SVENSKA HANDELSBANKEN: ACCOMPLISHING RADICAL DECENTRALIZATION THROUGH "BEYOND BUDGETING" [1]

by

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[1] *This case was written with the assistance of Steve Player and the Beyond Budgeting Round Table utilizing their source research documents. We would also like to thank Ken Mark for his research assistance and the Social Sciences and Humanities Research Council of Canada (SSHRC) for their financial support.*

SVENSKA HANDELSBANKEN: ACCOMPLISHING RADICAL DECENTRALIZATION THROUGH BEYOND BUDGETING

As her plane was about to taxi down the runway at La Guardia Airport in New York en route to Toronto, Nancy Cartwright sat back in her seat and pondered the events of the last three days. Cartwright, Director of Financial Planning at a very large Canadian financial institution, had just attended a Beyond Budgeting Roundtable conference in New York. At the conference, Sven Grevelius, former Finance Director at Svenska Handelsbanken and others spoke about Handelsbanken's rather unique management model. Among other things, Handelsbanken did not utilize budgets in controlling its operations. Cartwright couldn't help but be impressed by the bank's financial performance and the apparent simplicity of its management model. But could such a model of control work in companies beyond Handelsbanken?

HISTORY OF HANDELSBANKEN

Svenska Handelsbanken AB (Handelsbanken) began operations in 1871 with 12 employees working in the Schinkel Palace located in the Old Town of Stockholm. Through internal growth and acquisitions, Handelsbanken transformed itself from a Stockholm-based bank to a national Swedish bank.

In the 1960s the bank's objective was to be the largest bank in Scandinavia based on the strategy of increasing business volume. It operated within a traditional multi-divisional model. Senior managers created strategy, made the key decisions, and allocated resources. Middle managers communicated senior management's directives to the front line who then implemented them. Budgets were used as the primary tool to plan, coordinate, and manage capital.

Costs rose significantly during this period due to a growing bureaucracy, the handling of a large number of small accounts, and increasing marketing expenditures. Moreover, the bank was considered to be unresponsive to its customers. The bank experienced a large financial loss in the late 1960s. Additionally, Handelsbanken was in trouble with the regulatory authorities.

Dr. Jan Wallander was hired as the CEO in 1970 to help the bank get through this crisis. He changed the Bank's management policies radically. These policies have continued to provide the foundation for the modern Svenska Handelsbanken and the three CEOs who have followed Wallander.

In the ensuing years Handelsbanken has grown consistent with its aim to cover the entire spectrum of banking. This growth has been largely achieved organically rather than by takeovers. In 2002 Handelsbanken had 560 branches and 10,000 employees across the four Nordic countries and twenty offices in other major world centers. The bank offered a full range of financial services, supported by five product-based subsidiaries, including mortgage, finance, life insurance, mutual funds, and telephone and internet banking.

Handelsbanken's Success Story

With Wallander as CEO, Handelsbanken was a perennial top performer from virtually any perspective (see Exhibit 1 for financial information). Some of the bank's key accomplishments included:

- Ranked by Moody's as among the 10 best rated listed banks in Europe.
- The only Swedish bank not asking for government support during the financial banking crisis in the early 1990s.
- Voted the 2001 Bank of the Year by Privata Affärer, a Swedish periodical for private finance.
- World class performance on two key banking ratios (see Exhibit 2). Handelsbanken's cost/income and cost/assets ratios — two closely watched measures for banks — were the best among large listed European banks. To put their cost performance into perspective, Handelsbanken would have to triple its costs in order to equal Deustche Bank in terms of the costs/total assets ratio.
- According to a survey by Svenskt Kvalitetsindex, Handelsbanken had the greatest proportion of satisfied customers in Sweden among large Swedish banks every year but one (see Exhibit 3 for a comparison of Handelsbanken with the sector average).
- The compound rate of return for Handelsbanken's investors was 20.3% during the 1982 to 2002 period. This was in contrast to the 16.8% return by SE-Banken (the only competitor whose shares still trade over the same twenty year period). Exhibit 4 illustrates Handelsbanken's share price performance.
- Employee turnover was the lowest in the sector. University graduates rated Handelsbanken as their first choice among financial services companies.

Wallander's Management Principles

Based on the lessons of the 1960s, growth was never the primary focus. Instead, Wallander established the overall goal to be the most profitable of the Nordic banks as measured on the basis of return on equity. This goal was to be achieved through radical decentralization, better customer service, and lower costs than competitors. With respect to costs, Wallander stressed that that the quality of the lender should never be neglected in favor of higher volumes. Wallander developed a number of key management principles and policies to support these objectives. These were codified in a publication called *Our Way* which became compulsory reading for all new employees. This publication has undergone only marginal revision over the years by Wallander's successors.

