Traditional Budgeting vs. Beyond Budgeting: Three Core Differences

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An interesting counterpoint to signs of economic recovery is the problem the U.S. Government is having as it tries to pass a new budget.

Even though the Federal budget debate is being acted out in the political arena, it illuminates the importance of budgeting processes in addressing needs and determining outcomes. It also serves as a reminder that companies can benefit from looking at how their own internal budgeting processes impact liquidity, credit, and shareholder value.

This article looks at the differences between two general approaches to the budgeting process, one – for the purposes of this article – we'll call Traditional Budgeting, and the other being Beyond Budgeting.

Traditional Budgeting we all know well: the top-down, command and control approach with authority firmly seated at the executive level. The Beyond Budgeting approach is a significant shift: executives empower and coach decentralized teams that are more closely connected to customers and to changes in the marketplace.

Now just may be the time to get beyond the classic fixes – cost cutting, increasing sales quotas, and investing in better software – for regaining profitability and growth. At best, these are Band-Aid solutions. At worst, focusing on them may leave the core management approach issue unaddressed and limit future gains.

The following sections compare Traditional Budgeting with Beyond Budgeting in three key areas.

1. Management style: command and control vs. empower and coach
The two management approaches are fundamentally different in how they position executive leadership.

Traditional Budgeting: command and control
Traditional Budgeting is grounded in command and control. The core approach: the executive team is best equipped to translate objectives into operational goals, plans, and initiatives for all business units and employees.

An underlying assumption can be that managers and employees do not have the skill sets, motivation, or honesty to act in a way that supports company objectives. Skepticism around how much employees can be trusted extends to how much information is shared and when, both factors tightly controlled at the C-level and relaxed only on an "as needed" basis.

A command and control approach is too often driven by an end-over-means focus on short-term profits that can foster questionable and even dishonest behaviors. Occurrences like these drove

Sarbanes-Oxley reforms nearly a decade ago, but the new regulations did not prevent disastrous financial outcomes during the most recent financial crisis.

Beyond Budgeting: empower and coach

By contrast, Beyond Budgeting is grounded in empowering and coaching. The core approach: results improve when management relinquishes control and allows business units and teams to leverage customer proximity and act autonomously on goals, plans, and initiatives.

The executive role shifts toward a coaching role characterized by entrusting business units and teams with executing on high-level goals – and then challenging and supporting them as needed.

Managers and employees are seen as trustworthy and entirely capable of assuming responsibility for actions and outcomes. They see their work from a holistic, partner-based vantage point, and their efforts are characterized by high levels of collaboration and cooperation.

Executive management supports high levels of access to needed information as this transparency is essential to better and quicker decision making, as well as enhanced accountability.

The empower and coach approach emphasizes the means or process of reaching goals. The core belief is that business units and teams will act in more responsible and accountable ways to support company growth and success.

2. Seat of authority: centralized bureaucracy vs. decentralized teams

Applying an empower and coach model drives the seat of authority out to the business units and teams most in contact with internal and external customers.

Traditional Budgeting: centralized bureaucracy

Under a Traditional Budgeting approach, authority is centralized at the top of a management bureaucracy. Objectives, plans, and initiatives are handed down through multiple levels of the organization, and business units and teams are micromanaged to deliver results aligned with these mandates.

This centralized management structure is a hungry beast that consumes enormous amounts of dollars, resources, and time just to support it. And the layers of management structure insulate executives from fast-paced market developments that can lead to missed opportunities and business going to competitors.

Beyond Budgeting: decentralized teams

With a Beyond Budgeting approach, power is delegated to decentralized business units and teams that are now empowered to act autonomously. Because these groups are closer to customers and engaged with them on a daily basis, they are more aware of shifts in customer needs and able to respond to these shifts more effectively and more quickly.

The Beyond Budgeting approach is a change in where decisions are made rather than a change in the structure of the organization itself. Charged with innovating and experimenting based on more intimate day-to-day customer interactions, front-line groups are empowered to obtain the resources they need, as well as the freedom to act as they see fit.

The result: decentralized, front-line groups deliver better products and services more quickly. Satisfied customers are more likely to turn into loyal advocates and long-term champions.

3. Performance measurement: fixed targets vs. relative targets
With Beyond Budgeting, traditional fixed targets are replaced by relative comparisons to peers, benchmarks, and best practices.

> **Traditional Budgeting: fixed targets**
> Under a Traditional Budgeting approach, executive management sets fixed targets and assigns them to the appropriate business unit or individual in a silo-like or standalone manner. Executives see fixed stretch targets – in budgets, service level agreements, incentives, and other key performance indicators – as the best way to predict and manage to desired results.
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> But unforeseen shifts in the economy, new competitor offerings, or other constantly changing market conditions can result in significant plan-to-actual variances. When this happens, the focus on end-over-means, short-term results can set the stage for questionable management and accounting practices.
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> **Beyond Budgeting: relative targets**
> A Beyond Budgeting approach foregoes fixed targets in favor of relative targets. Contrasted with comparing business unit and individual performance to fixed budgets, service level agreements, and incentives, Beyond Budgeting compares team performance to dynamic and more relevant performance indicators like peer performance, benchmarks, and best practices.
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> The goal is not to meet or exceed rigid stretch targets, but rather to achieve success by cooperating as a team to continuously improve relative performance. Evaluation criteria are cooperatively developed using comparative, weighted metrics that lead to incentives based on these relative goals.

While both approaches seek improved performance and shareholder value, the paths to achievement are very different. Beyond Budgeting and its shift of authority to front-line business units and teams results in quicker and more agile responses to customer needs. Employees gain motivation and pride as they experience greater ownership of strategizing, planning, and executing on product and service delivery. The bottom line: companies applying the principles of Beyond Budgeting see continuous improvement in performance and shareholder value.

Perhaps this is a time for executives to take a deep breath and consider a business paradox: less bureaucratic control can yield better long-term results.

About CFO Edge
CFO Edge is a leading Southern California provider of interim CFO services. We are a group of experienced chief financial officers who engage with CEOs and CFOs on demand to address strategic planning, business management, and day-to-day financial operations challenges. Our seasoned professionals deliver services as interim CFOs, part-time CFOs, project-based CFOs, recruitment-to-permanent CFOs and interim-to-permanent CFOs. At CFO Edge, we're passionate about helping our clients create, grow and sustain value. For more information, visit www.cfoedge.com or call 626.683.8840.

