

Creating Budget-less Organizations with the Balanced Scorecard

by Thomas Boesen, eBusiness project manager and former financial controller and secretary to the executive board, Borealis Group

Six years ago, Borealis, a leading European plastics company decided it was time to do away with budgets — no small task for a global company operating in a cyclical, highly technical and fast-changing industry. Borealis’ then-controller Thomas Boesen explains how, thanks to the Balanced Scorecard and other innovative management techniques, the company was able to drop its budgets and gain an edge on the competition.

In 1994, two large Scandinavian companies merged their petrochemical divisions to create Borealis, the largest polyolefin plastics producer in Europe. Makers of everything from diapers to dashboards, our newly-created, Copenhagen-based company had 5,400 employees, sales of Euro 3 billion (\$3.3 billion) and a big question mark: could it be managed?

In the wake of the merger, our top executives saw a unique opportunity to create an entirely “new, different and better” management approach that would give the company an edge on the competition. The goal was to be able to respond more quickly to the cyclical and ever-changing plastics business. Today, six years later, thanks mostly to our decision to become a budget-less organization, it is fair to say that we are a completely transformed company.

Flying Blind

The first order of business for the numerous controllers in our newly combined entity was simple: to create a useful budget. After lots of discussion and debate, we produced a detailed budget, put it in a large binder and, sadly, never looked at it again. Our product and supplier markets were changing so fast that the budget was out of date within weeks. This led us to the idea of dropping the budget altogether and

moving towards the budget-less organization.

We are probably not the first company to notice that budgets are almost always unable to serve simultaneously the two functions for which they are designed: performance management and forecasting financial performance. If a budget is an accurate forecast, it will probably not provide an effective set of “stretch” targets. On the other hand, if the budget is composed of aggressive targets to serve as an incentive to management, it is unlikely to predict very accurately the actual financial performance of the company.

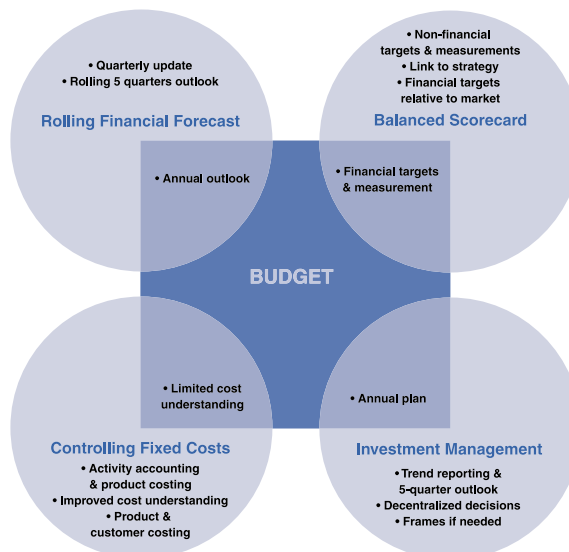
Combine these concerns with the fact that the traditional budgeting process absorbs huge amounts of time and tends to make financial control an annual autumn event rather than a continual process, and the picture is clear why we were looking for other options.

The Four Pillars of a Budget-less Company

In designing the new management system at Borealis, we found that our major challenge was to separate our performance management and financial planning systems — simultaneously encouraging managers to reach for stretch targets and at the same time presenting the most accurate picture of what the financial future of the company looked like. We arrived at the following four-part plan, which would replace the traditional budget cycle (See *Figure 1*, “Breaking the Budget at Borealis: The Four Pillars of the Budget-less Organization”).

1. Rolling Forecasts. The rolling forecast system we use has a single objective: to provide as clear a picture as possible of expected financial performance. Since the forecasts do not affect managers’ compensation, there

Figure 1. Breaking the Budget at Borealis: The Four Pillars of the Budget-less Organization



By adopting rolling forecasts, a Balanced Scorecard, activity-based costing, and decentralized investing, Borealis was able to replace the budget with a much more flexible and effective management system.

is little incentive to game the system. Objectivity is all that matters.