Customer (not Product) Focus

Wallander abandoned the establishment of product sales targets along with the central marketing department. He believed that while the product-led approach and its supporting information system informed managers about product sales, product profitability, and the market share of individual products, it provided them with little information on customers, their changing requirements, and, most importantly, their profitability. As former president Arne Mårtensson stressed:

> The selection of the right customers determines the productivity and profitability of the branch. Making a telephone call now and then, or a spontaneous visit, or sending a birthday flower or a personal letter to mark a special occasion are all ways of keeping in contact with the customer. You do not usually lose a customer because of high prices. You lose them because they are not valued. When we study branches with low cost-to-income ratios it becomes apparent that they seek out customers that don't require lots of time expended on them. This emphasis on selecting each individual customer is also the reason why we do not offer particularly advantageous terms for special groups such as students, retired people or shareholders. We should offer good customers good terms and conditions, and it is the branch that decides who is a good customer.

Structure

Wallander adopted a radical system of decentralization which was based on two key tenets. First, people at the branch were considered to be best placed to make operating decisions (e.g., granting a loan, setting prices, or offering a discount) because they knew the customer best. On average, half of branch staff had lending authority, permitting customers to receive answers very quickly. The few decisions that could not be made at the front line were pushed up the hierarchy, and an answer was normally available within twenty-four hours. For example, in 2001 Handelsbanken approved approximately 400,000 credit decisions. Of these, 390,000 were made at the branches. Another 10,000 were recommended by the branches but had to be approved by the region because the amounts exceeded the branch managers' limits. Finally, another 800 were recommended by lower levels but had to be approved by the management executive board.[2]

[2] J. Wallander, *Decentralisation—Why and How to Make it Work: The Handelsbanken Way*. English translation by M. Knight (Stockholm: SNS Forlag, 2003), p.51.

With respect to marketing, apart from the few occasions where a new product common to all branches was being launched, there was no centralized advertising. Instead, marketing decisions were made at the branch level and the costs were charged to the branch.

Branch managers' authority on spending became virtually complete in the early 1990s when it was increased to include staffing level and salary decisions along with decisions on property lease costs. The branch manager was considered to be best placed to determine the optimal level of staff if, for example, customer demand fell or if new IT systems resulted in fewer staff being required. This change produced a pleasant surprise: far from increasing staff numbers as many people expected, the number of staff decreased as managers took a more realistic view of future performance.

Notwithstanding, some activities and decisions were made centrally. Investment funds were centrally produced. Currency trading was also centralized, as was the large capital amounts invested in various funds. In addition, the managing level of the bank posted interest rates and charges, although branch offices were entitled to make departures from these published rates for good customers. For reasons of efficiency and standardization, branch managers had low levels of authority on investments such as furniture, office and computer equipment. The offices were also committed to using the Bank's computer system and data center in Stockholm.

Wallander's second tenet was based on the belief that success with decentralization depended upon having capable and committed employees and this required that they become more "involved." This occurred in such ways as being "seen," being able to identify with a group, obtaining increased responsibility, having the authority to implement one's ideas, and seeing how one's work affects results. The use of decentralized branches that were very small and independent from one another was considered to facilitate such involvement.

As a consequence of these two tenets there were only three management layers in the firm's structure: branch managers (560), regional managers (11), and the management board. The size of the average branch was 10 employees. Regions and branches were established as profit centers. Branch managers reported directly to the regional manager. The former had responsibility for financial results and could take whatever actions deemed appropriate to improve them. Profit center managers were held accountable for only those items and costs that they influenced, directly or indirectly.

<u>Philosophy</u>

During Wallander's tenure a number of principles comprising the management philosophy emerged. First, Wallander's vision was that beating the competition should be an integral part of the performance management process at Handelsbanken. Towards this end, he instituted a relative performance measurement system, whereby branches, regions and the overall bank's performance would be compared with relevant others. The basic idea here was that the more people tried, the higher the mean increased, and thus it became a struggle with no end.

Second, resisting the temptation to interfere was considered crucial to prevent centralization from returning through the back door. For example, issuing memos, instructions, and directives were a symptom of such centralizing forces and had to be resisted. To emphasize to employees that management was serious about not interfering, a policy was established to eliminate head office directives or reports. As Wallander noted, "No one missed them. Many central staff members were quite shocked when life carried on as normal." Higher level managers were expected to set the example and use a coaching style of management in support of the decentralized structure. If a senior manager knew that a poor decision was being made, the expectation was that they would only send an e-mail or make a brief phone call to inquire about the issue. The final decision ultimately remained with the local manager. The discipline of not interfering was considered to be one of the toughest parts of operating within a decentralized framework. As Mårtensson reflected, "You have to learn to keep your hands down by your side even when you could intervene and help solve a problem."

Third, employees were held strictly accountable for their performance. This emphasis on accountability became well entrenched within the organization due to what senior management called their "excellent accounting system."

Fourth, the branch was considered to be the bank. Responsibility for the individual customers existed with the branch closest to the customer. Everybody else in the organization was considered to be servants of branch offices.

The final value was thrift. Building shareholder value through customer satisfaction delivered by happy, autonomous employees was the essence of Handelsbanken's management philosophy. Any expenditure not related to this linkage was to be avoided.

