:

- The quality and depth of a company's management was an important factor in share price valuation. Analysts tend to judge this by the performance record of the management team through an analysis of publicly available data, and during the dialogue that takes place during analyst briefings [32]. Of particular importance was evidence of management's strategic planning capability and tendency to meet stated objectives.
- More than 80% of investors said they would pay more for shares of a well-governed company [10].
- Management credibility is one of the top 3 factors that investors consider when making investment decisions [22]. Confidence in management is a key input to investment decisions [50].

### **Contributory Factor 2 – Communication with Investors**

Research has highlighted the importance of effective communication and investor relations. It suggests that for the market to value a company accurately, not only must the company be well managed, but the appropriate information must be effectively communicated to investors. The study also highlights the importance of identifying the appropriate drivers of performance and using effective communication channels, especially Internet technologies, to communicate performance to investors [12, 13].

This research is consistent with the growing realization that current financial statements fail to communicate the real drivers of future performance, and fail to capture and communicate strategy [22, 73]. There is a gap between strategic decisions made and the actual performance data available. Increasingly, future growth is being determined by intangible assets, which are not contained within current financial statements [2].

Further studies indicate that analysts forecast better in environments where information disclosure is good; [21, 50] and that analysts using more reliable data make more accurate forecasts [75]. Therefore, investor relations management is a key factor underpinning 'management credibility', since this is how companies communicate and manage financial expectations. However, management still has to deliver against those expectations.

A number of studies indicate that analysts and investors are demanding increasing amounts of information to help them value companies and make more informed investment decisions. Specifically, companies are being asked to release:

- Non-financial performance data – studies and surveys reveal that 33% of investment decisions can be explained with reference to non-financial data [22], and non-

financial performance accounts for 35% of institutional investors' decisions. Studies suggest that the more sell-side analysts use non-financial measures, the more accurate their forecasts [22]. Research also suggests that there is a positive correlation between the use of non-financial data and the accuracy of analysts' forecasts [2, 16, 20, 22].

- Qualitative information regarding the governance of the company, such as boardroom procedures and ethical guidelines<sup>7</sup> [56].
- Information regarding the organization's strategy and the way in which it will be executed [72].
- Information regarding intangible assets, which are considered to be the drivers of future growth and value [2].

### **Contributory Factor 3 – Strategy Formulation and Execution**

Many analysts feel that corporate strategic plans and planning systems are of great importance in the stock valuation process. This is supported by findings of a survey investigating the most valuable non-financial data types. The survey revealed that the quality of strategy and execution of strategy are two of the three top ranked factors considered by investors; 90% of respondents rated execution of corporate strategy as very important [73]. Analysts also look at the credibility of strategy, along with other factors such as management credibility and market dominance, to validate financial and economic variables [32]. Despite this, analysts feel that the information on strategic plans and planning provided by management is generally of low quality [32].

## **3.2 So what is the impact of the planning and budgeting process?**

Having identified the primary and secondary factors that affect share prices, it is necessary to consider how these relate to one another and the way in which they interact with the planning and budgeting processes. Specifically, it can be argued that more efficient and effective planning and budgeting processes should result in greater shareholder value through 3 specific routes:

### **1 Improved management by better planning and budgeting**

An often-quoted criticism of traditional budgeting processes is that they are rarely strategically focused [3, 58, 70, 84]. It is argued that new approaches to planning and budgeting enable greater alignment to the company's strategy [3, 69, 92, 100]. Some proponents claim that activity-based [18, 25] and value-based [36, 69] approaches specifically link planning and budgeting to strategy. In our view, it is questionable whether this has been achieved in practice; but it is clear that the right budgeting and planning process should enable better strategy formulation and execution. Not least, this is because the right process will free management time for more productive activities, such as strategy formulation and execution [9]. In essence then, our argument is that improved planning and budgeting practices can improve the management of the business in 3 ways: by improving the cost efficiency of the planning and budgeting activities themselves; improving strategy formulation and execution; and improving the accuracy of the forecasts that the company produces.

- (i) The inability to achieve more cost efficient planning and budgeting is the most often quoted cause of dissatisfaction with traditional planning and

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<sup>7</sup> Study by Shelley Taylor & Associates, a consultancy based in Palo Alto [2].

budgeting systems and is typically the main driver of change. To varying degrees, each of the 'better budgeting' techniques, and the 'beyond budgeting' model in particular, seek to reduce the amount of effort required to complete the budgeting process and to ensure the activity adds value, rather than becoming a form-filling exercise fraught with political 'gaming' [25].

- (ii) Better strategy formulation and execution of strategy are facilitated by a more strategically focused planning and budgeting process. The strategy formulation process can be facilitated by using planning and budgeting processes that highlight the key performance gaps that need to be closed in order for the company to be competitive. Furthermore, strategically focused budgeting processes enable close control of strategic performance. And by reducing the bureaucratic burden on management that results from a traditional budgeting process, time is freed up that can be devoted to strategy formulation and execution.
- (iii) Better company forecast accuracy means the predictions a company makes about its future performance (in terms of profits, sales turnover etc.) are more realistic. Better planning and budgeting facilitates this by more inclusive and strategically focused forecasting. If budgets and forecasts are built upon explicit and well-founded assumptions and assertions, and they, in turn, are regularly challenged and questioned, then the company is likely to make realistic forecasts that it can deliver against. Specific techniques, such as rolling forecasts, are particularly important in this regard because more frequent planning and

budgeting enable more responsive and hence more accurate forecasts [48, 84, 104], as do forecasts covering time periods that are shorter than the annual budgeting cycle [56].

## 2 Managing market perceptions

The improvements in management facilitated by better planning and budgeting enable companies to manage market perceptions better. This enables:

- (i) Communication with investors – there is a growing stream of literature highlighting the ineffectiveness of standard approaches to corporate performance reporting, in general, and financial statements, in particular. As with traditional approaches to budgeting and planning, conventional corporate reporting approaches fail to reflect the drivers of future performance and also neglect to communicate these drivers to investors and analysts. Improving communication to investors requires greater consideration of investor and analyst requirements and tailoring information to meet those requirements, such as including the provision of non-financial data and the use of appropriate communication channels. Furthermore, the resulting improved forecast accuracy and strategy formulation from improved planning and budgeting ensures the information communicated provides a more realistic indication of future performance.
- (ii) Management credibility – several pieces of research emphasize the importance of management credibility to investors' and analysts' perceptions of a company and their expectations of future performance. Increased forecast accuracy reinforces confidence in the ability of management to plan effectively for the future and predict the future

environment in which the company will operate. It also reflects management's ability to deliver the planned performance levels. The ability of management to formulate and execute an appropriate strategy over a sustained period further emphasizes management's capability. In the same way, performance versus market expectations further reflects management's ability to manage not only investor and analyst expectations, but also their ability to deliver the actual financial performance that the market expects. Clearly, communication with investors is the key to making a positive impact on management's credibility.

### 3 Improved performance

The ultimate link in the relationship between planning and budgeting processes and shareholder value is the impact on performance.

