

## Life Beyond Budgets? An Implementation Story - Beyond Budgeting at Unilever

Steve Morlidge<sup>1</sup>

This article describes how in Unilever we are attempting to change the conventional annual fixed budgeting process in a fundamental way. In particular it outlines how we are taking the ideas of 'Beyond Budgeting' – which will be familiar to many - and operationalising them in the context of a large, traditionally managed, company with its own unique and venerable business culture.

*“No wonder it's called the annual plan... it takes all year!”.*

*“ Yes I know it's the right thing to do... but it isn't in the budget”.*

*I don't care that you gained market share.... why didn't you hit your growth target? “*

*“You didn't spend your budget....how can you be so stupid?”*

Does this all sounds familiar?

All the evidence suggests that most of us who work in large organisations do. In survey after survey business people make the same three complaints about their budgeting system:

- *Cost and bureaucracy:* Resources are wasted in this exercise and that the benefits are dubious.
- *Bad behaviour:* In the words used in recent survey conducted by the Hackett Group 'the quality of budget data is compromised by cautious behaviour and that it fosters political agitation instead entrepreneurship'<sup>2</sup>.
- *Inflexibility:* It takes too long (usually about six months) to complete the process and as a consequence plans are often obsolete before the results are published. Also the annual nature of the event makes businesses slow and unresponsive.

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<sup>1</sup> Steve Morlidge is change leader for Dynamic Performance Management at Unilever Plc, the Unilever Group's "Beyond Budgeting" project. He also is actually chairing the European arm of the BBRT.

<sup>2</sup> see the Hackett Study „Quo Vadis Budgeting?“ from 2003

It also common to hear this refrain:

*“this process is rubbish.....next year it will be different.”*

The experience of most of us is that *despite the very best of intentions somehow nothing ever really changes.*

Why is this and what can we do about it?

### **The Problem...and the Solution**

Perhaps the most important insight given to us by the Beyond Budgeting movement is that we are talking about a performance management *system*. A system made up of a series of interdependent and interlocking processes.

If we don't fully understand how these processes comes together to shape practices and collective behaviour and deal with the problem holistically our attempts to bring about change will be doomed to failure. Having understood the problem we then need to then find ways to build individual processes that achieve the same purpose – but without systemic failings of the old ways of doing things.

What might this involve?

#### *Target Setting “FROM CEILING TO THRESHOLD”*

In a conventional performance management system targets are expressed as annual, fixed, absolute numbers (e.g. ‘E20m in 2004’), which are usually arrived at through a process of negotiation. Once targets are struck it is then the role of management to deliver a performance in line with the targets and in the process they take on the nature of a quota

In this way a target becomes a ceiling on performance.

In order to create an adaptive system – adaptive to the real world - ideally a target should be drawn from the environment; the growth of our markets, the performance of our competitors. Then, instead of trying to meet a negotiated number, we should try to beat this performance standard.

#### *Rewards System “FROM MEET TO BEAT”*

Typically incentives are linked to the achievement of targets in a mechanistic way. The argument goes that ‘people need to be incentivised to meet

targets'. Incentives – where the link between performance and pay are defined exactly in advance – are 'necessary to motivate people'.

All too often in practice however it is most common to see the power of incentives to motivate expressed in the wrong way - in driving people to negotiate harder for less stretching, more achievable targets! It is invariably easier to negotiate a target down than it is to lift performance up

In order to eliminate dysfunctional and damaging behaviour that we often see associated with the setting up or achievement of targets, we need to decouple incentives from fixed, negotiated targets.

There is no one 'right' way of doing this. One approach might be to base rewards on a judgement made 'after the event', in context. It is only after the event that we know what actually happened in the business environment rather than what we assumed would happen and how our performance compares to our competitors or peers.

#### *Planning “ FROM PREDICT AND CONTROL TO PROJECT AND ACT”*

For many businesses building the annual plan is effectively an exercise in target negotiation. The original purpose – the requirement to anticipate the future and put in place appropriate plans – has been forgotten. Planning arteries become clogged because of need to demonstrate why our targets (or budgets) should be lower or, if you are on the other side of the negotiation, higher.

Once agreed the plan it then becomes 'contract'. Changing it involves breaking this 'contract' and a different outcome a failure to deliver on a commitment.