Budgeting — An Unnecessary Evil[3]

Wallander issued the directive in 1970 that the company would no longer engage in any formal strategic planning process, nor prepare and approve annual plans or budgets (short or long term). With respect to strategy, he believed that strategic

[3] *This section and the quotations within it are based on the following article: Jan Wallander, "Budgeting—an unnecessary evil,"* Scandinavian Journal of Management *15 (1999), 405-421.*

planning was only 10 per cent whereas execution was 90 per cent and thus he focused on the latter. His views about budgets were influenced by his previous experience as a professional economist involved in macro economic forecasting and his employment at a competitor bank called Sundsvallsbanken which operated without budgets. These views were reinforced by his experience as a non-executive director at the Swedish electronics company L.M. Ericsson during his tenure as CEO at Handelsbanken.

In Wallander's view, the usefulness of budgets depended on the validity of the assumptions underlying their construction which fell into two basic types: "the same weather tomorrow as today" and "different weather tomorrow." Under the former, a budget was prepared under the assumption that management's current knowledge was an appropriate basis on which to prepare the budget. In effect, you were telling people to work as they were doing, and that perhaps they should attempt to increase sales and be a little more efficient. However, he believed that you did not need to have an intricate budgeting system to accomplish this.

On the other hand, if you could forecast that a very different situation was going to exist, resulting in very different trends that required major changes to operations, then budgeting would prove to be enormously useful if the forecast turned out to be accurate. However, Wallander's previous experience suggested that such an outcome was rare. "How can you foresee something for which you have no experience?" Moreover, Wallander believed that psychologically, it is difficult for humans to perceive that something new is on its way even when, in hindsight, it is difficult to comprehend how one could have missed the signs.

> We all have a built-in psychological filter that prevents us from realizing what is really happening. Unpleasant facts are filtered away. We will say of some revolutionary technical innovation that it will be of no interest on the market, will be of only minor importance, will meet with unsurpassable technical obstacles, etc…. We will say to ourselves that the small signs we have observed that something new is developing are only ripples on the surface and everything will certainly return to normal…. To believe in something that deviates from common opinion is not only difficult but also risky. If the whole flock of sheep is running in one direction it is very trying to be the single little sheep that runs in quite another direction.

Wallander gave up trying to predict discontinuous change as he considered this to be beyond human capability. Instead, the crucial task was to be able to adjust to the situation quickly. The use of a fixed budget was considered to be antithetical to this requirement. Thus his dictum:

> A budget will thus either prove roughly right, and then it will be trite, or it will be disastrously wrong, in which case it will be dangerous. My conclusion is thus: Scrap it!

Managing Without Budgets

Planning

Consistent with Handelsbanken's philosophy that branch managers were to run their own business, planning was devolved to branch managers. Emphasis was placed on each branch manager preparing an operational plan. Following discussions with branch staff, these plans considered the customers they should attempt to acquire (and by implication those that they should eliminate), the products these customers might want, prices (including any discounts), and individual responsibilities for executing the plan. Such planning took place within the overall directive that costs had to be around 40 per cent of income and that *each* member of staff had to contribute to profit.

Magnus Lindskog was the manager of a medium-sized branch in Kista on the outskirts of Stockholm (Sweden's Silicon Valley), where one of the branch's customers, Ericsson, was the largest employer. He had twenty-five staff and was responsible for the profitability of the branch. He explained how the process worked:

> We decide which of the bank's products to offer and at what price. Each year I prepare an informal work program—a rough action plan that sets the direction for the forthcoming period. I might discuss this with my regional manager, but it is not submitted to anyone as a formal action plan. It is merely a guide and is subject to constant review depending on the threats and opportunities that appear through the year. My staff is fully involved in the preparation of the work program, and also has its own informal action plans that are reviewed every six weeks.

Rolling cash forecasts were prepared each quarter, although they were given low visibility. They were only seen by the CEO and the vice president of finance. These forecasts informed the CEO of the likely quarterly results. They also provided an early signal that cash flows were starting to improve or decline, and thus helped to plan investment and liquidity requirements. The forecasts were prepared by the finance department and were based on current trends and brief telephone calls with key people. The amount of resources spent in preparing these forecasts over the course of a year was approximately one quarter of one person.

Coordination

The objective of providing customers with a timely, seamless solution to their requests was to be achieved by support units assisting the local bank to serve the customer. The modularization of products and the bank's IT systems facilitated this process. Sven Grevelius provided the following example:

> The new life assurance policy introduced in 1997 can include an old-age pension, a family pension, and accident and sickness insurance, depending on the needs of the customer. This policy can be taken out in any branch, tailored to customer needs, prepared on site, and presented to the customer before he or she leaves. In other words, there is no further processing; the policy is valid and all the work is completed before the customer leaves the branch.

In addition, the discipline of the external market place was instilled in support services (e.g., legal, financial, human resources, IT development and operations) to create downward pressure on costs and increased responsiveness. Whenever possible, all central costs were allocated to the profit centers based on a standard price on the basis of actual usage (e.g., per hour of legal services utilized or the number of mortgages or loans processed). If transaction charging was not feasible, profit centers would be charged on some other agreed-upon basis. No internal markup (profit) was included in the price. The idea was for the service department to show a profit of zero at the end of the period. Corporate (head office) absorbed any over- or under-allocated amounts provided they were less than 10 per cent.

