

While many CFOs see themselves as corporate controllers first and business leaders second, few realise the influence they have on management behaviour and the bottom line. The CFO is in a pivotal position to switch on key performance drivers, such as innovation, growth, adaptation and endurance. Unfortunately for most organisations, these performance drivers are switched off.

Despite all the rhetoric about becoming strategy-focused, customer-orientated, knowledge-based, process-driven organisations, companies will struggle to keep up with the innovation economy until the performance management system is changed. That is where the performance drivers lie, and their primary owner is the CFO.

For the most part, culture is determined by the drivers set within the performance management system, which was never designed to support creativity, speed, flexibility and collaboration. It was designed to enable senior executives to dictate and direct what every team and person should do and monitor their performance against a multilevel performance contract. However, this command-and-control model cannot create the right culture to encourage ambitious, creative and collaborative work, and this is why so many organisations struggle to innovate, grow, adapt and endure.

In many organisations, the command-and-control system is so ingrained that CFOs cannot turn on the right performance

drivers. They implement new tools, such as the balanced scorecard, activity-based costing and benchmarking, to fix the old control model rather than using them to enable the drivers of innovation, growth, adaptation and endurance.

To compete successfully in the fast-changing global markets of the 21st century, the whole leadership team urgently needs help to enable and encourage innovation, growth and endurance.

#### **The innovation economy**

Over the past 25 years, organisations have embarked on one efficiency drive after another, reengineering, delayering and downsizing. They have unlocked shareholder

# Are you restricting growth?

The challenges of the future cannot be met by traditional command-and-control business cultures, say **Peter Bunce** and **Jeremy Hope**. They explain why devolution is the only way to survive.



value by offloading underperforming assets and acquired competitors or partners in an often fruitless search for synergies. They have implemented process improvements and outsourced non-core processes.

Yet innovation and organic growth have proved elusive to a great number of organisations. Such organisations have also failed to adapt to shifts in global competition, technology and customer needs. How will such companies cope as we move into the innovation economy, driven by disruptive changes caused by globalisation, deregulation, new technologies and empowered customers?

The switch in power from the supply chain to the demand chain is forcing suppliers to be more innovative in the ways they meet changing customer needs. At the same time, the lifecycles of products, strategies and business models are shrinking, placing greater pressure on response speeds and the continuous renewal of strategies. Entry costs into many markets are falling and the key driver of value has switched from financial to intangible capital. Intangible capital, such as brands, innovation capability and loyal customers, accounted for around 80% of value creation in 2005 compared with zero in 1980.

But perhaps the most dramatic change is the fall in transaction costs, causing traditional organisational boundaries to evaporate. In the industrial economy, information was imperfect and hard to acquire. It was far less expensive to vertically integrate, sourcing parts internally, than to search for suppliers.

Today, knowledge is abundant, free and easily accessible thanks to the internet, together with greater speed and processing power and increasing levels of storage capacity. Even physical resources can be acquired and shipped quickly and often at a much lower cost than producing them internally. And an expanding range of outsourcing services is offering new levels of flexibility as well as lower costs.

These changes have disrupted traditional industry groups and value chains and many management principles, and conventional wisdom is being challenged. If organisations do not respond to these changes they will be vulnerable to smaller, more agile competitors unhindered by stifling bureaucracies and risk-averse cultures. This has already happened in just about every

	Traditional budgeting organisation	Beyond budgeting organisation
Success	Maximise shareholder value	Relative improvement
Organisation	Centralised and hierarchical	Decentralised and networked
Governance	Command and control	Diffused responsibility
Social and environmental	Sustainability external to strategy	Sustainability integral to strategy
Accountability	Senior executives	Shared by all teams
Information	Restricted and limited access	Transparent and shared access
Goal setting	Short-term targets, contractual	Medium-term goals; self-imposed
Strategy	Linear and rigid	Holistic and adaptive
Planning	Annual and restricted	Continuous and inclusive
Resource management	Annual allocations; just-in-case	Dynamic; just-in-time
Measurement and control	Budget variances; central control	KPI trends; local control
Recognition and rewards	Meet target	Beat peers

Figure 1. The traditional budgeting organisation and the beyond budgeting organisation have very different approaches to the management process.

## 'The switch in power from the supply chain to the demand chain is forcing suppliers to be more innovative in the ways they meet changing customer needs.'

industry: small, niche operators, such as Google, eBay and Amazon, have rapidly become global brands and industry leaders.

### No more commands and controls

Beyond budgeting means moving away from the traditional command-and-control. In this context, 'budgeting' describes both a management culture and a performance-management system.

The beyond budgeting organisation (BBO) is very different from the traditional budgeting organisation (TBO) (see Figure 1, above). Strategy, planning and decision-making is transferred to business units and self-managed teams who are accountable for continuously improving

their performance against peers and best practices. The strategy is focused on learning, adaptation and renewal.

