Moving Beyond Budgets to Create the Lean Enterprise

By: Steve Player, North America Director, Beyond Budgeting Round Table

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About the Speaker

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Managing Director, The Player Group

• Steve Player serves as the North America Program Director for the Beyond Budgeting Round Table (BBRT) and works with BBRT member companies to implement continuous planning processes.

• He has over 30 years experience with improving performance management and implementing strategic planning processes. He is also the Managing Director of Beyond EPS Advisors, a Business consulting firm, and founder of ABM SMART.

• He is the co-author of *Future Ready: How to Master Business Forecasting* and *Beyond Performance Management* as well as five other books. He writes the “Finance Transformation” column for Business Finance Magazine featuring CFO interviews from leading organizations on innovative finance and planning processes.
Why You Should Ditch Your Annual Budget
Exemplars of the new vision

Handelsbanken

Google

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Move to Lean Planning

• The goal of Lean Enterprise
  – To better serve the customer by eliminating waste

• The goal of Lean Accounting
  • Eliminate waste in finance processes

• How does this apply to budgeting and planning?
How does your planning department spend their time?

- Collecting and validating the data: 47%
- Administering the process: 30%
- Providing value-added analysis: 23%
At what point do you expect your annual budget targets to become obsolete?

Budget Target Life Span

- Before the year begins/ already have: 8%
- 1 - 3 months into the fiscal year: 32%
- 4 - 6 months into the fiscal year: 64%
- 7 - 9 months into the fiscal year: 71%
- 10 - 12 months into the fiscal year: 74%

CFO Magazine 2009
Identify Waste
In Traditional Planning & Budgeting Processes…

Lean approach to improvement by identifying waste

Eight types of Muda (waste):
1. Defects
2. Overproduction (of items not needed)
3. Inventories (awaiting further processing)
4. Unnecessary processing
5. Unnecessary movement of people
6. Unnecessary transport of goods
7. Waiting (unbalanced work flows)
8. Design of outputs that do not meet users’ needs

Source: Taiichi Ohno, expanded by Womack & Jones
Complete Worksheet

Identify Muda in your current planning & budgeting process

In their landmark book, *Lean Thinking*, authors James P. Womack and Daniel T. Jones begin with a discussion of the Japanese word “muda” which means “waste.” Lean thinking is prescribed as a powerful antidote to eliminate waste. In addition to the seven types of muda first identified by Toyota’s Taichi Ohno, the authors also add an eighth. These are listed below.

**Instructions:**
In this exercise you are asked to think about your existing planning and budgeting process. Using it as an example, please list the areas where there is potential waste.

- Defects
- Overproduction (of items not needed)
- Unnecessary processing
- Unnecessary movement of people
- Unnecessary transport of goods
- Waiting (for the process to finish or upstream activities)
- Design of outputs that do not meet users’ needs
How traditional budgets block your efforts to become lean

**Push**

1. Resources → Agree fixed plan “the budget”
2. Production units → Produce to the plan
3. Stock for sale → Hold in stock
4. Customer → Persuade customer to buy

**Pull**

1. Customer → Coordinate production
2. Coordinate production → Produce to meet demand
3. Production units → Acquire resources
4. Resources → Produce to meet demand

Source: Bulmers
Seven Key Problems with Traditional Budgeting

1. Budgets take too long to prepare (often making them out of date when published)

2. Budgets cost too much

3. Budgeting is based on assumptions that are nearly always wrong

4. Budgeting causes gaming that erodes the ethical foundation of the company

5. Budgeting triggers unnecessary spending

6. Budgeting gives the illusion of control by robbing potential

7. In the words of Jack Welch, “It [Budgeting] brings out the most unproductive behaviors in an organization…” (Jack Welch, “Winning,” p. 189)
# 12 Beyond Budgeting principles

## Change in leadership

**Governance & transparency**

1. **Values** – Bind people to a common cause, *not* to a central plan

2. **Governance** – Govern through shared values and sound judgement, *not* detailed rules and regulations

3. **Transparency** - Make information open and transparent, *don’t* restrict and control it

**Accountable teams**

4. **Teams** - Organize around a seamless network of accountable teams, *not* around centralized functions

5. **Trust** – Trust teams to regulate and improve their performance; *don’t* micro-manage them