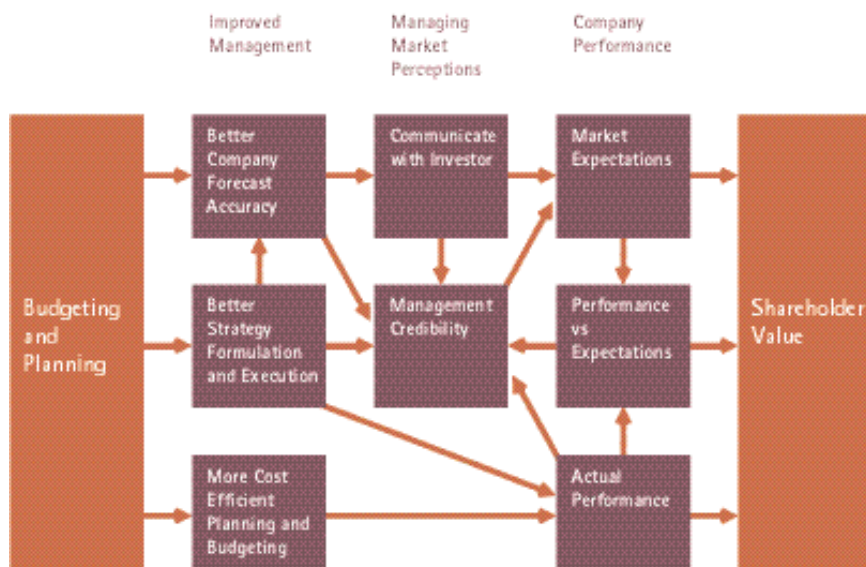
(i) Actual financial performance – the clear correlation between actual financial performance and shareholder value is supported by numerous empirical studies. Investors are eager to invest in companies that deliver growing profits and dividends. Planning and budgeting processes directly affect actual financial performance in 2 ways.

Much of the literature on the subject of planning and budgeting highlights the fact that considerable cost efficiency improvements can be realized by changing traditional processes. Secondly, the ability to formulate and execute appropriate strategies directly affects the ability to deliver profits.

(ii) Market expectations – in addition to current and recent financial performance, expectations of future performance significantly affect share price. Investors seek companies that are expected to deliver future value in order to gain return on their investment via dividends and increased capital. Management credibility will significantly affect market perceptions of whether future performance will be delivered, as will communication with investors, which includes consideration of the amount and quality of the information that is delivered to investors so that they can formulate expectations.

(iii) Performance vs. expectations – the ability to deliver the expectations of the market is a key determinant of share price since it indicates the predictability of future performance. Delivering to predictable results reduces investor risk.

Figure 1: The Theoretical Link Between Planning and Budgeting and Shareholder Value.



# 4.0 Planning and Budgeting: The Practice

Our review of the academic and practitioner literature reported in earlier sections suggests there are 3 direct ways in which better planning and budgeting processes may contribute to building shareholder value (see Figure 1):

- 1 More cost-efficient planning and budgeting.
- 2 Better strategy formulation and execution.
- 3 Better company forecast accuracy.

This section, which is based on interviews with 15 senior executives from a wide variety of companies, describes how the companies participating in this research tackle each of these issues. Many of the companies studied have stopped using the term 'budget'. They consider budgets to be static and bureaucratic. They believe budgets are a hindrance to achieving high levels of performance and are irrelevant to modern business. Most companies use the term 'financial plan' as a replacement. In reality, this is very similar to a budget. The difference lies in how these financial plans are developed and used. For the purposes of this report, however, we will continue to use the word budget, as this still conveys the essence of what is happening.

"The word budget we don't use... The government is given a budget. They are given the money. They spend it all. Budgets are something static. A plan is where you want to be – to take you somewhere."

Bo Gustavsson, Vice President, Financial Reporting & Business Control, AB Volvo

"BP doesn't use the word 'budgeting'. The dog ate my homework... I mean we don't talk a lot about the excuses for poor performance."

Ellis Armstrong, Vice President, Planning, Performance Management and Control, BP.

"The organization is not interested in budgets. You may as well just say at the start – try harder next year to do better than this year – and then not bother with all the form-filling."

Dr. Jan Wallander, Honorary Chairman of Svenska Handelsbanken.

## 4.1 More Cost Efficient Planning and Budgeting

It is an undisputable fact – producing plans and budgets consumes valuable resources. The resource-level required depends on the availability of the data, the detail required and the number of iterations (budgeting, review, amendment requests – leading to re-budgeting, etc.).

### Access to data

Many of the companies interviewed had difficulty managing legacy systems. For example, when BP and Amoco merged, one organization was using a SAP system, while the other was using an Oracle system. These problems, when combined with local use of spreadsheets for the generation of budgets and plans, means most companies do not have a single view of the data. Consequently, most organizations don't have an up-to-date, single data set to use as the basis for the planning and budgeting process.

Most of the organizations were moving towards an integrated system. BP has a major project in progress to migrate to a single software platform. Ford is creating a materials database accessible to both commercial and accounting functions. Electrolux is implementing a centralized financial planning database, and Volvo has centralized all of its ledgers and reporting tools.

The trend towards integrated systems enables more efficient planning and budgeting since everyone in the organization is using the same and latest set of information. Cisco Systems has taken this approach a stage further by introducing a fast close, allowing them to produce an actual result at the end of each working day. Because of this closing ability, Cisco Systems is often cited as the best example of how to financially manage a business.

## Ford's experience

Ford has been making significant improvements to its budgeting and forecasting processes during the last few years. For example, in the past revenue forecasts in the 19 European markets were done in 19 different local systems using 5 different methods, each requiring between 2 and 7 man-days. Now there is 1 method and system in Europe requiring 1-hour per market. Quality has increased remarkably, where quality is measured in terms of forecast accuracy. Control has also increased in that management action appears to give the results that were expected. Improvements like this are being implemented globally with the F@ST (Financials at the Speed of Thought) program. In terms of financial impact, the figures are significant. Today the costs of the finance function are estimated to be 0.7% of revenue. Ford's objective is to progressively reduce this to 0.4% of revenue, a saving of approximately \$500 million.

## Volvo's experience

There is now a shared business center called VBS (Volvo Business Services) for much of the group. They run an ERP transaction processing system for Financial Reporting, Sales and Purchase Ledgers, Cash and Fixed Assets.

The VBS was expected to save 400 jobs. In reality, this figure was not realized because of the sale of cars to Ford, and because of interface inefficiencies between the ERP transaction processing system and others. Also, volumes grew. However, despite all these changes, 50% to 60% of the planned savings were achieved.

## Cisco Systems' experience

Cisco Systems is extremely good at getting actuals out very quickly (on a daily basis) because the organization has a single integrated database. Even when Cisco Systems takes over businesses, they strongly encourage those businesses to adopt the same technology used by Cisco Systems – even if this means throwing away a newer database version and replacing it with an older one. While this has caused some difficult conversations with particular organizations, it means everybody within Cisco Systems is operating from a common system, and integration of data is extremely easy.

