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Many companies are currently reengineering their target setting, planning, reporting and control processes, i.e. their overall enterprise performance management system, in order to master the challenges of today’s highly dynamic and competitive global market environment.

Should they scrap the traditional annual budget, like Svenska Handelsbanken, a Swedish retail bank, did already more than 30 years ago? Or should they move away in steps from the traditional annual fixed budget by applying a more „rolling” way of planning and forecasting and by focusing more on managing the gaps to targets and underlying evolving risks and opportunities, rather than to continue with detailed actual/budget comparisons – like Zurich Financial Services and SAP? And what about the growing importance of intangible assets – like acquired and internally created brand values in the cases of Cadbury Schweppes – that are not included in traditional financials-based performance management systems?

In the following discussion, that took place at the SAP European CFO Roundtable Meeting on December 3, 2004, in Venice, Italy, Juergen H. Daum explores with the CFOs of these four companies what they regard as best practice in enterprise performance management, the practical consequences, and what this all means for the future role of the CFO.

### Budgets or Beyond – What do we need, what is best practice?

**Jürgen Daum:** We have heard this morning in the presentation of Lennart Francke about the case of Svenska Handelsbanken and how they manage quite successfully without any budgets for more than 30 years. Mr. Buess, can you imagine managing a company like Zurich Financial Services without a budget?

**Thomas Buess:** I am not a big fan of having no budgets. But on the other side, there is sometimes also an „overdose of budget”. That is the case, when you are a slave of your budget and when you use it just as an administration tool, rather than as a management tool.

It also depends on the situation, on where you are in as an enterprise, how strong the budget-based control need to be. When you need a lot of discipline and you need to inject that discipline into the organization, you may need to put more emphasis on your budgeting process and on following the budget. If you are cash-short, then how can you manage a company without a budget?

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I think when we talk about a budget, we first have to define what we understand under the term „budget“ and what its objectives are.

One objective, for example, is to define targets in a coordinated way. And I am a big fan of targets, because I think what is not measured against a target cannot be managed. Therefore I think it is very important to have clear metrics and targets in place, not too many as I mentioned this morning in my presentation, but you have to steer towards a goal. And then you have to have a dialogue with the businesses, which is facilitated by the budget.

And the most important thing is not the numbers in the budget. The most important thing is the process how you get to these numbers and also the process how you track what is going on and how you decide on corrective action.

Jürgen Daum: Mr. Brandt, what is your view? Could you manage SAP without a budget?

Werner Brandt: My answer is a clear no for the time being. The issue for us is more what level of detail we really need in order to come up with a budget and a forecast for the entire corporation.

We are currently implementing a quarterly rolling forecast. Since two years we have monthly year-end forecasts and based on that, monthly conference phone calls with all our operative business units. We will apply this mechanism now on a 5-quarter rolling basis.

This new approach can represent a real challenge for the organization. If we are too detailed, the forecasting process can produce a considerable additional workload – and that every quarter, not just once a year. If you want to move to such a planning cycle of 5 quarters rolling forward, you have to concentrate on the key performance drivers represented by only some selected KPIs. You must be able to identify the KPIs you really need – dependent on your organization and your business. We have defined approximately 20 KPIs for the whole company and I don’t think we need more.

Another area that represents a challenge is the compensation system. It’s hard for us to align compensation to this new way of how we now want to manage the business. If this is based now on a 5-quarter rolling forecast, how do we then put in place the compensation targets for the units?

One point I will definitely take back with me from the discussion we had this morning is the importance of a team component in performance measurement. The team/group component must be significant so that we really create and incentivize the willingness to help each other so that the whole group does not suffer and underutilizes its potential. For this it must become less important that only my region, my product area, my unit performed well, and more important that the whole group is achieving its overall targets.

Additionally, you need a good combination of short term targets – we have to manage the expectations of the capital markets – and long term targets that help to be successful also in the long term view.

Jürgen Daum: Mr. Kappler, what is your opinion based on your experiences at Cadbury Schweppes?

David Kappler: I want to add the culture issue that came to my mind during the presentation this morning. Beyond Budgeting worked in Scandinavia, but would it work anywhere else? Being publicly traded in the US, with quarterly reporting, you would certainly be in serious trouble without a quarterly budget. Being in a CFO position, you have to have a fair bit of comfort with the figures that must come up on a quarterly basis so you need to put a certain amount of review into the planning and forecasting process. I think that culture issue will be with us for a long while.

The other point I want to make is, that it is a matter of definition what the budget is. I think that top-down, top extrapolation, bottom-up and the negotiation that happens in the middle, and how that evolves, will remain quite a dynamic process in business.

