Thirty successful years without budget

Experiences from a financial company

Sven Grevelius

Svenska Handelsbanken is one of the largest banks in Northern Europe. Originally working in Sweden, its domestic markets are today Norway, Finland, Denmark and Sweden. The Bank has around 9000 employees and assets of around 120 billion euro.

Handelsbanken found itself in a crisis in 1970 and the top-management of the Bank was replaced. The new CEO Dr Jan Wallander changed the Bank radically and designed a new overall policy. Decentralization, low costs and no central planning were the key words in achieving the new goal to be the best bank in the Nordic region and report better return on equity than peers. The Bank abandoned budgeting work in 1970 and has never returned to it. Since then it has reported significantly better key-ratios than its peers (and also compared to listed European banks). Return to shareholders has been outstanding.

In this paper I would like to explain which considerations regarding budgeting and planning were behind the measures taken by Dr Wallander in 1970. The article is mainly based on Dr Wallander’s book „Budgeten – ett onödigt ont“ (Budgeting – an unnecessary evil). My focus is very much upon the pros and cons of budgeting. Management alternatives to budgeting will be presented. A short description of „Handelsbanken in practice“ will conclude the presentation.

1. Budgets and the purpose of budgeting

Definition of budget

What do we mean in general when talking about a budget for a company or a group of companies? Generally it is a way of trying to plan and forecast the future for the Group. We often try to translate the most probable development in quantitative terms down to a detailed level. Typically a large proportion of the employees are deeply involved and the final budget will cover the whole Group in terms of both profit & loss account and also balance sheet and cash flow. Mostly the budgetwork is done during autumn and will cover the coming financial year. Medium term (2 – 5 year) budgets are also produced though this is less common today compared to a few years ago.

Purpose of budgeting

Which objectives or needs is the budgeting process trying to satisfy? Most companies try to achieve as good return on equity as possible (within the norms of society) and generally the use of budgeting is supposed to facilitate this. Subobjectives which might then be facilitated are

- future internal coordination within the Group in terms of production capacity/volume, pricing regarding internal services, capital requirements
- what will be critical?
- Are there facts/assumptions or events that might be vital?
- To what extent will they be vital?
- will we reach the objectives laid down?
• motivate managers and facilitate follow-up for top-management

The main objective and the sub-objectives are, of course, all very important. Equally important are the assumptions and presumptions upon which the whole budget process is based. The important question is whether the budget process is really the most efficient way of moving towards or beyond the objectives. Are there also reasons for such a large proportion of the staff being involved in what is rather theoretical work with many „if’s“ and „buts“?

2. What limitations are linked to budgeting?

When we look at the limitations of budgeting (see figure 1) we also consider the impact the budget process will have on your organisation. Below you find a discussion regarding limitations of budgeting. Some matters caused by budgeting that might harm the organisation will also be discussed.

Forecasts

All budget work is based upon forecasts regarding the future. Somewhat simplified it can be said that all forecasts are based upon either a development which is a continuation of the past (same weather tomorrow as today) or the situation is abnormal and if it continues the curves will go through the ceiling or the floor. In such cases you will believe that there will be a return to „normal“. It is obvious that it would be of immense value to you if you could predict these changes. That is not possible, however. To predict or forecast these significant changes or shifts is extremely difficult in terms of what the trigger might be and also when it will happen and what will happen. Examples of this kind of change are oil-price crises, the Kuwait-crisis, technical shifts e.g. mechanics to electronics or fixed to mobile phones, drastic changes in currency levels or interest rate levels etc. To be prepared for changes of this kind is judicious. It is doubtful whether time-consuming and labour-intensive budget work will improve a Group’s chances of meeting the challenges of major changes in its environment.

Negotiations rather than objective (actual) facts

When it comes to budgets and forecasts regarding the possible outcome experience tells us that people tend to look at these issues tactically, i.e. that what you „promise“ to do in your budget is influenced by

• tactics in general
• impact on bonuses or other incentive programs
• expectations perceived in the organisation
• possible will to regulate your performance

The conclusion is that the budget does not really show the probable „reality“. It is rather biased towards subjective „wishes“ and „perceptions“.

Reduced flexibility

The comprehensive budget work focuses very often on many aspects in order to prevent the company from all the theoretical risks that might occur. Through this procedure you create a false sense of security within the organisation. When „the non-expected“ then happens you find the organisation rigid and without energy to react to the „realities“ at hand.

Limited number of strategic variables

In order to forecast the impact of changes as a rule you can identify a limited number of variables which may cause the changes. You don’t need to involve a vast number of employees in order to know what will be the overall impact. The impact of these variables might as well be estimated by sketching on the back of an envelope.

No substitute for continuous supervision, coordination and planning

It’s important to note that we do believe in a certain degree of supervision, coordination and planning. The difference is that we believe that these things can be done in a much more efficient way if you don’t utilize the budget tool.

Budgeting tends to be something which is a kind of self-governed procedure where the input comes from your crystal ball once a year and other parameters are changed according to „common truth“ and other unreliable instruments. As a responsible manager for a Group, what you need to implement is the duty for most staff to look at what is going on and happening on a more or less daily basis. To think about and plan for the future in a continuous way. With this kind of attitude, you maintain flexibility and awareness and keep the organisation on its toes.

3. Alternatives to budgeting

As mentioned above, the impact of budgeting is heavy. The alternative to working without the „help“ of a budget requires certain ways of organising your Group as well as certain administrative tools (see figure 2). By organising the Group in such a way you will create a much more decentralised organisation which will become powerful, flexible and openminded.