However, we believe from this study that although Cisco Systems' fast close may serve them well, it shouldn't necessarily be a goal for other businesses. One solution does not fit all and there are other important factors in planning and budgeting than knowing the actual result each day. In fact, there may be some dangers with fast close since it may encourage organizations to react quickly to short term 'blips' in the marketplace, rather than fundamental trends.

### Level of Detail

The level of detail presented and reviewed in a budget directly influences the level of effort required. Within the companies studied, there was a tendency to move away from detailed reviews and towards a focus on key figures. This reduces the level of effort required and increases effectiveness by focusing attention on the real issues.

### BP's approach to performance reviews

BP's monthly review of financial performance is based on 1-page of figures for each division or business unit and 1-page of commentary text. The figures show current performance, forecast year-end performance and information on how successfully the gaps are being closed against the stretch targets.

### Volvo's approach to performance reviews

Volvo manages their reviews around 3 numbers:

- Last year's performance
- The plan for this year
- The estimated end-of-year result

It is important to note that actual performance is not considered separately.

### Skandia's approach to performance reviews

Skandia uses a common planning framework, the Skandia Navigator. Planning reviews in Skandia focus purely on the major assumptions used in the Navigator.

### Lightness of review

In many traditional planning and budgeting processes, considerable time and effort is spent developing, reviewing and redeveloping the figures to create a budget, which both local management and senior management can accept. This negotiation process is usually influenced by the consequences of not reaching the budget – being seen as performing poorly and/or not receiving bonus payments, etc.

Much of this problem has been eliminated with the companies studied, however, by separating bonus payments from achievement of the budget.

When bonus payments are separated from budgets, negotiations are clearer and simpler, but BP provides a further example of how protracted negotiations can be avoided.

### BP's Board bonus plan

Senior executive remuneration in BP is based on hitting performance contract targets, a large percentage of which is based upon comparative performance – i.e., BP's performance against their direct competitors, the other 'Super-Majors'.

### Handelsbanken's staff bonus scheme

At Handelsbanken, bonuses are based on beating the competition and bonuses are calculated on the amount by which the company has outperformed the rest of the Scandinavian banking sector. A third of this additional performance is paid as bonus and split equally among all the staff. However, this is not received as salary, but put into the individuals' pension scheme. Many employees have been working for the bank since the 1970s and now have significant sums invested as a result.

### BP's stretch targets

In BP, when the consolidated financial plan created by the operating units does not add up to the financial result required by the Board, the gaps in financial performance are simply allocated across the businesses in the form of a stretch target. This removes all the argument and negotiation between the different layers of management about what is going to be achieved and what the budget should be. Reviews during the year usually focus on how well each of the business units are doing to close their gaps and how much of the gap they have covered through improved performance and cost savings.

At Borealis, the management system removes the need to negotiate a budget or financial plan at all. The forecast is generated from the forecasting model and targets are then set using external benchmarks.

## Borealis' use of benchmarking

Fixed cost management was originally managed through ABM (Activity-Based Management). However, in 1997 it was found that the company was not performing to its potential. Benchmarks were used to set long-term targets and on-site development plans were put in place. The individual operating sites determined the "how" of what was to be achieved, so that they owned the improvement process and thereby maintained their motivation.

Extensive benchmarking is now conducted using regular surveys and studies. Borealis buys the Phillip Townsend Survey and updates their information every quarter. This provides operational data on running, utilization, "up-time", etc. Customer satisfaction benchmarking is conducted every other year. Customer surveys are carried out quarterly. Employee surveys are conducted once a year and benchmarking is also conducted on other subjects, such as Technology, and Health and Safety.

## 4.2 Better strategy formulation and execution

One of the key issues in business performance is not the development of strategy, but ensuring that the strategy is executed. Budgeting and planning processes are regularly cited as a barrier to strategy deployment as they are often not aligned to strategy. Interestingly, and in contrast, this study found that all the companies started their planning and budgeting process with a review of the strategic plan.

In addition to this review, many companies<sup>8</sup> started the process each year with communication from the Board or the CEO. These set the broad performance expectations for the next financial year, usually based on competitive position and market expectations, and in Volvo's case, included specific areas of improvements in non-financial performance.

Strategy execution in the different organizations took a variety of forms:

- Some companies managed solely by using their balanced scorecard or equivalent performance measurement framework.
- Some managed through feedback and action.
- Some companies separated capital planning from operational planning.

### Use of Scorecards

Many of the organizations studied had scorecards in place<sup>9</sup> – these were considered key tools in managing performance and were often used as the basis for performance contracts. Each of the Ford divisions, for example, agrees to annual contracts with Dearborn headquarters, which cover expectations in terms of financial and non-financial measures.

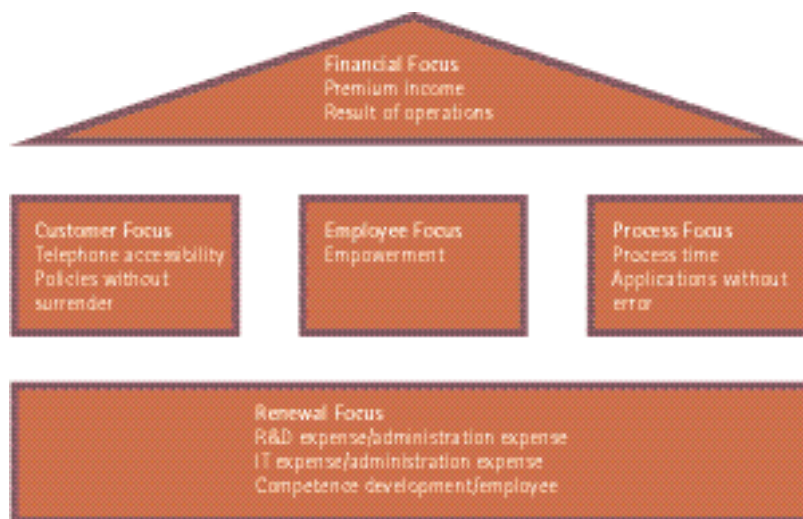
The use of scorecards was generally based on the premise that financial performance is the result of achieving non-financial objectives and if these are achieved, financial performance will follow.

Three organizations studied had reached the stage of truly managing without budgets: that is to say, managing without reference to the expected year-end financial result. These companies were Handelsbanken, Borealis and Skandia. The main driver for performance at Handelsbanken is based on inter-branch comparison and return on capital league tables. Borealis is not in the same position, since it has far fewer operating units, which are much less comparable. This company truly uses its scorecard to manage the business, relying on the profitability resulting solely from achieving the performance measures contained in the scorecard. Skandia, with its Navigator framework, adopts a similar model.