Each year a planning committee headed by the CFO brought buyers of the services (branches and regions) and representatives of the sellers (support services) together for some tough negotiations which resulted in "service agreements" regarding the price, type, amount, and level of a particular service. Buyers checked the prices against similar services in the marketplace and ensured that they were receiving value for money. The buyers' attitude was: "Since we are not increasing our costs, we expect you to do the same." Regional and branch managers had every right to challenge costs and even to reject them. This process could be quite demanding. Grevelius recalled the example where the head of IT left after some buyers would not accept his price.

A further coordination mechanism consisted of the monthly meetings of regional managers, the managing director, and other managers located at head office. The purpose of these "conversations" was to inform each other and reach a consensus concerning the way current issues should be resolved or to share information on new opportunities. After each meeting, the managing director wrote a letter to all employees to communicate his personal view of issues and opportunities. Following this, each regional branch manager would send similar letters to branches within their regions.

Finally, the managing director spent at least two days per year with each region and its branches during which he would challenge the assumptions of regional and branch managers contained within their operational plans, as well as to hear about their views on the market, customers, competitors and the problems they were facing. These visits were seen as helping to reinforce a high performance culture, whereby setting "stretch" goals was willingly embraced.

<u>Information</u>

The bank relied on reporting "fast actuals" of a few simple measures reflecting their competitive situation. These measures — reported at every level of the organization — consisted of return on equity, cost-to-income ratio, profit per employee, and total profitability. Rolling averages were also reported. In addition, customer profitability for medium and large customers was reported at the branch level. Since 1990, customer satisfaction was measured on a national basis and for each region. This measure was based on dividing the official number of customer complaints received by the total number of customers. Each month all parts of the organization provided written reports to the management group regarding the previous month's performance.

In addition, head office monitored such things as transaction volumes, productivity measures, customer acquisitions, defections, and the level of customer discounts being granted by branches. If a branch was underperforming, the regional controller would be made aware and possibly a phone call to the branch would be made to enquire about the situation.

With respect to risk management, Ulf Hamrin, the group controller, was able to view branch and regional balance sheets each day. He could see the patterns of loans and investments and assess their risk exposure across the portfolio of loans.

In summarizing the bank's management information system, former president Arne Mårtensson believed that the bank replaced the budget with "an excellent accounting system" that permitted honest and frank discussions within a framework of strong accountability.

> Radical decentralization can only work with fast and open information systems that provide effective multilevel controls. We are quick to spot any changes in trends within regions and branches and this leads to searching questions being asked on the telephone. Problems are transparent; they are not hidden within the nooks and crannies of management layers and allowed to fester.

Ulf Hamrin added the following comments in regards to this point:

> Too many senior managers seem to accept that obtaining fast information is beyond their reach. These people don't know what they're missing. The problem is not lack of investment. It is caused by a poor understanding of what users require. We have spent many years fine-tuning our management information system so that every manager receives exactly what is required both for his or her own decision-making purposes and to stay in touch with the wider aspects of the organization. Speed is of the essence. Our branch managers know the cost of every proposed transaction and can see what's happening across the customer base at any time. We at head office can also monitor this information but we don't use it to undermine the authority of the local manager. These are the checks and balances that make our system work. Managers know that we know what's going on, but they equally know that they have the freedom to take decisions and fix problems without interference.

<u>Target Setting</u>

Wallander believed that people had to be involved in setting their own targets or goals. Imposing targets on others was considered to result in little or no ownership or commitment. Thus, no formalized, *ex ante* goal-setting process existed at Handelsbanken. Instead, continuous improvement was fostered by the relative performance measurement system. Regions and branches established their own targets, with full knowledge that managers in other regions were doing the same thing. Continually worrying about and anticipating the future automatically became everyone's concern. It was no longer an annual event centered on budget preparation.

<u>Performance Measurement</u>

Relative performance measurement occurred within each level at the bank. The bank compared itself to its competitors using return on equity. At the regional level, regions were compared to each other using ROE and cost to income (which was measured by dividing costs by revenues). Each year, the best region was awarded a trophy cup. At the branch level, branches were compared to other branches within the region using cost to income, profit per employee, and total profit metrics.

Wallander explained the relative performance measurement system as follows:

> We just communicate to people the average and a ranking that shows which branches are above and which are below. The system works on its own. Senior executives don't need to push people, they just advise. Managers know "what is acceptable performance"—you can't linger in the depths of the league table for long! Of course

> it also relies on high levels of trust and motivation. Our managers can do anything to improve performance. Peer pressure plays an important part in this process. No branch manager wants to let down the regional team, and as they speak to each other all the time, there is both pressure to perform and a willingness to help each other. It is this tension between internal competition and cooperative support that enables us to keep improving.

