

Yes!
Beyond Budgeting Does Apply In
The Public Sector

(and for not-for-profits, more generally)

A few issues ago (SAM # 139) we looked at beyond budgeting in the private sector and asked whether it could apply within the public sector, too. Most respondents felt that it could not—while at the same time wishing that it could! (SAM # 140 and 141)

However, once we realise that ‘Beyond Budgeting’ doesn’t mean throwing away the budget, but an improved form of budgeting that focuses on achievement of performance targets, it not only seems (and is!) feasible but it is more in line with current day management thinking.

I asked John Bragg, a director of the Beyond Budgeting Round Table, whether BB was possible within the public sector. “Absolutely!” he responded—and he has written the lead article in the current issue citing the work of the Asset Management Section of Sydney Water (which has saved many tens of millions of dollars in a few years by doing so) and a not-for-profit organisation, Sight Savers International.

In the next issue, we will feature an in-depth interview with Sydney Water’s Aubrey Joachim, who will tell us how they did it, and what insights he has gained that may help others wanting to do the same.

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*A genuine multi-disciplinary budget approach for the multi-disciplinary science of
Asset Management*

PROGRESSING “BEYOND BUDGETING” IN THE PUBLIC SECTOR

By John Bragg, Program Director, BBRT Australia

Many organisations, in both the private and public sectors, are seriously questioning the effectiveness of the annual financial budget as a principal mechanism for performance management and are exploring alternatives more suited to today's fast changing business, social and economic environment. A detailed, traditional, budgeting process is criticized by many as taking too long, adding too little value and, more important, encouraging dysfunctional, gaming behaviour.

These organisations are recognising that:

- the traditional, fixed annual budget can constrain managers' ability to respond to rapidly changing market and economic conditions; it reinforces the “command and control” management culture and can inhibit efforts to devolve responsibility for decision-making down the line to managers closer to the customer;
- there is often confusion about whether the budget is a plan of what should be achieved, a “stretch” target, or a forecast of what is most likely to be achieved;
- the budgeting process can be counter-productive, particularly if management contracts and rewards are linked to budget performance, when managers may perceive it as a “gaming” process of negotiating performance targets which they can beat and resource levels which they don't really need; this process can encourage a “spend it or lose it” mentality, leading to valuable resources being wasted in one area while another desperately needs more;
- the process provides little encouragement for organisational units to improve or “stretch” their performance; success may be seen as “meeting the budget” rather than improving service levels and efficiency and maximising potential;



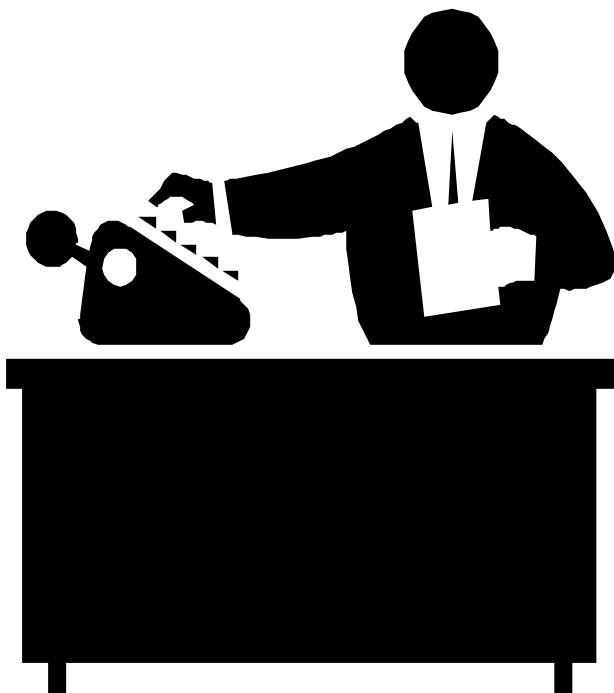
- the budget may be a serious barrier to the achievement of strategy, if there are not clear and consistent linkages between the budget and the critical success factors and KPIs (both financial and non-financial) reflected in the organisation's strategic plan;
- a detailed budgeting process can consume substantial amounts of valuable management time, particularly in large organisations, where several budget iterations may be needed before obtaining management sign-off; and the budget is often out of date by the time it is finally approved.