However, once the critical step of decoupling targets and reward has been made, the planning process is free to do the job that it needs to do - to anticipate what the future might look like and so help ensure that we have plans in place to exploit opportunities and mitigate likely risks.

#### *Measurement and Control “COMPLY TO PLAN TO SIGNALS FROM NOISE”*

The restrictive nature of conventional planning processes is compounded by our over-reliance on one measurement tool: variance analysis. Variance

analysis reduces the complexity of real life to one number - usually a simple comparison between an actual and a plan. The latter, the plan, often constitutes no more than an informed guess made perhaps twelve months prior to the event.

The world is a complex and dynamic place. In order to understand it properly we need a range of measures that help us detect those trends and patterns that are important for the health of our business.

### *Investment Management “FROM ENTITLEMENT TO EARN”*

The process of building annual plans and negotiating targets in a conventional system requires us to fully allocate all available resources to projects or areas of the business. Once allocated in this way they become an entitlement to spend.

When we do this do we know what the money will be spent on? Do we know how effective any expenditure is likely to be? Are we aware of the alternative uses for these resources? Do we even know whether we can afford to spend resources in this way?

The answer to all these questions is usually no.

We need a dynamic resource allocation process where we make resource allocation decisions when we need to (and not before) based on a full understanding of the merits of any particular investment and those of the alternatives available to us.

Those of us who have asked a bank manager for a loan will be familiar with this kind of process.

### *Co-ordination “FROM PUSH TO PULL”*

In anything but the smallest business annual business plans come together to form an interlocking network of fixed financial contracts, which ties the business up in a rigid structure.

Having created a flexible system of business units, able to respond quickly and flexibly to challenges thrown up by the outside world, how do we make sure that this new found freedom doesn't result in chaos?

We need to build processes to continuously co-ordinate the activities of multiple business units such that collectively they continue to work in a synergistic way.

### **The Challenge of Change**

All this might sound like a big, radical change.

That's because it is!

It would be, even in a small company, but Unilever has a turnover close to E50 billion, a quarter of a million employees working in 250 individual business units in 150 countries all over the world.

It won't be surprising, therefore, to discover that probably the most common response to this initiative in Unilever is that 'this is too big'. 'Big' not just because of the need to change processes, but also big because it involves a shift in mindset and behaviour and not only in Finance people.

The answer to this problem lies in 'sequencing'. Managing the order in which things are done, such that change can be 'chunked' up into smaller manageable initiatives, each of which deliver some incremental benefit at acceptable risk but which, collectively and over time, come together to shift the state of the whole system.

### **The Unilever Experience**

There are a number of ways in which this issue of sequencing can be tackled. I will offer a couple of perspectives that have been particularly helpful in tackling this issue in Unilever.

#### *The Roadmap*

The first is embodied in what we have christened our DPM 'Roadmap'. This 'roadmap' sets out, for each of the six processes, a transition process from 'fixed, annual, negotiated' to 'flexible, continuous, improvement compared to peers' based on three key steps which are shown in Figure 1.