To ensure that the playing field was reasonably level for consecutive years, Handelsbanken adopted a system of handicapping. Each year, a theoretical amount of capital was allocated to regions based on the results of the past three years using the Bank of International Settlements (BIS) rules (i.e., standard lending-to-capital ratios set according to the risk profile of the investment portfolio). Based on this capital allocation, a charge was made for the required capital adjusted for the level of risk. The most successful region received the highest capital allocation, making it harder to achieve a high ranking in the following year. On the other hand, the poorest performing region received the lowest capital allocation, making it easier for it to compete in the following year. In this way, the system attempted to provide incentives to continue working hard. At the branch level, branches were debited a cost corresponding to the level of capital employed.

To avoid disputes customers were attached to a single branch and all transactions were credited to that branch. If one branch served someone else's customer (say a tourist), they would only recoup their costs: no profit would be attached to the transaction. The bank "owning" the customer would receive the profit.

<u>Rewards</u>

The bulk of employees at Handelsbanken (85 to 90 per cent) were paid straight salaries based on market considerations and their individual performance. As well, the bank contributed to a pension plan. A few employees in investment banking were eligible for bonuses in order to be comparable to competitor firms.

The bank established a performance-based profit-sharing system for its employees in 1973. Profit sharing occurred when the Handelsbanken Group had a higher after tax return on shareholders' equity (excluding extraordinary items) than the average for the Nordic banks, i.e., had a better than average result. One half of the excess amount was placed in an employee fund managed by the Oktogonen Foundation. All employees received the same amount in order to make everyone feel that they were equally responsible for the performance achieved. Disbursements from the fund could be made when the employee reached the age of sixty. An employee in the plan since its inception would have accumulated around 3 million Swedish krona (US$430,000) by 2000. By 2002, half of the funds in the Oktogonen Foundation were invested in shares of Handelsbanken, making the Foundation the bank's largest shareholder, with 10.2 per cent of the outstanding shares.

Outside observers often found it hard to understand the lack of individual financial incentives. Wallander's reply to them was as follows:

> Beating the competition or one's peers is a far more powerful weapon than financial incentives. Why do people need cash incentives to fulfill their work obligations to colleagues and customers? It is recognition of effort that is important. Managers will only strive to achieve ambitious goals if they know that their 'best efforts' will be recognized and not punished if they fail to get all the way.

BEYOND HANDELSBANKEN

As the plane began to lift towards the sky, Nancy pondered the situation. Her company was attempting to become more customer focused and to react faster to change. Deep down senior management knew that granting more decision making authority to people closer to the customer made sense. This is why her boss recommended that she attend the conference. But several troublesome issues remained:

- Her boss was a person who left nothing to chance. She knew he would be very concerned with how the bank would maintain adequate control when employees were increasingly empowered to respond to customers' needs. There was talk that the regulators within the industry would also be concerned.
- Currently, the budget performed several key roles. Not only did it provide the basis for allocating resources to departments, it was the key mechanism for planning and coordination in the bank. It also was the principal tool that senior management used to set financial goals for its top managers and the basis for a major portion of their bonuses. Senior management could earn a very significant bonus if they met their financial targets (profitability and revenue growth) for the year.
- Numerous participants at the conference noted that the culture in Scandinavia appeared to accommodate Handelsbanken's management model better than the North American culture that was centered on the individual and the value of extrinsic rewards in motivating them. Yet, she was intrigued by Grevelius' sub-title to his presentation: "Managing with human nature instead of against it."

Exhibit 1
FINANCIAL INFORMATION

Handelsbanken Group Profit and Loss Account

In accordance with Finansinspektionen´s directives.

SEK m	2001	2000	1999	1998	1997
Interest income	57,667	66,308	58,048	61,940	57,209
Interest expense	-43,141	-55,024	-46,540	-50,510	-46,040
Dividends received	309	504	245	139	150
Commission income	5,894	6,048	4,693	4,077	4,024
Commission expenses	-1,038	-770	-715	-669	-687
Net result on financial operations	1,577	3,049	969	1,242	593
Other operating income	219	343	354	616	563
Total income	**21,487**	**20,458**	**17,054**	**16,835**	**15,812**
General administrative expenses					
- Staff costs	-5,909	-5,300	-4,888	-4,579	-4,150
- Other administrative expenses	-3,346	-2,928	-3,030	-3,543	-2,926
Depreciation and write-downs in value of tangible and intangible fixed assets	-805	-753	-750	-684	-616
Total expenses	**-10,060**	**-8,981**	**-8,668**	**-8,806**	**-7,692**
Profit before loan losses	**11,427**	**11,477**	**8,386**	**8,029**	**8,120**
Loan losses incl. Change in value of repossessed property	-152	67	219	-319	-302
Participations in result of associated companies	82	32	2	2	3
Result of banking operations	**11,357**	**11,576**	**8,607**	**7,712**	**7,821**
Result of insurance operations	-149	107			
Operating profit	**11,208**	**11,683**	**8,607**	**7,712**	**7,821**
Pension settlement	306	797	603	505	532
Profit before taxes	**11,514**	**12,480**	**9,210**	**8,217**	**8,353**
Taxes	-3,202	-3,353	-2,525	-2,168	-2,326
Minority interest	-22	-22	-22	-22	-19
Profit for the year	**8,290**	**9,105**	**6,663**	**6,027**	**6,008**