To create the forecasts, the organizational units use the most objective data they can find within the organization. This includes: price information from corporate planning; expected sales volume from the business units; fixed cost, investment, and depreciation information from the manufacturing sites; and exchange rates, inflation, and loan information from corporate finance. By combining these numbers, a corporate-wide, five-quarter rolling forecast is created. The forecasts are made five quarters out so that when they are being revised each quarter there is always a year's worth of data that we can see.

We are often asked, "If there is no budget, what do you compare your actual performance to at the end of a period?" The answer: we compare our quarterly results to those of the previous quarter or the year-earlier quarter, and we compare the preceding four months to the four months before that. Every six months we also compare our results to those of our competitors. This is the real test of performance.

2. The Balanced Scorecard.

Separate from our financial forecasting process, the Balanced Scorecard was introduced to improve and broaden our performance management. Employee surveys showed us that plant workers were having a hard time relating to the corporate strategy. The CEO would visit the plants and talk about our growth targets and our innovative technology, but we were not able to translate those goals into terms that made sense to the workers. This led us to look into the Balanced Scorecard, which we knew was a system that could provide employees with their own set of objectives linked to the corporate strategy.

The Balanced Scorecard is at the heart of Borealis's management system. Scorecards help us track our performance against our objectives and the key performance indicators

(KPIs) for our business, rather than against, for example, budgetary line items. The monthly reports we focus on now are all based on the scorecard. When our executive board sits down to review performance, the first thing they do is review the corporate scorecard and the performance in each of the objectives. The profit and loss statement and the balance sheet are referred to only as needed. The scorecard allows us to focus on the drivers behind the financial numbers and gives our senior managers much more leverage over the future of the company.

In *Figure 2*, "Tracking Performance at Borealis with the Balanced Scorecard," we provide an example of how the Balanced Scorecard is used by our senior management team. In the report, we list the objectives and KPIs for our business. For each KPI, we show how the six divisions are performing. Green indicates that a division has met its target, while red indicates that it has not. For example, four out of the six divisions were not performing up to par on the KPI entitled "customer complaint handling." This approach gives a simple yet thorough overview of how our company is performing and what areas need attention.

3. Activity-Based Cost Management.

The third pillar supporting the replacement of budgets at Borealis was activity-based cost management. Although it sounds contradictory to talk about cost management without a budget, that is what we set out to do: to track expenses using 12-month moving averages of activity-based costs rather than budgets.

By tracking costs according to activities rather than budgetary line items, we can achieve a much clearer understanding of the business. It is easier to conduct benchmarking studies of our performance against the

competition. It is easier to talk to employees about how and why to control costs. And it is easier to understand customer and product profitability levels when costs have been broken out by activity.

4. Investment Management. The last pillar of our budget-less organization is decentralized investment management. This is a way to move away from capital budgets and put control

Although it sounds contradictory to talk about management without a budget, that is exactly what we do: track expenses using 12-month moving averages of activity-based costs rather than budgets.

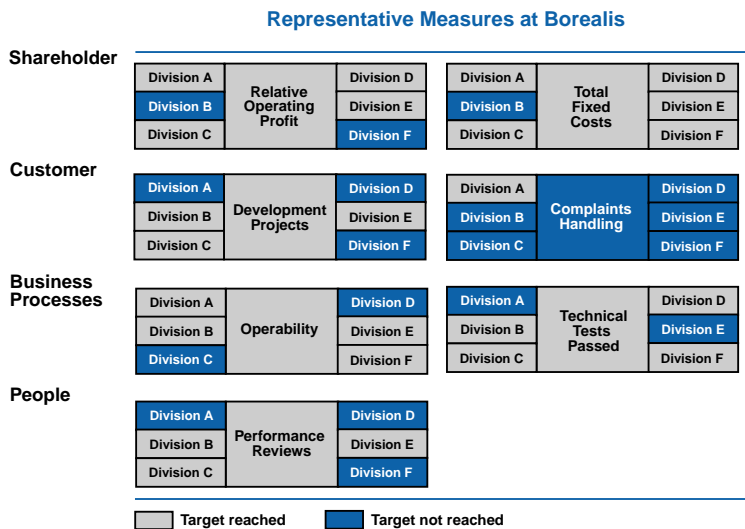
in the hands of the people closest to the marketplace and the customers. Though it is highly unusual to allocate this much control of capital spending decisions to front-line managers, we believed we could do it because our employees had a much clearer picture of our strategic priorities thanks to the Balanced Scorecard and decentralized profit accountability.