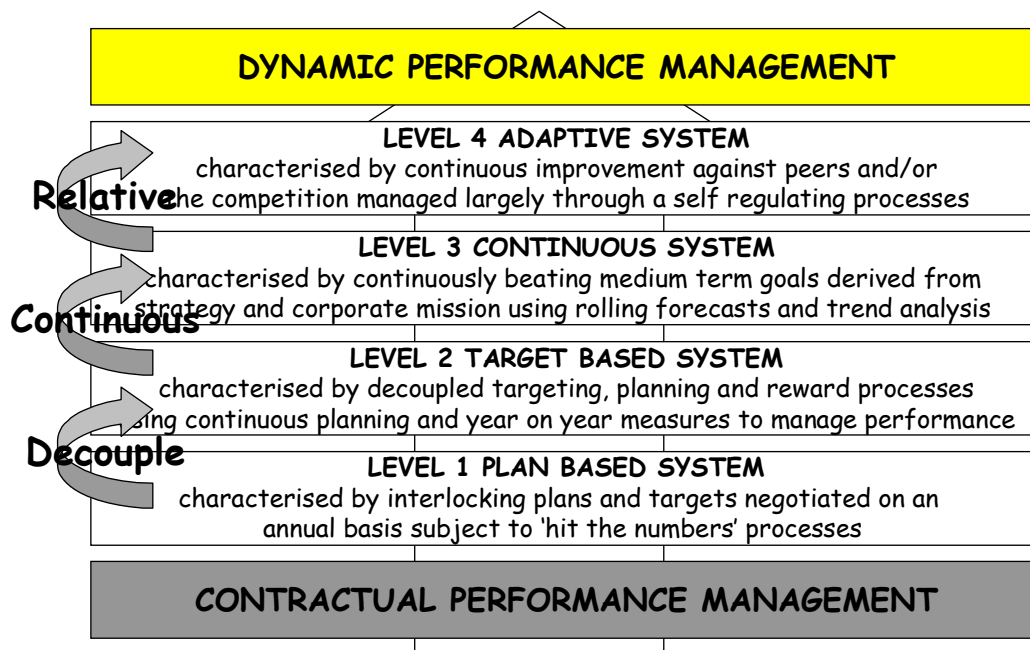


Figure 1 The Roadmap

This roadmap is based on simple logic, which, we argue, suggest a broad sequence in which changes have to take place – recognising that in reality things will inevitably be more complex. It is only a map – everyone will have to choose their own destination and plot their own route depending on the needs of the business, the means at their disposal and the local ‘terrain’.

Step 1:

The first step involves moving from Level 1 (a conventional system) to Level 2, which is still conducted within the constraints of the financial year but which is more FLEXIBLE. The key to making this step is to decouple target setting from incentives

Step 2: The second step – from Level 2 to Level 3 – involves breaking the constraints of the financial year, making performance management CONTINUOUS in nature. The key to making this step is to create stable medium term goals.

*Rolling forecasts (which are the engine of such a system) cannot be made to work properly without medium term goals.* Where targets are still negotiated annually the forecast almost inevitably becomes the first ‘bid’ in the process. Also – perhaps more to the point – one cannot act upon the output of the forecast process if no goals exist. If we don’t know whether performance is satisfactory or not – we don’t know whether action is required.

### Step 3

The third step – to Level 4 – involves the creation of a truly adaptive system by factoring the relative performance of others – competitors or peers into the target setting process. In this way the objective becomes **IMPROVEMENT COMPARED TO PEERS.**

### *The Change Factors*

The second perspective on change involves thinking about the factors of change.

There are two. The first set are those that provide the **ENERGY FOR** change. The second are those that create the **RESISTANCE TO** change.

Often we only consider the forces *for* change – the problems we are aware of, the vision for how things might be in the future and the practical steps we can take to change things. In practice we commonly find that if we simply ‘push’ harder we stiffen the resistance to change.

It is this that has guided our thinking in Unilever. What then we have done to help remove some of the obstacles to change?

### *Corporate Level Planning*

The majority of ‘budgeting’ activity is carried out at relatively ‘low’ levels of the business – and this is where most of its negative effects are felt. But, at least in our business, a significant barrier to change is the corporate (‘high’ level) requirement for ‘budgets’ or detailed annual plans.

Over the last three years in Unilever this corporate requirement has been progressively reduced.

In the first year the requirement for monthly phasing was dropped.

In the second year quarterly phasing was eliminated.

This second step is more significant than it first appears since, without phased plans, calculating ‘variance against plan’ is not possible. Backward looking, static analyses have been replaced by analyses that help explain the dynamics of the business.

At the same time fixed phased annual plans were replaced by monthly forecasts – for the quarter and the balance of the year.

Over the last year, in addition to the periodic requirement to ‘roll’ these forecasts to the end of the next financial year, our processes have been augmented by ‘Range Forecasting’.

Range Forecasts describe a range of possible outcomes around the conventional ‘single point’ forecast with a defined probability - in our case 90%. They are key to our new process – as well as providing us with an understanding of risk they play a critical role in helping to change the nature of conversations in the business.

The replacement of a set of corporate budgeting processes with ones based on risk based forecasts doesn’t automatically change practices right throughout the organisation. Those people in Unilever who still budget in a conventional sense (and most still do) do so, because they choose to, not because they are required to. But each year that passes will help convince them the requirement for detailed plans will not creep back (old habits die hard).

### *Incentives*

Two years ago Unilever's incentive scheme was fairly typical of example of the genre.

Every individual business unit had significant sums of incentive pay tied to the achievement of financial targets derived from the ‘Annual Plan’. The exact level of pay was determined by the position of the business unit within a ‘matrix’, the axes of which were made up of ‘revenue growth’ and ‘profit’.