Exhibit 1 continued
FINANCIAL INFORMATION

Handelsbanken Group Balance Sheet

SEK m	2001	2000	1999	1998	1997
Cash	10,614	5,258	6,285	4,054	3,025
Interest-bearing securities	128,347	88,262	93,291	107,709	65,858
Lending to credit institutions	70,857	94,677	98,859	139,823	134,472
Lending to the general public	800,068	689,106	626,206	587,405	586,824
Shares and participations	18,488	14,401	9,863	3,326	2,226
Assets in insurance operations	20,429	17,762	13,731	6,644	3,182
Tangible assets	2,466	1,758	1,859	1,778	9,329
Other assets	123,252	109,129	86,162	82,106	57,532
Total assets	**1,174,521**	**1,020,353**	**936,256**	**932,845**	**862,448**
Liabilities to credit institutions	220,126	155,414	186,503	261,146	241,436
Deposits and funding from the general public	283,692	255,350	221,483	206,524	204,747
Issued securities etc	440,981	401,489	359,540	299,378	284,051
Liabilities in insurance operations	17,535	17,276	13,649	6,541	3,135
Other liabilities	134,838	129,031	96,400	101,429	73,227
Subordinated liabilities	28,976	19,066	19,850	23,135	23,231
Total liabilities	**1,126,148**	**977,626**	**897,425**	**898,153**	**829,827**
Minority interest in shareholders´ equity	261	261	261	261	268
Shareholders' equity	48,112	42,466	38,570	34,431	32,353
Total liabilities and shareholders´ equity	**1,174,521**	**1,020,353**	**936,256**	**932,845**	**862,448**
Memorandum items					
Pledged collateral	96,557	71,968	85,007	93,782	59,437
Contingent liabilities	79,644	67,162	61,927	76,731	81,921
Pension commitments	-	-	-	-	-
Other commitments	6,426,421	4,770,643	5,713,401	6,304,560	5,452,935

Exhibit 2
HANDELSBANKEN'S KEY RATIOS VERSUS THE EUROPEAN COMPETITION

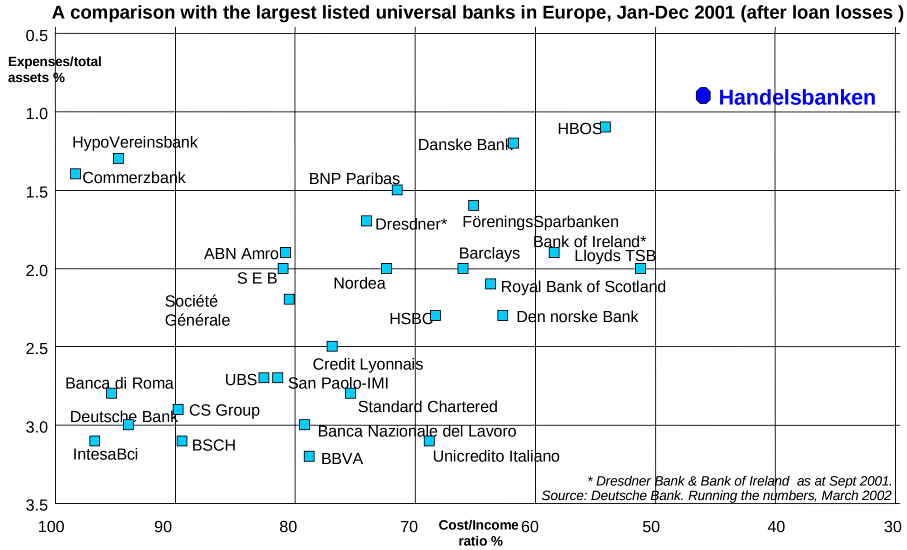
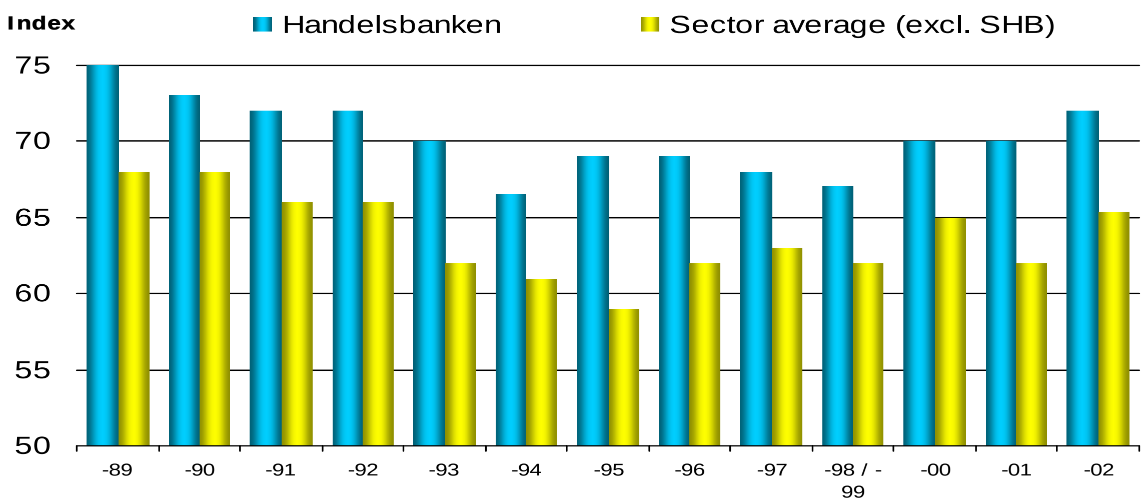