6. **Accountability** – Base accountability on holistic criteria and peer reviews; *not* on hierarchical relationships

## Change in processes

**Goals & rewards**

7. **Goals** – Set ambitious medium-term goals; *not* short-term fixed targets

8. **Rewards** – Base rewards on relative performance; *not* on meeting fixed targets

**Planning & Controls**

9. **Planning** - Make planning a continuous and inclusive process, *not* a top-down annual event

10. **Coordination** - Coordinate interactions dynamically, *not* through annual budgets and planning cycles

11. **Resources** - Make resources available as needed, *not* through annual budget allocations

12. **Controls** - Base controls on fast, frequent feedback; *not* on budget variances
# Dumb Stuff We Do in Finance… and what to do instead

<table>
<thead>
<tr>
<th>Common mistakes</th>
<th>Best Practices</th>
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<tr>
<td>1. Forecasting to the wall</td>
<td>1. Consistent Rolling Forecast</td>
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<tr>
<td>2. Confusing forecasts with targets</td>
<td>2. Independent forecast of most likely case</td>
</tr>
<tr>
<td>3. Demanding forecast accuracy</td>
<td>3. Tracking forecast accuracy to eliminate bias</td>
</tr>
<tr>
<td>4. Relying on Excel spreadsheets</td>
<td>4. Use specific purpose technology</td>
</tr>
<tr>
<td>5. Excessive detail</td>
<td>5. Driver-based key items (big rocks)</td>
</tr>
<tr>
<td>6. Relying on “probability-based forecasting”</td>
<td>6. Separate scenarios for discrete events</td>
</tr>
<tr>
<td>7. Immediately assuming a growth forecast</td>
<td>7. Use of industry growth factors</td>
</tr>
<tr>
<td>8. Treating forecasting as a “special event” rather than an on-going part of monitoring the business</td>
<td>8. Ongoing forecasting process</td>
</tr>
<tr>
<td>9. Picking out time horizons for all forecasts with the same interval</td>
<td>9. Forecast time horizons matched to business needs using an integrated system</td>
</tr>
<tr>
<td>10. Failing to learn from your forecast record</td>
<td>10. Constantly learning from forecast results</td>
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</table>
Mistake #1—Forecasting to the wall
Migrate from annual budgets to 5-quarter rolling forecasts
Mistake #2 – Confusing forecasts with targets

Forecasts
Where you think you’re headed

Targets
Medium term aspirations & goals
Forecast vs. Target

Identify your initiative to correct the trend...

Target 10% Improvement

What is your plan?

Projection

Actual Trend – 4% growth
Mistake #3 – Insisting on forecast accuracy in an unpredictable world

Daily Wheat price cents/Bushel

Crude-Oil Futures
Daily settlement price on the continuous front-month contract
Wednesday: $65.30 a barrel, down $5.23 or 7.4%

Source: Thomson Reuters via WSJ Market Data Group

Forex Race
The yen and the euro against the dollar, and the dollar versus the currencies of major U.S. trading partners (J.P. Morgan trade-weighted index)

Source: Thomson Reuters via WSJ Market Data Group
The price of forecast accuracy is often suboptimal results

Actual performance is predictable with a tendency to come back to plan, but below true potential as surplus resources are held in reserve rather than deployed as investment.

Actual results dip as a result of underinvestment due to the pressure to meet targets.
Mistake #4 – Relying on Excel spreadsheets
Mistake #5: Excessive detail
The 80/20 rule……

100+ drivers = 80% data gathering = 20% analysis

Focus on key drivers = quick data gathering, less calculation more time for analysis

Which one would you choose?

5 to 20 drivers = 20% data gathering = 80% analysis
Mistake # 6: Relying on “probability-based” forecasting

“According to this theory, it’s strongly improbable that anything should ever happen anytime, anywhere.”
Mistake #7: Immediately assume a growth forecast

Source: Beyond Budgeting Round Table 2006
Mistake #8: Treating forecasting as a “special event” instead of an ongoing part of monitoring the business

We haven’t forecasted in a while, maybe we should try that again....
Mistake #9: Only using one time horizon for all forecasts with the same interval

Use different time horizons for different decisions, but integrate the system

- Sales and operations planning
- Financial planning
- Capital planning
Forecast process example – tw telecom

- Forecasts of key metrics would be completed quarterly on a rolling basis.
- Field units would forecast the next two quarters’ metrics.
- Finance will project an additional 4 quarters from trends.
- Capital plans extend multi-year.