Jürgen Daum: Mr. Francke, after hearing those three opposing opinions the question is: what is different at Handelsbanken so that you can manage or even have to manage without budgets? What should other companies consider, when they want to rethink their planning, budgeting and reporting process in the direction of „Beyond Budgeting“?

Lennart Francke: First of all I want to make clear that I am not a missionary. I have no ambition to make you abolish your budgeting systems. In fact, I am grateful if competitive banks continue their budgeting. That’s a great idea – for competitors.

However, we also have to guide analysts and investors when they produce quarterly outlooks, not least outside Sweden.

It is also not a question of metrics, we certainly are very much into measuring performance in our company and we do it very much in detail. A lot of emphasis is put on having a trustworthy, timely, very open accounting decision to our shareholders, but also inside our company.

We haven’t missed the budget for one day during the past 30 years. We cannot see how it could support the flexibility that you need in reacting to a changing environment, how it could support the decisiveness you need to have to do good business and keep customers satisfied.

We are so happy not to have the game we hear so much about at other companies with formal planning systems and we are managing our performance relatively to peers instead of doing it against a fixed budgets and pre-set absolute targets. This works very well for us.

I should be very cautious in making recommendations to other companies. There might be a point in saying that circumstances are very different in different parts of the world, different industries etc. We have not been in a crisis situation during the past 32 years; we haven’t had to manage equity day-by-day. And there might be something to it,
that there is a typically Nordic way of managing people and organizations.

Changing a management control system so fundamentally so that you are able to run a company “beyond budgeting” is very much a top-down process. As CFOs – with all the respect for ourselves – we cannot bring about such a change on our own. It has to come from the Board of Directors. We can be part of it and play a crucial role in it – I certainly do play a crucial role in maintaining our system, since there are always centralizing powers and struggles going on in our organization too – but the fundamentals that you have to lay, the changes that have to be made, have to come from a completely convinced top management board.

**Target Setting, Planning, and Forecasting – What is the main challenge, what is best practice?**

**Jürgen Daum:** Let’s go into a little more detail now and let us discuss first target setting, planning and forecasting. What are best practices there?

**Mr. Brandt,** you mentioned already that SAP is moving towards rolling forecasts. What are the major challenges – in addition to the ones you already mentioned?

**Werner Brandt:** We have a forecasting process at SAP for two years now, we use our SAP SEM system to do so and since this year, it is also supported by our SAP CRM system to really forecast the revenue side adequately.

The challenges in moving to the 5-quarter rolling forecast system is that we are a matrix organization and that we are living in a dynamic market environment so that we have to align our organization quite often to respond to market challenges – for us changing is permanent. These changes have to be reflected in the 5-quarter rolling forecast. In our industry, the dynamics are challenging but nevertheless, as a leader in this industry, we need to be able to adapt very fast and we in fact succeed in that.

**Jürgen Daum:** Is there something in the area of target setting that you would like to change?

**Werner Brandt:** I think the target setting process is working really well. As always, it is a question of discipline in the organization. I can only agree to Lennart Francke’s statement: as a CFO alone, you cannot set targets; you need a close cooperation with your CEO. If this relationship works well, you can achieve a lot, without this type of support from the CEO, you are lost.

**Jürgen Daum:** Mr. Francke, Svenska Handelsbanken is managed without budgets, but you mentioned it in your presentation that there is some planning done at branch level and that some type of planning exist in the support units. What is the role of this planning in comparison to traditional planning? What is the difference?

**Lennart Francke:** The important thing about the planning in our bank branches and in the support units is, that they write down what they do, what they plan to do and how they divide the work between different members of staff. But it is not part of the planning process to crunch numbers and come up with absolute numeric targets.

I am myself in charge of core capital management of the group and I have to come up with some picture on how our capital base will develop the forthcoming one or two years. The important thing to watch is, that we have sufficient capital and that we are not constantly over-capitalized – we are a bit overcapitalized right now – and these are numbers that I really have to crunch. That means, I need to have some kind of forecast as to results, business volume growth, the likelihood for acquisitions etc. That is not a planning process but a forecasting activity, and I keep it more or less to myself and the CEO.

The other thing is, when we are making investments, surely we are calculating whether the investment will be profitable. So we all know, that you then need to make a forecast on revenue and cost impact.

Sometimes I get the question: „How can you guarantee that there is no „subversive budgeting“ going on somewhere in the organization?“”. The sure answer to that question is, that I am fairly sure that there is budgeting going on in various parts of the organization – just because if you really put trust in your local branch managers, you will have to appreciate that some of them do believe that they are going to produce the best results if they do this. So some of them set absolute sales targets and have a vigorous planning process for their respective branch offices. I don’t like that and I don’t think it is a good idea, but if they think it is, it is also their own responsibility and we should not interfere in their leadership process as long as they are doing well. But even if the do so, they are not themselves committed to any regional or group-wide plan.

