June 2014

Effective Management Control: Beyond Budgets

Budgets have been the core of management accounting in most companies for as long as today's executives remember. But how useful is a budget for control and decision-making? And is a budget by itself enough? ***Trond Bjørnenak****, a distinguished professor at NHH Norwegian School of Economics who teaches at BMI, specialises in the evolution of management accounting. This text is based on ideas in some of his recent publications on the modern management-control toolbox.*

Distinct from financial reporting for external stakeholders, management accounting provides internal reports on costs and performance to help managers monitor and make decisions. Over the past decade, a movement known as "Beyond Budgeting" emerged based on a critique of budgets and a search for better alternatives. Oil major Statoil is one proponent, as are several Nordic banks – including one Dr. Bjørnenak chaired that has worked successfully for years without any budgets.

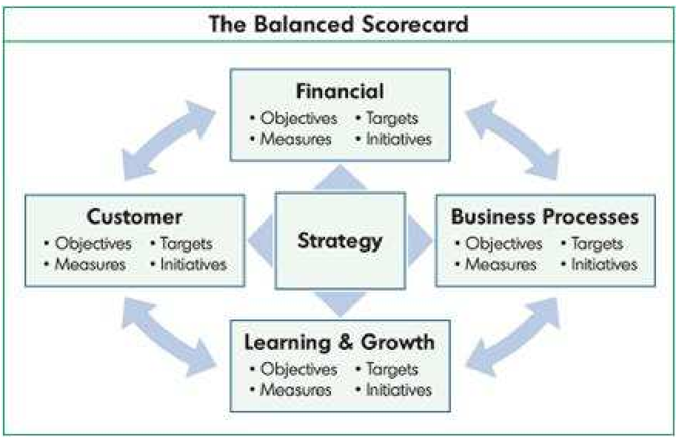
Some 'Beyond Budgeting' Fans

Statoil, Unilever, Southwest, Google, American Express, Toyota

Criticism of the budgeting process centres on: the huge management resources it tends to demand; its reliance on forecasts that may quickly become outdated; its arbitrary 12-month rhythm for planning; and the incentives for manipulating results that budget performance targets tend to create. Thus budgets often don't give managers the information they need to make effective decision in a rapidly changing world.

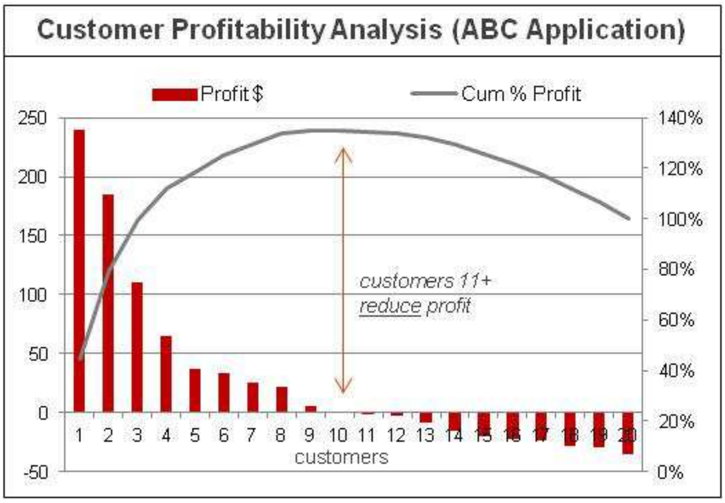
In fact, the need for more dynamic control systems to improve competitive agility has been discussed for decades. Development of new approaches intensified after the publication in 1987 of Johnson and Kaplan's book Relevance Lost: The Rise and Fall of Management Accounting. Numerous tools have emerged, of which some more common ones are Activity-Based Costing, the Balanced Scorecard, Target Costing, Rolling Forecasts and Benchmarking.

- **Activity-Based Costing (ABC)** involves analysing the resources consumed by business activities, at a more sophisticated level than required for external reporting, in order to assess the profitability of products, customer segments or distribution channels, for example.
- **The Balanced Scorecard** is a logical map linking events that management can initiate and measure with the goals management seeks to achieve. It helps guide decision-making for non-financial aspects of a company's work that ultimately impact its financial results, including intangible assets such as learning and growth, internal processes and customer perspective.



- **Target Costing** involves planning in advance for the price points, costs, and margins that a company wants to achieve for a product. It allows management to monitor and control product performance right from the design phase.
- **Rolling Forecasts** get away from once-a-year budgeting by regularly revising business-driver predictions, on a monthly or quarterly basis, for example.
- **Benchmarking** is the process of comparing a company's performance measures with those of the best firms in the industry.

Effective control systems require a healthy sense of the costs and benefits of your efforts and of what problems need to be solved and what the manager wants to stress. Note that a company's controller, rather than just a reactive monitor, can be an active consultant to management, someone with the knowledge and competences to help improve performance who not only produces information but also communicates it and puts it to use.



When choosing management control tools, consider the degree of uncertainty in your business environment and your ability to react to new information if you get it. Annual budgets may be fine for a company operating in a context of flexibility and low uncertainty. With the same flexibility but high uncertainty, rolling forecasts may be better. When high locked-in costs limit flexibility, look to longer-term planning tools such as target costing. Recall that the various tools can be applied globally (throughout the organisation) or locally (in just one part of the company). They can also be used continuously or on an ad hoc basis.

Finally, note some tools may send conflicting signals and create confusion if used together improperly. An example is using an annual budget, with its focus on financial measurements and the short-term, together with a balanced scorecard, which also considers non-financial measures and has a more long-term focus. In short, consideration must be given to how the different parts of your management control "package" fit together.

-- By Bryan Bradley, BMI, based on:

Bjørnenak, T. & Kaarbøe, K. (2013). The Dynamics of Management Accounting and Control Systems. In The Routledge Companion to Cost Management, 163-173. New York: Routledge.

Bjørnenak, T. (2013). Management Accounting Tools in Banks: Are Banks Without Budgets More Profitable? In Kaarbør, K., Gooderham, P.N. og Nørreklit, H. (eds). Managing in Dynamic Business Environments. Between control and autonomy. 51-68. Northampton: Edward Elgar.

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Nørreklit. H. Nørreklit, L., Mitchell, F., & Bjørnenak; T. (2012). The Rise of the Balanced Scorecard! Relevance Regained? Journal of Accounting & Organizational Change, Vol. 8 (4), 490-510.