Exhibit 3
Customer Satisfaction Surveys*



* Private customers - Source: Svenskt Kvalitetsindex

Exhibit 4
Handelsbanken's Comparative Share Price Performance

SVENSKA HANDELSBANKEN:
ACCOMPLISHING RADICAL DECENTRALIZATION THROUGH "BEYOND BUDGETING"

TEACHING NOTE

CASE SYNOPSIS

This case explains how Svenska Handelsbanken AB, (Handelsbanken), under the leadership of CEO Dr. Jan Wallander, not only successfully overcame a crisis in 1970, but through a change of policies, including the elimination of formal budgets and adopting a radical system of decentralization, has grown to become one of the most successful banks in Scandinavia. The case provides a rich description of the control system that Handelsbanken uses in place of relying on budgets—a system that underlies many of the principles that the "Beyond Budgeting" movement is espousing. The decision point in the case is whether the model of control could be widely adopted outside of Sweden and Handelsbanken in particular.

TEACHING OBJECTIVES

The Handelsbanken case is considered to be the exemplar case of the "Beyond Budgeting" movement which is espoused by the Beyond Budgeting Roundtable (BBRT). It can be used to explore a new management model which is focused around fostering extreme decentralization among employees and adopting certain key performance management principles. A key aspect of this model is that traditional budgeting is considered to be dysfunctional because it impedes performance and interferes with decentralization. For this reason budgeting is to be eliminated. Other key differences include the use of relative performance measures and group profit sharing.

Second, in addition to exposing students to a new and alternative model of control and discussing its merits, the case can be used to examine the problems with traditional budgeting that have been raised on a number of fronts in recent years.

Third, we recommended teaching the Handelsbanken case with the Codman & Shurtleff case by Robert Simons (see recommended reading below). Codman is a division of Johnson & Johnson, a highly successful company that uses their budgeting system extensively for performance evaluation and management control. Through this contrast, it is possible to shed light on the key aspects of traditional control practices that may be dysfunctional. In this way students are guided to a more realistic position than simply having to decide whether budgets are "good" or "bad."

Fourth, the case provides the opportunity to discuss the underpinnings of an "excellent accounting system" for measuring the performance of highly decentralized employees.

Finally, if the instructor is using Robert Simons' "Levers of Control Model" the case can be used to connect with three of the four levers of control. This case illustrates that high performance is as much cultural as it is about formal systems. In addition, the case is connected to Simons' theme: how do you control for empowered employees?

It is important to recognize that there is too much material in this note to cover in an 80 minute session. The instructor will have to prioritize the objectives to be accomplished.

CASE USE

This case has been used very successfully a number of times in an elective Management Control Systems class for both senior undergraduates and second year MBA students. In addition, the case has been used on numerous occasions with executives. The uniqueness of the control system elicits considerable discussion (and scepticism). It is fun to teach and students seem to enjoy it very much. The key consideration in teaching this case is not to be too ambitious in the number of objectives covered and let the discussion run its course.

CASE BACKGROUND AND THEORY

The theory underlying this case was developed by Hope and Fraser of the Beyond Budgeting Roundtable (BBRT). They have developed a model of control that focuses on instilling adaptive processes and an enabling culture to facilitate the move from a "predict and control" to an "adaptive and devolved" orientation which they believe is necessary in managing contemporary organizations. Perhaps their most important contribution lies in their identification and cogent explanation of how tying rewards to the achievement of budgeted financial targets—what they call "the fixed performance contract"—undermines organizations objectives of becoming adaptive and flexible by reasserting centralized control. The authors recommend abandoning the traditional annual budgeting process and replacing it with 12 principles fostering adaptive processes and radical decentralization.

This is not the first time that the budgeting process has been criticized, but there is a big difference this time. In the past criticisms were leveled at poor practices within the budgeting tradition. Improvements could be made or problems avoided. The BBRT's message is different. Their argument against traditional budgeting follows from the requirement that firms today need to become more focused and adaptive strategically, as well as flexible and responsive in order to deal with the unpredictable, discontinuous change, hyper-competition, and increasingly fickle customers. They argue that this translates into the need for more effective strategic management and replacing the command and control orientation to one which devolves much more authority to the front line. In their view the budget re-asserts centralization through the back door and makes companies less adaptive because of the rigidity that is typically built into the budgeting process (e.g., that's a great idea but it's not in the budget). Moreover, it needlessly leads to gaming occurring so that managers can "look good" in meeting their budgetary targets. At its worst, firms make promises to the street based on the outcome of their budgeting process and this further perpetuates the rigidity and dysfunctional nature of budgets when circumstances dictate that the original budget is no longer meaningful. For these reasons the BBRT argues that the budget has got to go. It *is* an unnecessary evil.