<sup>8</sup> BP, Electrolux, Volvo, Credit Lyonnais, Cisco Systems

<sup>9</sup> Skandia, Borealis, Ford, BP, Shell, DHL, ABB, Belron

Figure 2: Skandia's 'Navigator Framework'



### Feedback and Action

Traditional budgeting and planning focuses on variance analysis and explanations of over and under performance. To achieve high levels of performance this effort needs to be refocused towards taking the necessary actions to ensure the plan or budget is actually met. In many of the companies visited, this was achieved by focusing more on estimated year-end performance than on the actual result achieved. The consequence of this is that the debate focuses on what actions can be taken to improve performance or close the gap, rather than revisiting past mistakes.

### Financial plan reviews at BP

Now the focus of performance reviews in BP is:

- "How are you doing relative to where the business should be?"
- "What interventions (operational improvements) are you making?"
- "What is your judgment as to where you are going to get to by year-end?"
- "How do the gaps look, and are we closing them?"

### Variance reporting at Volvo

Forward-looking plans are used to report expected variance in advance of the variance actually occurring.

Volvo, in particular, was concerned with the time lag between an action and its impact on company performance. They took into account the long cycle nature of their business and were therefore planning performance improvements 12 months in advance of when their impact was required on the bottom line.

### Capital Investment

In traditional planning and budgeting, one way cited in the literature of achieving short performance gains at the expense of long-term financial and strategic results, is by under investment in items such as capital and research and development. Two companies deliberately adapted their planning and budgeting processes to overcome this problem by segregating operating capital requirements from capital requirements for the ongoing development of the business.

## Reviews and action planning at Volvo

Monthly meetings are held between the Group CFO, VP of Business Reporting and Control, one of the reporting and control team, and the Business CFO and CEO. It should be noted they are not focusing on the actual results, but the estimate (the forward forecast for the quarter). Also, in traditional variance reporting one is providing explanations for differences between budget and actual. In Volvo, these differences are forecast, so they need no explanation. The meeting focuses on the actions being taken to close the gaps.

Because of the planning cycle, actions to improve performance are not usually taken in the year of the plan. To be effective, the actions have to be taken the year before. Therefore in June 2001, the Businesses will start deciding the business actions to drive performance improvement in 2002. Priorities are then set for improvement projects and research and development (R&D) work.

## ABB's approach to capital

ABB abandoned budgets in the last quarter of 1999. The business now operates a 5-quarter rolling forecasting system, based on pre-defined value drivers and associated key performance indicators. The business' approach to planning is one that involves managers for each of ABB's 30 business areas, which develop detailed 5-year free cash flow forecasts. Deliberately, and somewhat unusually, the business separates sustaining investments from growing investments. The philosophy underpinning this separation is that all businesses have to make a certain level of investment if they are to be able to sustain their current business. Similarly, all businesses have to make an additional level of investment if they are to grow their business. Too often these 2 sets of investments are included under the same heading in plans. If business is not going well, the first set of investments to be cut are all of those associated with the long-term, i.e., the expansion investments. This might be the right short-term decision, but it can fundamentally damage the business in the longer-term. So, ABB asks all of its managers to be explicit about which investments are for the short-term, and which are for the long-term.

## Borealis' approach to managing capital

At Borealis, all approved capital projects are managed by a central committee, which meets monthly to review expenditure and progress. In addition, all potential capital projects being prepared for approval submission are also kept on a central database by the committee. In this way, Borealis separate the management of capital expenditure and longer-term investments from the day to day running of the business.

## 4.3 Better company forecast accuracy

Traditionally, forecasting and re-forecasting has been achieved through the planning and budgeting process. Requests for re-forecasts are issued from the head office and forecasts are built, bottom up with the revised forecast being discussed, reviewed and agreed at each level of management in the organization<sup>10</sup>.

The shortcomings of this approach identified by our interviewees include the fact that:

- It is time consuming, involving every level of management.
- It is more time consuming when done quarterly as part of a rolling budget.
- It is slow because it requires time for negotiation.
- It is not necessarily accurate as it is based on a negotiation at each stage of management review.
- The assumptions underpinning the forecast are lost in the process of forecasting, making the result unsuitable for sensitivity analysis.

As the competitive environment becomes more volatile with growing global competition, rapid developments in technology and the new economy, companies are being forced to respond more quickly. The publishing of quarterly financial returns has been a long established practice in the USA, but has now also caught on in Europe, forcing all the companies we interviewed to re-forecast at least every 3 months, creating in effect, a rolling forecast.

These challenges have led to radically different approaches in some companies studied. On the one hand, Handelsbanken has stopped forecasting altogether. On the other hand, companies such as Ford and Borealis are using models specifically designed for forecasting.

## Jan Wallander of Svenska Handelsbanken

In Handelsbanken's view, there are 2 types of forecasts or budgets. The first assumes there will be the same weather tomorrow as today. The second assumes the weather tomorrow will be different from the weather today. The problem is with the first type of forecast, i.e., same weather tomorrow as today – organizations go through an extensive process of form filling and gathering data, only to then say at the end of it, next year let's try and do a little bit better than this year – for example, achieve a few more sales and do so more efficiently. The point is that if that is going to be the outcome of the forecasting and budgeting process, then there is no point going through a complex process.

## Peter Coote, Project Leader, F@ST (Financials at the Speed of Thought), Ford

Traditionally, forecasting started with an instruction letter sent from the Head Office. This then cascaded down the organization. The result was a bottom-up process, with forecasts produced and agreed at each level before being forwarded on up the organization. As a result, the process was slow and resource-hungry. Those at corporate level had to wait until the whole process was complete before they could look at a product range, for example.

Ford is replacing this approach with an integrated model, into which the revenue and material assumptions are entered and the system rolls this up using a single data set. As a result, multiple views are generated instantaneously and the whole management team has sight of the forecast at the same time. The process is being rolled out in the main markets, North America, Europe and for the Jaguar business unit, during the second half of 2001 and the rest of the world, during the first half of 2002.

## Thomas Boesen, eBusiness Project Manager, Borealis

There were a number of problems with the planning and budgeting system, mainly:

- The budget was trying to serve too many purposes at the same time.
- The assumptions failed to take hold so the budget was not valid.

Forecasting is now a staff process taking 3 to 4 days a quarter with the controller making the forecast. Forecasts are done on Excel spreadsheets, but corroborated by explicit assumptions about the organization and the market place. The new forecast is considered of better quality and takes 5% of the original effort required. Further, re-forecasting in a crisis (or after a big change in the environment) can be done very quickly as it is a staff process and does not involve negotiation.

<sup>10</sup> Past practice in many of the case companies.

Fundamentally, the model-based forecasts being used by Borealis and being developed by Ford have a number of advantages, in that they:

- Are quick.
- Require minimal management effort compared with the traditional approach.
- Are based on explicit assumptions contained in the model.
- Can be re-run using different assumptions.
- Are not based on negotiated positions.
- Are no less accurate than the traditional approach.

It is our view that these model-based forecasting approaches represent best practices because of the advantages cited above. By separating the forecasting from the budgeting and financial management processes, rapid, accurate and quick forecasts can be generated, and then re-run using alternative assumptions.