**Jürgen Daum:** Mr. Buess, What are typically the main challenges in target setting, planning & forecasting? What do you recommend to other CFOs how to tackle them?

**Thomas Buess:** I think the major challenge in target setting and the entire process is to create a culture of trust around it. Human beings tend to set themselves goals and targets that are a little bit over-ambitious unless you link them to compensation systems. So you will probably get a very good result in target-setting, when you create a culture of trust. It is important to look at the total outcomes at the year end and not just judge whether somebody has formally achieved the targets. Judge also on how somebody did it, if he or she really exploited all the opportunities aroused during the year. We also have to hold people accountable for leveraging unexpected opportunities and to overachieve their targets in such a case.

**Reporting, Performance Measurement & Analysis – What is the challenge and what are possible solutions?**

**Jürgen Daum:** The next topic I would like to discuss is reporting. What is best practice in management reporting
today? How can we make sure to include the relevant data in management reports?

**David Kappler:** In my opinion, internal reporting is really what you have to focus on as a CFO, because that is what is needed to run the company. Don’t get too hung up with what the external market expects. We need to look at our business both ways. The general problem is: there is too much data, but not enough information. How can top managers actually handle it all?

So you need to be consistent based on a clear set of definitions, you need a relevant set of data, the timing needs to be right – don’t look at data too often. If you do that, you probably end up with a „manage by exception” type approach. This requires your reporting system to focus on the areas which are going wrong, and on the absolutely critical areas for the business. Most companies have two or three businesses that drive 50 to 60% of the profit. So it is a question of getting focus on those businesses that are in the core and on what might go wrong there, and those that are in trouble.

**Lennart Francke:** I agree very much with this, in reporting you have to focus. In our case, this actually means that we put trust into all profit center leaders in our organization. We provide them with trustworthy reporting data; they do the business. They have to be able to trust that the data are not manipulated. There is always a temptation to manipulate the data and by that stressing various products or parts of the business – for whatever reason. We always try to refrain from doing that because whenever you do something like that, it tends to cost something on terms of lost trustworthiness and we don’t think we can afford that in a de-volved organization like ours. I also think that data should be integrated, it is important that reports are standardized, so that people know what is reported and can easily understand it. I think that customer profitability is an area where reporting is of increasing importance. I have to admit that this is an area, where we have been lagging behind and we are trying to improve that.

**Thomas Bues:** I think that management reporting and external reporting have to grow together and have to become more or less the same.

In fact, many companies have a long history of a big difference between the internal numbers, between the management accounts reported in management reports and between the numbers that were reported to the public. But this is changing and internal management and external financial reporting are becoming more and more aligned. I am a big advocate of making them the same, since at the end of the day you need internal transparency from a shareholder perspective, that is from an outside perspective, in order to be able to work in all internal units towards the externally communicated targets.

**Werner Brandt:** Since we are listed in New York in 1998 and had to report according to US-GAAP, we did achieve a nearly 100% harmonization of internal and external reporting. For management purposes, we may perhaps apply a slightly different view, but always on the same set of data. And if you go deeper into the organization I think it is very important that we have a common data structure and data definition based on and reinforced through a common reporting tool.

**Pay-For-Performance Incentive Schemes – Yes or No?**

**Jürgen Daum:** The next topic I would like to discuss with you is the area of incentives or pay-for-performance incentive schemes. Do we need it or not? What do you consider Best Practices in performance-based compensation?

**Thomas Bues:** We should share the company’s success with the shareholders. If the shareholders do well, the management should do well. If the shareholders don’t do well, then management should also not get anything. I even go as far as to say that it should also be a component of the payment of the regular employee.

**Werner Brandt:** My answer is definitely yes, but we should not try to treat everybody in the same way. People in a sales organization can be motivated in a completely different way than in development. So we need to have that in mind before we come up with a compensation plan for the whole group. Targets in the organization need to be differentiated and you have to try and find the best solution for the respective area and the company.

**David Kappler:** I actually like the idea of looking on performance year on year rather than against fixed budgets. It prevents sticking to inflexible budget goals, and it also stresses the alignment and link with the shareholders. The compensation on performance needs to be based on multiple variables, but still needs to be comprehensible. Otherwise people do not understand how they can improve their bonus.

And how do you handle the flip flop from year to year? Budgets are set in October/November timeframe and until the year starts much can still happen, so that you get an easy head start or very much the reverse which may not be recognised in budget-based incentive plans in the last weeks of the year.

**Jürgen Daum:** Mr. Francke, at Handelsbanken, you don’t have any individual monetary performance-based incentive scheme. Why?