Small investments below 10 million Danish krone (dkk), or about \$US 1 million, do not require approval outside of the division, plant, or function in which they are made. These small investments are tracked through the rolling quarterly forecasts, and adjustments are made only when total investment levels move out of line with expectations. Medium-sized investments — those between 10 and 50 million dkk (between \$US 1 million and \$5 million) — are made based on whether they exceed a preset hurdle rate set by corporate for a given period, as opposed to on approval from a centralized committee. Lastly, all investments above 50 million dkk (\$US 5 million) — what we call strategic investments — require the approval of the executive board.

As you might imagine, our corporate board was uneasy about making the transition away from budgets. One of the few times of year that the board

Continued on next page

Figure 2. Tracking Performance with the Balanced Scorecard



An easy-to-follow performance tracking system allowed top management to see how well the company was doing against each of the companywide key performance indicators. The six smaller rectangles surrounding each KPI represent a different division within Borealis.

really could have a direct impact on the company was when it approved the annual budget. This is where the Balanced Scorecard comes in, however. Although using scorecards requires more work on the part of the corporate board — members have to have a deeper appreciation for the operational side of the business — in the end the scorecards provide a clear “line of sight” deep into the company and actually increase the traction of

the corporate and executive boards.

Proof Positive

The abolition of budgets has created other benefits as well. We conducted an internal survey that showed our new methods had allowed us to eliminate 90 to 95% of the resources formerly invested in the budgeting process (the shaded area shown in Figure 1).

More broadly, the organization is now much more aligned to achieve our corporate objectives. In customer satisfaction, for example, we have moved from a lagging to a leading position in the industry.

Fine-Tuning

The budget-less management system at Borealis has continued to evolve since it was first introduced. Benchmarking studies completed in 1997 showed that we still had a lot of room for improvement, and we have been making continuous adjustments.

None of these adjustments should take attention away from the fact that we are experiencing enormous success managing without budgets. We have more relevant cost information that is less driven by the calendar year. We have frequently updated financial forecasts looking out five quarters. We have better and tougher performance management standards, thanks to the Balanced Scorecard. And perhaps most thankfully, we don’t spend large amounts of time producing an annual budget that is rarely used.

Reprint #B0011B

In the News

Improving the Information Technology (IT) connection

After their central role in ERP implementations and Y2K preparations, the IT departments in many companies have fallen out of favor. As one comedian would say, they can’t get any respect. Complaints about IT range from concerns about their integration into the larger business to lack of faith that IT can help the company improve results.

The problem — the disconnectedness between IT and the core business — turns out to be pandemic. In a recent *Philippine Daily Inquirer* article (reprinted from *World Report*) two Andersen consultants warn of the

costs and consequences of disconnectedness in the new economy. Besides wasteful IT spending, the consultants found that IT priorities were changing too often and companies were lagging behind their competition in launching strategic IT initiatives (including e-commerce).

So what do connected organizations — those that have successfully integrated IT into their core enterprises — have in common? The Balanced Scorecard, it turns out. The authors find that at these companies, IT created the scorecard to measure such “critical quantitative and qualitative factors as business impact, client satisfaction, value creation and on-time/on-

expectation delivery.” Since the scorecard will serve as the “central tool” for ongoing communication, IT develops the scorecard with its key internal clients. IT conducts regular customer satisfaction surveys and solicits feedback. It also gives in-person presentations throughout key departments about business opportunities for technology. Like shared services units, IT departments at many connected organizations put their relationship agreement in writing. And to make strategy everyone’s job, IT links compensation directly to business results.

Sounds like respect to us.