The alternative approach of having no forecast, adopted by Handelsbanken, has many merits. However, there is one critical concern. If the world does change, how fast will the organization change in response? Having a model enables the impact of significant change to be quickly assessed at the group level and alerts senior management to the need for change. This can then be communicated throughout the organization. The absence of such a model leaves management vulnerable in not having this foresight and hence, increases the business' reliance on the individual responses of the business units.

#### 4.4 Learning from the case studies

The case studies illustrate how these companies try to improve the outcomes and benefits from their planning and budgeting systems in the ways suggested in the literature. That is to say, companies are trying to do the following:

- Forecast more accurately (in particular, Borealis and Ford).
- Enhance the efficiency of planning and budgeting (in particular, Cisco Systems, Ford and Volvo).
- Better execute their strategy (in particular, ABB, Borealis, BP, Skandia and Volvo).

#### Best practice in planning and budgeting

The case studies revealed considerable development activity in the planning and budgeting arena. Different companies were developing on different fronts. All of this revealed the following best practices:

- **Forecasts: 'assumption not opinion-based'**

Leading companies are achieving more accurate, faster and lower cost forecasts by using explicit forecasting models. These are deliberately separated from their financial management systems. The models are based on clear assumptions. If and when the world changes, the assumptions are changed and a new accurate forecast is generated quickly, with virtually no manual intervention.

- **Costs of budgeting and planning: 'lean not mean'**

Leading companies are reducing the cost of their financial planning and reporting by judicious investment in IT to create common and widely accessible cost and revenue databases. These are designed to create a single view of the company, reducing duplication of effort in running separate systems. Leading companies are also light on their review process, focusing on a few key financial measures, and not reviewing every line item.

## Strategy development and execution

In strategy development and execution there are 3 main best practice themes:

- **'Competition, not budget-focused'**  
Leading companies are extremely externally focused. Comparisons are not made with budget but with the competition. Targets are set not based on current performance but by reference to external benchmarks. Incentives are disconnected from budget achievement and focused on beating the competition – both financially and in terms of achieving externally benchmarked non-financial targets.
- **'Action, not explanation-oriented'**  
Leading companies are less concerned with explaining past performance than managing future results. This is done by forecasting and explaining variances before the variance occurs; managing using the forecast and not the actual results; and focusing on taking the actions that really drive performance – most of which are non-financial.
- **'Strategically, not financially managed'**  
Leading companies understand that better financial performance comes from developing and executing good competitive strategies. It does not come from better financial management. Therefore, they plan and manage investments separately from the day-to-day operations of the business. They focus more on the achievement of non-financial targets than they do on the monthly financial results. Critically, they understand the concept of 'action-performance lag' – the time between the initiation of an intervention and the resulting improvement in performance. This prevents the continual initiation of projects, which are supposed to create short-term benefits but inflict long-term damage, as they consume management time and resources while failing to reach completion before they are overtaken by other events.

## One Final Ingredient

There is one fundamental difference between the traditional planning and budgeting processes many companies use and the approach forward-thinking companies are taking. Under budgeting, control was exercised by business units and divisions reporting their actual performance and variances, with the head office virtually left to use this information to predict the year-end results. Now, forward-thinking companies trust their managers to tell them what they will achieve. If a degree of trust is missing, these approaches will not work. One cannot work on management's year-end forecast, with almost total disregard for the actual monthly result, without trust. Therefore, it is probably not surprising that forward-thinking companies have quit using the term 'budget'.

# 5.0 Planning and Budgeting: The Link with Share Price Performance

In addition to our detailed investigations into the practices of specific companies, we also set out to review the financial performance of about 20 companies which were cited as having modified their planning and budgeting practices, both through an analysis of their share price performance and by gathering views of investors on them.

Some of these firms, most notably Borealis, Handelsbanken and Volvo have gone as far as abolishing budgets. Others, such as, Sprint Corp., the U.S. telecommunications company, have revised their budgeting and planning processes. Sprint, for example, no longer has an annual budget. Instead, the business relies on quarterly reviews of rolling forecasts for the next 6 quarters. The emphasis within the organization is on the key business drivers and exception reporting. What was the stimulus for the change? Benchmarking data from the Hackett Group indicated Sprint was taking too long to prepare annual budgets and was spending too much time collecting data rather than analyzing it<sup>11</sup>.

Of these 20 companies, 16 were listed on the stock markets and for these we collected share price performance data for the last 10 years (Table 3). While not offering conclusive proof on the impact of changing the budgeting and planning processes, some interesting observations can be made from the share price performance. Take, for example, Electrolux. Over a 3-year period (from March 1991 through to March 1994), Electrolux shares increased in value by 111%, against a European sector average of 75%. Over a 5-year period the same business' shares increased in value by 241%, against a European sector average of 104%. And over a 10-year period Electrolux's shares increased in value by 368%, against a European sector average of 173%. Similar data exists for a variety of other businesses.

Clearly, not all of these companies changed their budgeting and planning practices 10 years ago. And even if they had, it would be naïve to attribute all of their subsequent improvements in share price performance to their new budgeting and planning practices. What we can say from this data, however, is on average, those companies cited as having changed their budgeting and planning

Table 2: Companies with Enhanced Budgeting and Planning Processes<sup>12</sup>

Company	Sector
ABB	Engineering
Boots	Retail
Borealis	Chemicals
BP	Integrated Oil
Bulmers	Food and drink
Electrolux	Consumer
Ericsson	Electronics
Handelsbanken	Financial Services
IKEA	Retail
Johnson & Johnson	Consumer
KF	Retail
Novartis	Pharmaceutical
PepsiCo	Consumer
Schlumberger	Chemicals
Skandia Financial	Services
SKF	Engineering
Sprint Corp.	Telecommunications
Texaco	Chemicals
Volvo	Automotive

<sup>11</sup> Arterian, S. *Sprint Retools the Budget Process*, CFO Magazine, September, 1997

<sup>12</sup> See Arterian, S. *Sprint Retools the Budget Process*, CFO Magazine, September, 1997; Hope, J and Fraser, R. *Managing Without Budgets*, CAM-I Report, 1999; McLemore, I. *Winning the Battle of the Budget*, Controller Magazine, September, 1996; Simons, R. *Levers of Control*, Harvard Business School, 1995 and the *conference circuit*.

Table 3: Share Price Performance for Selected Best Practice Companies

Company	Company % Change in Share Price			Sector % Change in Share Price		
	3 years	5 years	10 years	3 years	5 years	10 years
ABB	86	136	209	126	180	306
Boots	68	98	173	83	119	202
BP	142	214	367	115	178	273
Bulmer	118	64	168	96	122	165
Electrolux	111	241	368	75	104	173
Ericsson	69	338	123	121	220	319
Johnson & Johnson	121	186	360	127	253	435
Novartis	117	214	656	119	233	385
PepsiCo	102	147	274	82	137	312
Schlumberger	96	166	241	121	182	251
Skandia Financial	196	667	613	65	178	257
SKF	112	116	186	72	92	140
Sprint Corp.	71	114	249	105	156	253
Texaco	108	150	204	111	165	228
Texas Instruments	272	566	1468	137	271	645
Volvo	64	125	304	67	87	128
Average	116	221	373	101	167	280

practices have seen a share price growth of 116% over 3 years, compared with 101% for the sector; 221% over 5 years, compared with 167% the sector; and 373% over 10 years, compared with 280% for the sector.