The behaviour it generated was also fairly typical.

Energy was focussed inwards not outwards. On negotiating targets, rather than on beating the competition. On sticking to ‘plans’, rather than responding to opportunities.

Clearly the incentive scheme was an enormous block to the kind of change we want to introduce and had to be changed.

Fortunately the problems with the scheme were obvious to many people and we were able, in partnership with HR colleagues, to engineer changes to the scheme.

The main changes that have been made were:

- Moving the 'incentive pay point' from local 'Operating Company' to 'Business Group' level (250 to 15) to reflect the fact that most of the portfolio management decisions made in the business (which drive changes to 'plans') are made at BG level
- Widening the incentive range, so that fewer business units will find themselves 'off the matrix' (above or below) and consequently without any financial incentive to improve performance
- Replacing the 'stepped' structure of the matrix with a linear profile to eliminate the 'gaming' that takes place wherever the incentives take a 'jump'
- Introducing a significant (typically 25%) 'judgemental' component in incentive pay – based on three main criteria - performance in context (of the market), sustainability and execution of strategy.

2004 is the first year of operation for the new scheme, so it is too early to make a judgement about how successful it has been in operation. However, if you take the view, as I do, that the most one can achieve in large complex organisations is to minimise the damage caused by 'global' incentive schemes, then there is good reason to believe that this modest goal has been at least partially achieved.

### *Forecasting*

Without reliable forecasts we will be reluctant to let go of detailed annual plans. Even though we might be aware of the defects of annual budgeting, the rigour and the wealth of detail that it produces can give us a sense of comfort in an uncertain world.

My experience is that forecasting is a poorly developed competence in most businesses, in large measure because of our traditional over reliance on detailed 'bottom up' annual planning. In this respect Unilever is no exception.

The steps we are currently taking to address this weakness are:

- Establish forecasting policies and definitions: Well defined accounting polices and practices are a prerequisite for good ‘historical’ information. The provision of quality information about the future requires us to define what a forecast is, how we should deal with different classes of events, and how we measure success.
- Define forecasting best practice and provide training where appropriate: Too often businesses attempt to forecast using the same processes they use for building annual plans – processes which require hundreds of man hours to produce a result and which overwhelm the user with information often in a form which cannot easily be put to good use.
- Provide practical help and support to operators: Even without the day to day pressures of business life building new processes is not an easy task – and every business has its own particular problems and issues which demand the support of a specialised team.

## **Conclusion**

So, in broad terms, these are the measures we have taken so far to introduce some of the ideas of Beyond Budgeting in a large and complex organisation.

What I have described is not comprehensive – there is much fantastic work that I haven’t mentioned – nor is it complete. In many senses the journey is only just beginning.

Perhaps all we have achieved so far is to create the potential for meaningful change, which for me means changing behaviours within our local businesses – changes which will impact almost everyone that works for our business in a positive way. But the signs are, I believe, promising and although every implementation is unique our story provides some lessons for anyone else wanting to tread the same path.

## **Lessons**

For me there are two big lessons.

The first is that this is, and has to be, a big change, both in terms of its scope and potential impact.

Failures that can be traced back to a lack of awareness of, or a reluctance to engage fully in, the whole system. The ‘Beyond Budgeting’ philosophy provides a rich and productive seam of ideas to be mined.

The second lesson is that, while there is a basic framework or set of principles provided by the nature of the problem, there is no single ‘right way’ of bringing about change of this kind.

Organisations will differ in scale, culture and business context. Change agents will have different personalities and will find themselves in different roles.

All this will effect the strategy that needs to be employed, and will make the process of change easier or more difficult. But no combination of factors will make change inevitable. Whilst I believe there are some basic principles, no combination of factors make change impossible.

Any change worth making needs a committed group of people with a mission – and the courage to step forward, when an opportunity presents itself (which it will) to make a difference.

Only in this sense is the journey of change the same for any of us.

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This article is an extract from the book (in German):



Juergen H. Daum (ed.):

## **Beyond Budgeting**

Impulse zur grundlegenden Neugestaltung  
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More information at:

[http://www.beyondbudgeting.de/bb\\_buch\\_d/bb\\_buch\\_d.htm](http://www.beyondbudgeting.de/bb_buch_d/bb_buch_d.htm) (in German)

<http://www.juergendaum.com/bb.htm> (in English)