### Diagram:

- **Traditional Budgets**
  - Q2, Q4
  - Q1, Q3
- **Rolling Forecasts**
  - Q2, Q4
  - Q1, Q3

- **Planning Efforts**
- **Quarters forecasted by all**
- **Quarters trended by Finance**
Mistake #10: Not learning from your forecast record

“Learn from your mistakes and build on your successes.”

John C. Calhoun
Case examples of how this problem is being overcome

1. Holt CAT
2. Group Health Cooperative
3. Statoil
“The “budget” is like a cockroach - it’s almost dead, but we have to bring “Raid” out every once in awhile to spray on it.”

- Paul Hensley, Holt CAT
## Group Health Cooperative

<table>
<thead>
<tr>
<th>BB Adaptive Process</th>
<th>Group Health Translation</th>
<th>Old Mgmt System</th>
<th>New Mgmt System</th>
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<tr>
<td>1. Setting Targets</td>
<td>Strategic Planning</td>
<td>1 yr time horizon</td>
<td>Multi-year plan</td>
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<tr>
<td>2. Rewarding People</td>
<td>Incentives</td>
<td>Budget</td>
<td>Metric improvement</td>
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<tr>
<td>3. Action Planning</td>
<td>Improvement Activities</td>
<td>Driven Top Down</td>
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<td>4. Managing Resources</td>
<td>Cost Mgmt &amp; Allocation</td>
<td>Budget</td>
<td>Metrics (PMPM and Efficiency)</td>
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<tr>
<td>5. Coordinating Actions</td>
<td>Goal Alignment</td>
<td>Individual</td>
<td>Team</td>
</tr>
<tr>
<td>6. Measuring &amp; Controlling Performance</td>
<td>Reporting</td>
<td>Budget Variance</td>
<td>Run Rate / Metrics</td>
</tr>
<tr>
<td></td>
<td>Forecasting</td>
<td>Periodic</td>
<td>Continuous</td>
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# Statoil

A systematic change of the whole process

<table>
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<th></th>
<th>&quot;Annual command and control&quot;</th>
<th>More dynamic &amp; flexible</th>
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<tr>
<td></td>
<td><strong>Target setting</strong></td>
<td></td>
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<tr>
<td></td>
<td>• Equal to forecast – &quot;what we can deliver&quot;</td>
<td>• Aspiration driven – &quot;what we must deliver&quot;..</td>
</tr>
<tr>
<td></td>
<td>• Only KPI targets</td>
<td>• The whole Ambition to action</td>
</tr>
<tr>
<td></td>
<td>• Absolute targets</td>
<td>• Relative targets</td>
</tr>
<tr>
<td></td>
<td>• Plan = target, forecast and resource allocation</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Gaps vs targets hidden</td>
<td>• Plan = actions and <strong>expected</strong> outcome (forecast)</td>
</tr>
<tr>
<td></td>
<td>• One outcome only</td>
<td>• Gaps vs. targets visible</td>
</tr>
<tr>
<td></td>
<td>• Very detailed</td>
<td>• Main uncertainty spans</td>
</tr>
<tr>
<td></td>
<td>• Plan = target, forecast and resource allocation</td>
<td>• Less detailed</td>
</tr>
<tr>
<td></td>
<td>• Annual pre-allocation through budgets</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Budgets &quot;an entitlement – my money&quot;</td>
<td>• &quot;Bank open all year&quot;</td>
</tr>
<tr>
<td></td>
<td>• Backward looking</td>
<td>• KPI targets + mandates + decision criteria</td>
</tr>
<tr>
<td></td>
<td>• Variance vs. YTD budget</td>
<td>• Monitoring of development</td>
</tr>
<tr>
<td></td>
<td>• Only based on budgets and KPIs</td>
<td></td>
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<tr>
<td></td>
<td>• A holisitic evaluation: &quot;Ambition to action&quot; + Behaviour</td>
<td>• Pressure testing KPI results</td>
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Beyond Budgeting
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Ready to Roll?

CFO’s May cover story explained why companies are abandoning budgeting in favor of rolling forecasts. Now, learn how to apply these concepts to your organization.

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