## 5.1 The Analyst View

To supplement this analysis, we investigated the views of financial markets analysts on budgeting and planning. We interviewed more than 30 senior analysts from 6 different houses – Deutsche Bank, Morgan Stanley Dean Witter, Merrill Lynch, Prudential Securities, Standard & Poor's and William de Broë – asking them specific questions about their views on budgeting and planning, including:

- Why particular companies tended to outperform (or failed to outperform) their peers?
- Whether the analyst believed that the company's performance had anything to do with its management control systems – i.e., planning and budgeting systems.
- Whether the company provided regular financial forecasts, and if so, whether these forecasts were seen as reliable.

- Whether the analyst believed that the company's share price was affected by the predictability of the company's financial results.

The data gathered during these interviews offered some valuable insights into the thinking of members of the analyst community:

- The factors that were seen as influencing share price most notably were, in order of frequency of mention – actual financial performance, predictability of financial performance and management credibility.
- At a more detailed level, 100% of analysts interviewed said that they believed that actual financial performance impacted share price, while 84% of them said that they believed that greater forecast accuracy/predictability had a positive impact on share price.

A significant number of the analyst community clearly felt that management credibility was an important, albeit indirect, determinant of share price performance. Indirect because 96% of analysts said that market expectations influence share price performance and 87% and 84% respectively, believed that forecast accuracy and management credibility influence market expectations.

When it came to planning and budgeting specifically, 84% of analysts interviewed stated that they believed that planning and budgeting systems have either a direct or indirect impact on the evaluations that they make of a company and therefore on share price performance. For example, as one of the analysts from Merrill Lynch, said, "We try to get a qualitative feel for the management system and its effectiveness. We do this by talking to people and get a feel from them. We talk to line managers and see how well strategic goals are understood... We try to understand, whether their management process is any good. This is all about management credibility... If they give unrealistic targets and don't achieve them the share price is negatively affected. This comes back to management credibility".

## 5.2 The Analyst Message

It is clear that many analysts see the link between well-executed budgeting and planning and overall company performance. They recognize, implicitly or explicitly that enhanced budgeting and planning should result in enhanced forecast accuracy and that accurate forecasts, provided they are well communicated to the analyst community, should result in better performance against expectations. Ultimately, however, as one of the analysts commenting on Texaco reminded us, the analyst community cares about performance.

'Although we look at a variety of things, including management control systems, what we are really interested in is performance. If you drive a car, you want to get the performance and do not really care about the process on the production line! So we focus on whether management attains their targets, not how they set them... We hear from companies that they have such and such in place, e.g. a unique management system, but we do not change our rating

until it filters down to the bottom line and impacts earnings per share... Texaco do not give regular forecasts. Instead they tend to pick and choose what they forecast (and generally they choose ones they feel they can achieve)... So the forecast is selective, but usually reliable... Once we as analysts receive any forecast, we check it. If they say they are going to increase production volumes, we look at the projects in place, the infrastructure, and ask, 'Is it possible?'... As for the effect of results predictability on share price, yes it has an effect. Not on the absolute share price, but the multiple relative to others in the same group (i.e., sector)!

For the analyst community, having a good planning and budgeting process in place is merely a pre-requisite. Without a good process it is highly unlikely that a company can deliver. With a good process, share price will only be positively impacted if the company delivers the numbers.

# 6.0 The Impact of Planning and Budgeting on Shareholder Value: Conclusion and Views on the Future

## 6.1 Findings from the companies

- The organizations we spoke to are clearly adopting and evolving new processes for planning and budgeting. Interestingly none of the companies involved in this study had adopted any of the approaches suggested in the literature (in their pure form). Instead they were implementing customized approaches.
- No single company had the perfect approach. Instead different companies had different strengths and weaknesses when it came to planning and budgeting.
- These strengths and weaknesses, however, allowed us to construct a list of best practices:
  - Forecasts should be assumption-based not opinion-based.
  - Budgeting should be 'lean not mean'.
  - The focus is the competition not the budget.
  - Reviews should be action-not explanation-oriented.
  - Organizations should be strategically not financially managed.

- Company practice generally confirmed the theoretical model developed from the literature, with one important exception. Whereas the literature focuses heavily on the cost reduction in planning and budgeting processes, the case material showed that companies implementing improved planning and budgeting systems did so not only to achieve cost reductions, but also to improve forecast accuracy, better formulate and execute strategy and to establish real connections between financial performance and value drivers.

## 6.2 Findings from the analysts

- Analysts identified the following factors that in their view most influenced share price: actual performance, predictability and management credibility.
- 96% of analysts said market expectations influence share price performance and 87% and 84% respectively believed that forecast accuracy and management credibility influence market expectations.
- 85% of analysts stated that they believe that planning and budgeting systems have either a direct or indirect impact on share valuations and finally on share price.

### 6.3 Thoughts for the future

Today's businesses need to use planning and budgeting processes as a strategic tool in maintaining a long-term competitive advantage. Budgets have to be aligned to strategies and effective strategic planning and management processes have to be introduced. Such processes need to be value-based, consequential and continuous and focused on identifying and managing the true drivers of shareholder value (value-based). These processes also need to make explicit the links between these value drivers (consequential) and involve a continuous process of questioning and challenging the assumptions inherent in the strategy (continuous).

During the research, none of the companies explicitly discussed how they were managing the evolution of their budgeting systems. Many organizations have ended up in a predicament because they have not changed their budgeting systems for years. Processes need to be established now so that organizations are encouraged to evolve budgeting systems over time.

In addition, none of the companies interviewed discussed in detail how they would make better use of their mass of company data. This was often mentioned in passing, but it appears many organizations are still stuck with the mentality: how do we more efficiently collect the data we need? And how do we make sure the processes associated with data collection stimulate strategic thought?

As this research irrefutably reveals, a company's main goal in a planning and budgeting system is to devise a seamless, faster system of top-down planning and budgeting that links performance to strategic vision. And through implementing the best practices revealed in this study, companies will be able to make the planning and budgeting process the essential enabler for worldwide competitive advantage.