At the operational level, the focus moves from selling products to building customer relationships. Fewer top-down control systems are needed, as information is integrated in the work, saving costs. Performance appraisal and reward systems place emphasis on the team and ensure that everyone is treated fairly.

Annual plans and budgets are replaced with continuous planning and rolling forecasts. Up-to-date, relevant information is delivered to front-line teams who regulate their own performance. Trend reporting also enables managers to ask the right questions and take the best decisions. And transparent systems provide essential checks and balances that support effective governance.

### UBS: a beyond budgeting success

When asked in an interview with German business magazine *Zfo* whether UBS Wealth Management had partially abolished budgeting, CFO Anton Stadelmann replied: 'We have not partially abolished budgets, we have abolished them altogether. It is a logical result of our new direction because budgeting is a defensive element. The aim is to negotiate the

### Model of innovation

The beyond budgeting organisation is led by managers who:

- define success in terms of customer service, long-term growth and endurance
- operate with a devolved and networked model, with local decision-making authority and accountability vested in self-managed teams
- share information widely, immediately and unreservedly
- set aspirational goals aimed at being the best in your peer group
- make strategy and planning continuous, adaptive and innovative
- operate with principles that conserve resources and respect the environment
- make everyone accountable for customer outcomes.

**‘Budgeting is a defensive element. The aim is to negotiate the lowest level of ambition possible in order to be able to exceed it as far as possible.’**

– Anton Stadelmann, CFO, UBS Wealth Management

lowest level of ambition possible in order to be able to exceed it as far as possible. To this effect, you look for reasons why you cannot afford something.

‘Budgeting contradicts our growth thinking. We would prefer to ask ourselves why and how we can afford something. We are replacing the budget with internal benchmarks as our reference points for performance appraisal.’

Beyond budgeting does not mean beyond planning. In fact, there is more planning than before, as Stadelmann explains: ‘We have probably never planned as intensively as we are doing today. However, we are planning something quite different now. We are planning actual market activities, finding out where we can create value and tap potential.’

Stadelmann believes the new model will attract entrepreneurial-minded people: ‘Whether you can stand by this model depends on your view of human nature. We trust our employees to be able to live this culture, that they want to be better every day, and that they want to help others to be better too. That is our view of human nature.’

‘If we succeed in persuading the majority of our employees to live this consistently, we will be an attractive employer for entrepreneurial employees. We will be attractive to people who are committed to this view of human nature. This would be a great competitive advantage in the longer term.’

#### One step at a time

Many CFOs are cautious of beyond budgeting because they feel that they do not have the control systems in place to enable them to let go of the management factory. This is understandable, and it is important to remember that getting the whole way will take time. The new control system needs to be seen as a holistic process of mutually reinforcing controls that are part hard and part soft. Being ineffective at any one part will not undermine the whole system, but simply dilute its effectiveness.

This is the new agenda for the whole leadership team, especially the CFO and the finance team. In some cases, they need to build closer working partnerships with other members of the executive team and with operating managers throughout the business. And in many cases they will need all their powers of persuasion to move these people from their entrenched mindsets and embrace the necessary changes.

Tackling entrenched mindsets and overturning decades of accepted management practices is no easy challenge. It takes courage, time, patience, perseverance and dedication. Most business leaders are not geared for the long term, as they need to achieve results quickly.

But it is a winning formula in the unpredictable climate of the innovation economy. Leaders need to get their thinking straight before launching into major change programmes. They need to act on the system rather than in the system.

This is not another improvement project; it is a completely new way of thinking about performance management and control. ■

### Peter Bunce

Peter Bunce is a director of the Beyond Budgeting Round Table (BBRT), an independent international research collaborative forum and advisory services organisation. He also convenes the module on global markets and future manufacturing for the Manufacturing Institute’s MSc in manufacturing leadership, accredited by Lancaster University. Prior to this, he managed research programmes for the Consortium for Advanced Manufacturing International relating to cost management, computer-aided process planning, geometric modelling and next-generation manufacturing systems. He earned a BTech in mechanical engineering from Loughborough University of Technology as part of his apprenticeship with Westland Aircraft Saunders-Roe Division and a PhD for research into the practical applications of group technology (cellular manufacturing) during his time at Lewmar Marine. He is a chartered engineer and a member of the UK Institution of Engineering and Technology. He also holds a Diploma in management studies.



### Jeremy Hope

Jeremy Hope is research director of the Beyond Budgeting Round Table (BBRT), an organisation dedicated to helping firms improve their performance management processes. He has written numerous articles and books on performance management and associated leadership issues. His article on beyond budgeting, written with colleague Robin Fraser, won the IFAC award for best management accounting article of 1998. He is co-author, with Fraser, of *Beyond Budgeting*, published by Harvard Business School Press, March 2003. He is also co-author, with his brother Tony Hope, of *Transforming the Bottom Line* (1995) and *Competing in the Third Wave* (1997), both published by the Harvard Business School Press. He began his career as a chartered accountant and has experience in venture capital and business management.