Distinct objectives

The objectives of the Group and its subgroups must be very evident to all employees. Simplicity is a keyword. Most activities should be measurable and benchmarks should be utilised on all levels (both within the organisation and with external groups/organisati-
Acceptance of changes

The attitude towards change should be positive. By having clear and accepted objectives and connecting the objectives to a remuneration system (profit-sharing see section 4 below) you will have a greater understanding and willingness to accept changes.

Requirements from the organisation

In order to know the results or the outcome of your activities (profit & loss account) as well as your situation (balance-sheet) you need to have a very consistent, reliable and accepted accounting system. It should be quickly and easily accessible. Having that together with comparisons with earlier periods as well as with comparable units, you will have a system where unusual things will be quickly found and hopefully adjusted. This financial information should then be supplemented with non-financial information (e.g. customer attitudes, customer complaints, employee attitudes). On certain occasions you might need project groups and ad hoc solutions.

Organisational requirements

The very distinct objectives and the measurability which I mentioned earlier create the opportunity for true decentralization i.e. to distribute power within the organisation.

Profitcentres which are distinct and (in most cases) comparable create responsibility and motivation in the organisation. Thus, centrally in the organisation, you don’t need to spend a lot of time on checking and controlling.

By doing so you also create an attitude where everybody needs to worry about the future, especially the future of their group or department. Thus the future is not hidden behind the budget-cloth but is truly delegated every day to the organisation. You must look around the corner all the time and consider what is happening, what might happen and the impact on your organisation. Within the organisation you must also create the opportunity and will to communicate and an open-minded atmosphere.

Given that you succeed in implementing the distinct objectives, the attitudes and the organisational structure and administrative techniques, you will avoid many of the shortcomings which are a frequent consequence of budgeting. You limit your bureaucracy, you obtain power of action and flexibility. You also get decision-making when you really need to decide, not because of the planning cycle but because of the demands of „reality“.

4. Svenska Handelsbanken in practice

Handelsbanken is a universal bank founded in 1871. In 1970 the Bank found itself in a major crisis. Dr Jan Wallander was appointed Chief Executive and started to build the modern Svenska Handelsbanken. Dr Wallander was at that time head of a provincial bank in Sweden and prior to that he had been a professional economist and head of a major research institute. Dr Wallander’s experience as professional economist was important when he decided to abandon budgeting and created the techniques and tools to steer Svenska Handelsbanken.

Since the early 70s, Svenska Handelsbanken has outperformed all other Nordic banks and is regarded as a model within the banking industry. The non-budgeting attitude has been one of the cornerstones in the philosophy of Handelsbanken since 1970. To understand the Bank’s conditions you must know the characteristics of Svenska Handelsbanken and the keywords.

Corporate culture in general

The core values are formulated in a booklet called „Our way“. It was published in 1970 for the first time and has been marginally revised by the subsequent three CEOs. It is compulsory reading for all new employees.

The overall objective (better return on equity than the average among other Nordic banks) is stated there. Other phrases expressing the policy of the bank are:

- profits come from customers not from products
- decisions are to be made locally
- local managers are accountable for achieving good results
- don’t copy others

The overall policy is simple and clearly communicated. Decentralisation and devolution are keywords. The real power is moved towards the front i.e. close to the customers. Long before the concept of focus on the customer was invented, the importance of the customer was acknowledged. As the organisation is very decentralised there is almost no hierarchy.

Administrative techniques and tools

The accounting system and key ratios are part of the culture. The accounting system is very well worked out. The number of general key ratios is limited (return on equity, cost to income and profit per employee) and well defined.

Benchmarking within the organisation and with outside peers (comparing keyratios and drawing conclusions) has long been a very common way of learning about and developing the organisation.

Having low costs is considered a safe means of reaching the objective. The
Figure 3: Compound Total Shareholder Return 1979 – 2001

The attitude and the motivation for the employees is supported by a performance-related profit sharing system called Oktogonen and established in 1973. The bank will allocate capital to the Oktogonen foundation when the Bank succeeds in reaching its objectives i.e. better return on equity than the average of its Nordic peers. The amount allocated is equal for all full-time employees and will be invested to some extent in Svenska Handelsbanken shares. The employees will have access to the money when they retire. Actually the Bank has succeeded in performing better than its peers since the inception of the foundation. Thus the amount paid to the employees is significant. The employee who has worked for the Bank since 1973 will get around 400,000 euros. To a large extent this depends on the very strong development on the equity market and especially for the Handelsbanken share.

5. The proof of the pudding is in the eating

The Bank’s performance has been extremely good. From the start of the new „regime“ (which included the concept of no-budgeting) the Bank has had profitability that has been higher than the mean of its peers.

In most years the bank has had the highest return and in the other years it has been number two or number three. Conditions for banks have varied very much during this period and Handelsbanken has showed the lowest volatility. When looking at the effective yield there are official figures since 1979. The Bank has had 24% compound total shareholder return, the closest competitor being at 18% (see figure 3).

Costs of the supporting units at the headquarter are scrutinized every year by representatives from the customer-oriented parts of the organisation.

This also stresses that power to a large extent is close to the customers.

The internal communication is rapid, open-minded and frank. Every month all parts of the organisation report general written remarks to the management group of the Bank. These remarks, good as well as bad, will be quickly exposed and not hidden within the organisation. Although there are no formal forecasts or budgets, there are of course discussions and ideas regarding the future going on all the time.

**Profit sharing**

When looking at the pros and cons of budgeting, Handelsbanken is a brilliant case. It shows that there are very efficient alternatives to managing corporate organisations. These alternatives can improve the efficiency and vitality of the organisation and thus give it a long-lasting strength.