# Appendix A: Summary Table of Case Study Companies

Company	Size	Objectives	Planning & Budgeting Practices – What Has Been Implemented?	Cost of Planning and Budgeting	Performance vs. Market	Analyst Comments
ABB	Turnover \$750m  160,000 Employees	The objective of the revised budgeting process was to encourage managers to think strategically and maximize value creation, not just hit return on capital employed (ROCE) targets.	<ul style="list-style-type: none"> <li>Abandoned budgets in 1999.</li> <li>5-quarter rolling forecasts based on value drivers and key performance indicators (KPIs) are used.</li> <li>Investments are separated into 'sustaining' and 'growing' investments to ensure that consideration of both the short- and long-term is maintained.</li> <li>The 30 business areas develop detailed free cash flow plans.</li> <li>The KPIs are designed to assess the success of their strategies and the impact on free cash flow.</li> </ul>	No data available.	Over the last 10 years performance has mirrored that of the sector.	The analysts believe the targets of 6-7% growth per year over the next 3 years, although targets and forecasts are not considered to be reliable.
Bank of Scotland	21,896 Employees  17050 FTE's as at 30/4/01	The primary objectives of budgeting are to manage costs, and improve forecasts.	<ul style="list-style-type: none"> <li>Use is made of budgeting and rolling forecasts. Budgets are re-forecast every 6 months. Budget variances are reported monthly.</li> <li>Some use is made of benchmarking.</li> <li>The process is a political one with managers manipulating budgets to ensure that the budget eventually agreed is somewhere close to what they actually wanted, i.e., they will submit a high initial budget forecast request, knowing it will be trimmed back.</li> </ul>	Approx.102,000 person-days are spent on planning and budgeting each year; 1,200 managers are involved in the budgeting process; it takes up 1% of managers' time.	Significantly outperformed the sector over the last 10 years.	The analysts rely on their own judgment to consider the management control system at the bank, and do not receive budgets from them or guidance on profits or earnings.
Belron (Autoglass)	Turnover \$201m  2,038 Employees	The main objective of budgeting is to formulate and communicate strategies, although they are also important for setting targets, providing forecasts, improving performance and providing coherence and co-ordination across the business.	<p>Budgets are re-forecast monthly, re-forecasting is to the year-end.</p> <p>Budget variances are reported monthly.</p>	It takes 8 weeks from the start of the strategic review to the approval of budgets, including 2 iterations.	The company is not listed.	The company is not listed.

Company	Size	Objectives	Planning & Budgeting Practices – What Has Been Implemented?	Cost of Planning and Budgeting	Performance vs. Market	Analyst Comments
Borealis	5,200 employees	The primary objectives of Borealis' efforts have been to improve the efficiency of the budgeting and planning process, and to address the shortcomings identified in the literature.	<ul style="list-style-type: none"> <li>• Last budget was made in 1995.</li> <li>• Budgeting has been replaced by a 4-level planning process:</li> <li>• High level financial and tax planning (forecasting) – using internal "stakeholders" from around the business;</li> <li>• Setting targets and managing performance – based on the balanced scorecard with targets set by external benchmark. CAM-I principle of comparative, rather than absolute, targets is followed. Scorecards are reviewed monthly and linked to bonuses, P&amp;Ls are not reviewed;</li> <li>• Controlling fixed costs – fixed cost benchmarks are done quarterly; and</li> <li>• Project and investment planning.</li> <li>• Benchmarks and regular surveys are used for measurement and target setting.</li> <li>• New owners accept the no budget principle but imposed 5-year planning process.</li> </ul>	Forecasting takes 3 to 4 days per quarter, 5% of the original effort required.	The company is not listed.	The company is not listed.
BP	Turnover \$120bn 97,000 employees	The primary objective of BP's efforts has been to improve the efficiency of the budgeting and planning process and to address the shortcomings identified in the literature.	<ul style="list-style-type: none"> <li>• The term budgeting is no longer used.</li> <li>• Planning is based on competitors and market expectations – broad targets set top down with detailed operational plans made bottom up.</li> <li>• Aim is to communicate a simple message including big picture targets.</li> <li>• Establishing the appropriate culture is key – the focus of performance reviews has moved to improvement rather than blame.</li> <li>• Performance review focuses on where the company wants to be and the actions being taken to get there.</li> <li>• Rewards and budgets have been separated – bonuses based on a combination of financials, performance measures (cost and volume) and leadership.</li> </ul>	Estimated: \$39 million, 110 staff (planning, performance measurement).	Significantly outperformed the sector over the last 10 years. Analysts have confidence in earnings forecasts.	<p>The company is considered to be well-positioned, strategically.</p> <p>Capital expenditure forecasts considered reliable; there is confidence in the management team, which has an excellent track record at delivering on its promises.</p>

Company	Size	Objectives	Planning & Budgeting Practices – What Has Been Implemented?	Cost of Planning and Budgeting	Performance vs. Market	Analyst Comments
Cisco Systems	43,000 employees	Cisco Systems has deliberately designed an IT infrastructure, which gives it the ability to keep track of the company's financial position in real-time.	<ul style="list-style-type: none"> <li>• Very close control of performance – accounts are closed each day, sales are tracked by the hour.</li> <li>• Single integrated database and single company-wide P&amp;L structure – facilitates control of performance and alignment of objectives.</li> <li>• Annual budget used for target setting</li> <li>• Boundary conditions set by board – based on sales growth from last year. P&amp;L modeling links to operational requirements.</li> <li>• The planning process takes 5 months.</li> <li>• Plan reviewed and reforecast quarterly.</li> </ul>	Between 10-20% of management time is spent looking at plans and budgeting.	Greatly outperformed the sector the last 10 years.	<p>The credibility of management forecasts is high.</p> <p>The company is seriously affected by the macro environment – this is the main problem for outlook and predictability of performance.</p>
Credit Lyonnais	Turnover \$1.6bn 40,000 employees	The planning and budgeting process is designed to deliver investor expectations; it translates the strategic plan into a short-term budget.	<ul style="list-style-type: none"> <li>• A traditional planning and budgeting approach is applied with two exceptions: (i) the budget is based on a 3-year plan and (ii) plans are reforecast 3 times a year (April, July and October).</li> <li>• The starting point for the plan is expectations of next year based on the previous year's performance.</li> <li>• One third of bonus is based on meeting budgets, two thirds is based on qualitative or quantitative objectives.</li> </ul>	Not quantified but the 3-year plan takes up considerable senior management time and significant amounts of departmental managers' time. A team of 22 brings the material together.		Forecasts are reliable but not very dynamic; generally they tend to hit the numbers. However, there have been significant fluctuations due to speculation.
DHL	Turnover £370 million 3,900 employees	Budgeting and planning activities are most important for setting targets, improving performance, managing costs, providing forecasts and motivating and rewarding managers.	<ul style="list-style-type: none"> <li>• Budgets and rolling forecasts are applied. Some use is also made of activity based costing/management.</li> <li>• Re-forecasting is undertaken quarterly to the year-end. Budget variances are reported monthly.</li> <li>• Resource allocation is based on budgets – leading to some manipulation by managers. HR and IT support are key constraints on resourcing projects.</li> <li>• Budgeting consumes large amounts of management time but delivers little value.</li> </ul>	<p>3-4 person-years are spent on planning and budgeting.</p> <p>Approx. 150 managers spend 5% of time on planning and budgeting; a small department spends 50-60% of their time. The process takes 20 weeks including 2 iterations.</p>	The company is not listed.	The company is not listed.