Perhaps the most serious concern has been about the practice of setting fixed annual targets, at increasing levels of detail (ostensibly to drive performance improvement). For example, a report by the UK's Public Accounts Committee in July 2003 stated, inter alia, that: *"Performance measurement should primarily take into account whether services are improving – not whether they have hit an absolute target... Fear of failure has led to fiddling of figures so that creativity is being directed more to ensuring that the figures are right than to improving services... Front line workers should be much more involved in target setting... A focus on progress would show which hospitals, schools, councils and police forces were making progress and which are going nowhere or backward"*

Governments and the public in many parts of the world are dissatisfied with the performance of their public sector organisations but their efforts at addressing these problems through detailed targets and micro-management have often failed to win the hearts and minds of key people and produce the desired results. However, just rewinding the tape and erasing the target setting approach *without a better alternative* is not the answer.

The BBRT Model

Over the past six years, the Beyond Budgeting Round Table (BBRT), an international research and development collaborative, has been researching and working with a range of innovative organisations in the private and public sectors to understand these problems and practical solutions that have been adopted.



The "BBRT model" has been derived from the best practices of these leading organisations and involves a combination of dynamic performance management processes and devolved managerial culture. This adaptive model includes the following principles of planning and performance management.

Continuous planning

Instead of the fixed (usually annual) strategic planning and budgeting cycle, the new model involves a process of continuous strategic and action planning, with interlocking long, medium and short-range plans, based on a system of rolling forecasts and regular planning reviews. The key is to involve all levels of management in the process and have regular reviews, as the rolling forecasts indicate changes that could

affect the longer-range plans. The rolling forecasts inform and support the high level planning and appropriation process, with the latest available information, but enable regular reviews of plans and resource requirements.

Goals and rewards

Goals are aspirational and relative, rather than fixed targets and are not linked to performance contracts and rewards.

Rewards are usually team, unit or enterprise-wide awards rather than individual incentives, and based on relative (to the industry, benchmarks, prior periods, and/or peer group) success, with hindsight. This approach eliminates the most common cause of budget gaming and manipulation, the perceived need to negotiate "soft" targets and then use all means to meet them, even when circumstances may have changed.



Resource allocation and coordination

Resources are made available to organisational units, subject to cash forecasts and KPI goals and within overall corporate guidelines/appropriations, as required and within current priorities, rather than on the basis of pre-determined, detailed, allocations. Cross-organisation interactions are coordinated through market like forces, as demand changes, rather than pre-determined annual budgets.

Performance measurement and control

Performance measurement and control is based on a clear governance framework, with fast open information measuring key, relative, performance indicators, both financial and non-financial, aligned with strategy. "Beyond budgeting organisations" use a variety of adaptive processes for this purpose, including techniques such as value-based management, benchmarking, scorecards and activity-based costing. The key to their success lies, not so much in the techniques used, all of which have their advantages for particular purposes, but rather, in achieving coherence between them in the way they are used. Information systems must enable managers, at all levels, to be able to access the information they need, when they need it. The information must be reliable, relevant, and at the right level of detail.

Devolved management culture

The BBRT model of performance management supports a devolved, team-based management culture, where responsibility and authority for decision-making, within the strategic objectives, values and boundaries of the organisation, are devolved to the lowest appropriate level of management for that decision. This requires a well-trained and experienced management team with an achievement-oriented culture, and well-communicated corporate values, goals, policies and coaching from a supportive leadership group.

Is this Model Relevant to the Public Sector?

Can this model work in a public sector or not-for-profit environment, which depends on an annual appropriation process and accountability to the public? This question has been asked by many organisations that have attended the BBRT's public seminars and meetings. The answer is – YES, it can - and it does not require the abandonment of the annual appropriation process or result in any weakening of public accountability; indeed, properly implemented, adoption of these principles should lead to improved accountability. It is the budgetary process that requires change, not the longer range planning and public appropriation processes.

Let me give two examples of organisations that have successfully adopted these principles: Sydney Water's Asset Management Division and SightSavers International.

Sydney Water Asset Management

In an article in CFO magazine (Bernard Kellerman: "How to beat the budget blues", May 2003) Sydney Water's Asset Management Division Financial Manager, Aubrey Joachim, described how his organisation changed from a fixed budgeting mindset and adopted a much simplified and more flexible approach, while still staying within an annual appropriation and high level budgeting regime. "Fixed" costs were divided into "core" and "discretionary". The core was funded on a continuous basis (without detailed budgets) while efficiencies were sought. Discretionary expenditure was applied for by managers and spending proposals reviewed by a peer group centrally, as and when needed (not allocated a year in advance). Budget and reporting detail was greatly reduced, from some 500 line items to around 25 expenditure categories. At the operating management level, monthly performance reports are compared with "benchmarks" (which are internally generated) rather than budget and the benchmarks are varied as appropriate during the year. The new approach has resulted in savings of some 12% in operating expenditure over the 3 years to 2003 and improvements are continuing.