**Lennart Francke:** This is part of our culture. We have a deep belief that it is important to the bank that people continuously do a good job. We are giving them a whole lot of responsibility to do just that and they should therefore be generously remunerated – and so they are. But generally speaking, we do not think that we can „motivate” them to come up with an even better performance by paying them individual performance-related bonuses. We expect that they already do their very best. Paying individual incentives could, in our believe, hurt our strong corporate culture and even add to business risks.

But if you are a manager of a branch office that performs very well, then of course you might expect that it would
be much easier for you to pursue a successful career in Handelsbanken, to be trusted with a larger branch office, to become an area manager or, eventually, to become the head of a regional bank. Our form of incentive system is never to recruit externally to key positions. In addition to that we have a profit sharing system that applies when the annual return on equity of our bank exceeds that of peer banks. Profit shares are allocated on an equal basis among all the employees of the bank. Everyone gets the same share – including the CEO. It is an legitimation system in a way. It means that all employees are eligible to share any excess-profit just as well as shareholders or other stakeholders are sharing profits of the bank. It is important that our people really feel motivated to be employees in Handelsbanken.

Do we need a different focus on intangibles for value and growth creation?

Jürgen Daum: The largest parts of the real corporate assets that the capital markets value are in many companies today intangible assets that are not reported in the balance sheet (except in form of acquired goodwill). The new IFRS rules try to tackle this issue, at least partly, through the new way of handling goodwill (no regular amortization but annual impairment test). Is this something that we have to address in the performance management process and if yes, how?

Thomas Buess: Just changing the accounting principles will not necessarily solve the problem. At the end of the day it is not the accounting principles that create the share price (and thus the market value) but economic reality. And that is why the entire discussion about amortizing goodwill or not is irrelevant. The relevant thing is the market capitalization that is based on how the financial markets value your business. The market has a perception about how you do. So the only thing what you can do is to perform. You have to deliver on a consistent basis and then you will get the credibility of the market. The market will make an assessment about the assets that you have. It values your brand, even though this value may not appear on your balance sheet.

Werner Brandt: For us it is a serious topic, since we as SAP have total assets of 7.6 billion and a market capitalization of more than 40 billion Euros – and that is a huge gap. I fully agree, you cannot solve it with accounting and it does not help much if you try to close this gap via the capitalization of specific intangibles. Instead you need to develop a concept that helps you to explain and to manage the gap between total assets and market capitalization – and with all the consequences. And I don’t think that this is limited to our brand value. We have other very important assets such as our employees, the customer base, and we should really try to value these assets or to define some measurements that help us to manage this „gap“ and to create value added from it. How is it then treated accounting-wise is a different story. My view is: Do not limit it to only one aspect or type of intangibles. In order to close the accounting gap, you have to look on all intangible assets a company has.

David Kappler: At the moment still many people believe that actual financial results represent business performance. But in the end it’s the share price performance represented in the development of the market value of the company, which reflects real business performance. And that includes intangibles. So a financial scorecard ought to be flexible in order to support real business performance management and that means that it has to look at the intangibles as well as on the performance traditionally accountants look at. I am very much in favor of conceiving a new and „real“ performance measurement system that can help to measure performance of intangibles and thus also help to value them.

Lennart Francke: Here is the cynical view from an old credit officer: There are only two items in external accounting – one is the nominal value of financial assets and liabilities and the second is the cash flow. And therefore I am not totally sure that the new IAS/IFRS rules that now come into play will clarify very much. I am not convinced when it comes to the chase for fair value of financial assets and liabilities. But we will see the result of all this in due time.

Vision for finance: What will be the future role of the CFO? Where is the function heading to?

Jürgen Daum: How do you think will the finance function look like in ten years? Will we still have CFOs as we have today?

Werner Brandt: I don’t think you can answer this question without looking back. The CFO’s role has changed over the last ten years and will also change over the next ten years. So it is an ongoing change. I am sure we will operate much more with Shared Services, putting all transactional processes into one location, or you outsource it, in order to concentrate more on the role of a business partner and to try to better support the business by providing the right information on market penetration, on business potential, on business performance and so on. Risk Management is also a very important factor for all companies. The CFO Function will exist also in ten years from now, I am sure.

David Kappler: I agree with a lot of that. What I see what will be different in the future from today is the range of responsibility. There a two fundamental demands for the CFO of the future. One is about reputation of the business: it’s about risk management, it’s about open accounting policies. It’s also about initiation, perhaps self-initiation in terms of Corporate Governance. That is a big area that CFOs will have to focus on. The other one is about decision-making support. I think we will see purely transactional financial processes disappearing out of the CFO...
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