Company	Size	Objectives	Planning & Budgeting Practices – What Has Been Implemented?	Cost of Planning and Budgeting	Performance vs. Market	Analyst Comments
Electrolux	Turnover SEK 120bn  92,000 employees	Electrolux is seeking to co-ordinate efforts from around the world, and make the budgeting and forecasting process more efficient.	<ul style="list-style-type: none"> <li>Annual planning cycle with rolling quarterly re-forecasting.</li> <li>Rolling forecasts have improved the information provided to internal analysts for decision-making, and helped satisfy market analyst requirements for quarterly information. They provide early visibility of performance and enable reaffirmation of commitment to forecasts on a quarterly basis.</li> <li>Data collection and reporting separated from data analysis.</li> <li>Centralized database used to collect data from all business units.</li> </ul>	Not known.	Constantly outperformed the market for the last 10 years.	There is belief in the management's ability to deliver its annual target and thrive in difficult trading circumstances. This is despite failure to deliver the targets last year.
Ford Motor company (Land Rover)	346,000 employees	Ford is seeking both to increase the speed of the budgeting and planning process and extend the scope of it – making it more strategic in orientation.	<ul style="list-style-type: none"> <li>Budgets have been separated from forecasts, separating cost control from the motivation cycle.</li> <li>The budgeting cycle is an annual one.</li> <li>Forecasts are updated monthly.</li> <li>Forecasts are driven by forward-demand and expected volumes for each operating company, which are aggregated for the company as a whole.</li> <li>In a parallel planning process, a contract between Ford head office and each operating company is drawn up covering financial and non-financial performance measures.</li> <li>Bonuses are linked to the measures and targets within the contract.</li> <li>The F@ST program is designed to facilitate easier access to data. Data is consolidated into a single database enabling easier data consolidation and analysis at corporate level and more efficient data collection.</li> </ul>	Finance Function costs are 0.7% of turnover. It is hoped that full implementation of the F@ST program over the next few years will progressively reduce this to 0.4%.	Despite disappointing performance last year, Ford has outperformed the Standard & Poor's 500 and Dow Jones Industrial Average since it first went public in 1956; and outperformed them in the last 3, 5, 10 and 20 years.	Ford provides annual stretch goals and quarterly production schedules. Analysts' confidence in earnings expectations is high.

Company	Size	Objectives	Planning & Budgeting Practices – What Has Been Implemented?	Cost of Planning and Budgeting	Performance vs. Market	Analyst Comments
SAS UK	Turnover \$1,020m  8,025 employees	The main objectives of the budgeting process are to set targets, manage costs, provide forecasts, measure and control performance, motivate and reward managers.	<ul style="list-style-type: none"> <li>The budgeting process is externally triggered.</li> <li>Projected turnover is communicated to the markets, and budgets are used to make sure that there are no surprises – this is important if the credibility of the management with the markets is to be maintained.</li> <li>In addition to budgets, a balanced scorecard is also used.</li> </ul>	Only the top team is involved in the budgeting process. The process takes 16 to 20 weeks from strategic review to approval of budgets, including 3 iterations.	The company is not listed.	The company is not listed.
Shell	Turnover \$149bn  95,000 employees	The company is seeking to align more closely its strategic planning processes with its budgeting processes.	<ul style="list-style-type: none"> <li>The company applies a range of tools and techniques across the business, including budgeting, balanced scorecard, activity-based costing/management, rolling forecasts and benchmarking. Value-based management is being developed.</li> <li>Budgets are reported quarterly; all managers are required to provide written explanations for variances.</li> <li>Budgets are reforecast monthly.</li> <li>A centralized database, the Basic Building Blocks ensures that data is consistent across the business.</li> <li>Prioritization of projects for investment is decided on a capital allocation day that all of the relevant managers attend.</li> </ul>	<p>Planning and appraisal is a normal part of management activities and many in Shell are involved. It is thus difficult to estimate exactly how much time is expended on this task.</p> <p>Strategic budgeting takes 6 months to complete, including up to 10 iterations.</p>	Steadily outperformed the market for the last 10 years.	
Skandia	Turnover SEK 198bn  Operating Profit SEK 8,029m  7,000 employees	Skandia is seeking to devolve responsibility to the operating companies and to use the budgeting process as part of the strategic planning process.	<ul style="list-style-type: none"> <li>Centralized budgets are set at business unit level. These only include key high-level budget figures.</li> <li>Quarterly bonuses are awarded based on a combination of financial and non-financial measures.</li> <li>Business units are run autonomously. Business planning is undertaken at business unit level based on "constructive debate with customers and suppliers".</li> </ul>	Not known.	The enormous growth in sales in recent years has made Skandia a very attractive stock. The recent downturn in sales has brought reduction in share price.	Information provided to the markets is reliable but complex. It is unclear whether the recent downturn in sales will be matched by cost reduction.

Company	Size	Objectives	Planning & Budgeting Practices – What Has Been Implemented?	Cost of Planning and Budgeting	Performance vs. Market	Analyst Comments
Svenska Handelsbanken	Operating profit SEK 8.6bn  600 branches	Handelsbanken wanted to reduce the resource consumed by budgeting and planning and to devolve responsibility to branch offices. Now they see no reason why they need to budget.	<ul style="list-style-type: none"> <li>Responsibility for performance is decentralized to branches.</li> <li>Budgets and forecasts were abandoned in the 1970s.</li> <li>Extensive use is made of branch league tables and benchmarking to drive performance improvement.</li> <li>Profit per employee is reported on a branch-by-branch and regional basis to promote competition with the objective of beating the competition, whether it is internal or external.</li> <li>Resource allocation linked to profit per employee.</li> </ul>	N/A	Constantly outperformed the market for the last 10 years.	Regular meetings with management allow exchange of information. Management is strong with a track record of delivering good results. Unusually, they don't prepare budgets but the credibility of management facilitates their good reputation.
Volvo	SEK 130bn  54,300 employees	Volvo is seeking to drive performance improvement and saw budgeting, in its traditional form, as an impediment to this.	<ul style="list-style-type: none"> <li>Volvo stopped using the word budget in 1996 as budgets are not dynamic or action oriented.</li> <li>Performance planning is based in expectations of income, quality, product development, volumes, selling and admin. over a 2-year planning horizon.</li> <li>Planning is undertaken annually with re-forecasting after 6 months.</li> <li>Culture is important – review of performance focuses on actions being taken to close performance gaps rather than explaining them. Review is plan vs. revised estimate rather than actual, to focus attention on future performance.</li> <li>Bonuses are not linked to achievement of budget, reducing 'gaming'.</li> <li>Consolidated information system was expected to save 400 jobs (50-60% of savings were realized).</li> </ul>	<p>Difficult to quantify – most of the work is undertaken with controllers within the business units.</p> <p>Previously 20% of management time was spent on budgeting.</p>	Over the past 10 years, Volvo has consistently outperformed the sector by a considerable margin.	<p>Ratings are constrained by uncertainty over future strategic decisions.</p> <p>Generally, there is lower deviation from earnings estimates for Volvo than for the market as a whole.</p>

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