A non-profit—SightSavers International

SightSavers International (SSI) is a major UK based charity, providing eyesight treatment services to poor nations around the world. In the year 2000, the then Finance Director, Adrian Poffley (now at the World Bank) led SSI's move to replace their traditional budgetary approach with an adaptive performance management process.



They had found the traditional budgetary process too long and bureaucratic, with assumptions quickly out of date and lacking adaptability to rapidly changing world events. Typically, SSI's projects take around 3 years from inception to delivery and an annual budgetary process is artificial. They replaced it with a continuous planning and monitoring cycle more suited to their planning horizon.

SSI plans and allocates resources in three directions, reflecting the nature of its operations – charity work, fundraising and support services – based on achieving KPI goals. Goals are set corporately using a relatively small number of high level KPIs, such as:

- % of total expenditure on charitable work
- Free reserves as a ratio of future commitments
- Fundraising return on investment
- Donor recruitment return on investment
- Number of surgeries established
- Number of eye screenings conducted
- Employee satisfaction
- Employee turnover.

Below this, the responsibility for resource management is devolved to operational units.

Management reporting is kept simple and at a summarised level:

- One page Operating Statement, balance sheet, cash flow and KPIs, produced within 5 days of month end
- Actuals, year to date and rolling history
- Future, rolling forecast – up to 3 years ahead
- Trends and moving averages
- No budget comparisons, no variances.

This approach has been found by SSI leadership to give better control and accountability than the previous annual budgetary approach and, in the process, has resulted in smoothing the expenditure cycle, which formerly had spiked substantially in the last two to three months of each financial year.

Conclusion

The budgetary process in the public sector and in not-for-profit organisations can be simplified and made more adaptive and performance-oriented, without departing from the annual appropriation process and without weakening public accountability. Indeed, adoption of relevant BBRT principles can significantly improve accountability through the better alignment of strategy, planning, resource allocation and performance management and the elimination of the incentive for budget gaming and dysfunctional behaviour. Further, it can release significant amounts of financial and management time from the detailed budgetary process, to spend more productively on strategy, planning and performance monitoring and in servicing the needs of customers and stakeholders.

Further information about the principles and processes involved and the work of the Beyond Budgeting Round Table (BBRT) may be obtained from the BBRT in Australia (contact details below) or from the website at www.bbrt.org.

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Beyond Budgeting

12 Step Process

1. Build a basis for devolution through clarity of purpose. Don't exert control from a central location.
2. Empower managers to act without constraints.
3. Hold managers accountable for hitting performance targets, not budget numbers.
4. Organise the business around customer-oriented business units, not hierarchical departments.
5. Let market forces dictate resource allocation requirements, not central planning and budgeting.
6. Don't command and control people. Challenge and coach them.
7. Beat the competition by setting and hitting performance targets, not budget targets.
8. Make strategy an ongoing process, not an annual event
9. Use technology to keep abreast of performance in relation to strategies, and change strategies when conditions warrant.
10. Allocate resource when needed, not according to annual budget.
11. Avoid micromanagement and provide quick access to up-to-date information about the company.
12. Reward on the basis of reaching performance targets, not predetermined negotiated targets.

(This is essentially the process followed by Sydney Water—and in the next issue, Aubrey Joachim will tell you how they did it.—and with what results)

Want a few more clues?

**Design ideas for Beyond Budgeting management
information reports**
by Matthew Leitch, 15 July 2003

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The freedom to do more than report variances against targets
The enemy
Design to help readers think
Ways to filter for errors
Ways to reveal what is happening
Ways to show what might happen in future
Ways to evaluate performance
Ways to evaluate and revise models and forecasts
Ways to focus on important information
General guidelines for clarity and compactness
Conclusion
Links and further reading

Introduction:

"The freedom to do more than report variances against targets

If you prepare or use management information reports, whether or not you have decided to go "Beyond Budgeting" (www.bbrt.org), this page will be of interest. One of the first, and easiest steps towards better performance management is to start presenting the management information you have in a more interesting and useful format than analysis of variances against targets. You can add extra pages even if you don't have permission to ditch budgetary control, and the benefits could far outweigh the effort needed.

Typically, you don't need a new computer system, or complicated mathematics, to do much more with the figures you have. In this paper I'll present a number of ideas, guidelines, and examples to show what is possible. I don't have a complete or definitive answer, but there are lots of ideas here to fire your imagination. If you'd like to have a go at redesigning your packs yourself, pump your brain full of these and any other ideas you can find and then have a go."

To access this 21 page reference, produced in conjunction with the Beyond Budgeting Round Table, type "design ideas for beyond budgeting" into google. (For some reason the direct URL is unreliable)