It is too early in the life of this innovation to make an assessment of the contribution that the Beyond Budgeting model will make over time. Nevertheless, the message of the BBRT appears to be resonating with some businesses. Over a five year period they have had 60 international firms pay significant sums to become members. These dues have funded their research. The authors claim that such companies as Boots, Borealis, Ericsson, SKF, Schlumberger, and Unilever have either abandoned budgeting or are in the process of doing so. They have had numerous publications in practitioner journals for the last few years, culminating in the publication of their book entitled *Beyond Budgeting How Managers Can Break Free from the Annual Performance Trap*. Since 2002 they have been active in North America and several companies are beginning to follow BBRT principles (e.g., American Express, Wachovia, Charles Schwab, CIBC, Guardian Industries, and Southwest Airlines). This case offers a vehicle for students to begin to think more about the underlying management philosophy and to understand the principles underlying this philosophy as espoused by the BBRT.

RECOMMENDED READINGS

The first two references below can be assigned to students, whereas the others are useful for an instructor preparing to teach the case.

- Libby, T. and R.M. Lindsay, "Budgeting – The Unnecessary Evil?" *CMA Management Magazine* (March 2003). This article outlines the traditional budgeting and control model and the various problems with it.

- Libby, T. and R.M. Lindsay, "Booting the Budget: How the BBRT Envisions a World Without Budgets," *CMA Management Magazine* (April 2003). This article discusses the BBRT's new management model.

  Both of the above articles can be can be accessed at the following website:
  http://budgeting-reconsidered.com/articles.html

- Hope, J. and R. Fraser, *Beyond Budgeting: How Managers Can Break Free from the Annual Performance Trap* (Harvard Business School Publishing, 2003). This book outlines Hope and Fraser's new philosophy of management and contains several case studies illustrating the various principles that underlie the new model, including several references to Handelsbanken.

- Barrett and Fraser "Conflicting Roles in budgeting operations" *Harvard Business Review* July (August 1977). This article provides a good discussion on the conflicting roles of budgets that leads to some of the problems with using budgets.

- Simons, R., "Control in an Age of Empowerment," *Harvard Business Review* (March-April 1995). This reference is helpful to the instructor who wishes to refer to Simons' Levers of Control framework when discussing the case.

- Simons, R. (1987c). *Codman & Shurtleff, Inc. Planning and Control System*. Case Study # 9-187-081, Boston, Mass: Harvard Business School Press. For those instructors who wish to juxtapose Handelsbanken's model with Johnson & Johnson, a company that places great emphasis on budgeting.

Assignment Questions

1. What is wrong with traditional budgeting? Do you agree with Wallander's view that "A budget will thus either prove roughly right, and then it will be trite, or it will be disastrously wrong, in which case it will be dangerous."
2. What do you believe are the key control mechanisms that allow Handelsbanken to manage without the use of budgets? Has the absence of traditional budgeting controls hurt them or helped them?
3. Arne Mårtensson stated that the bank replaced the budget with "an excellent accounting system" that permitted honest and frank discussions to occur. What do we learn about what makes an excellent accounting system?
4. Why would information sharing and assistance occur among the branches given the use of performance league tables which makes branches and regions compete against one another?
5. Do you agree with Wallander's remarks regarding the importance of incentives?

   > *Beating the competition or one's peers is a far more powerful weapon than financial incentives. Why do people need cash incentives to fulfill their work obligations to colleagues and customers? It is recognition of effort that is important. Managers will only strive to achieve ambitious goals if they know that their 'best efforts' will be recognized and not punished if they fail to get all the way.*

6. Is the success of Handelsbanken's management system tied to the right match of cultural environment? Would it work in North American companies?

CLASS DISCUSSION

Q. Why do we budget? What are the roles of budgets? (5 minutes)

Budgets play many roles in organizations. These roles can be broken down into several categories including the following (see TN-1):

1. Basis for resource allocation
2. Planning: what management wants to accomplish and how, evaluating alternative courses of action, implementing strategy
3. Coordinating various organizational units
4. Communicating objectives
5. Control: (i) signals remedial action may be necessary
   (ii) guides management to make decisions in accordance with budget provisions (because they are often evaluated at least in part on their performance in meeting the budget)
6. Motivating individuals (through linking rewards to accomplishments vis à vis the budget)
7. Performance evaluation of managers

Based on this list students can see why budgets are considered to be so important to organizations and the main plank in many organizations' control systems. This is why the thought of dropping the budget would be considered to be heresy in many organizations.

The instructor may want to write down students' responses on a whiteboard or flipchart and return to them after analyzing the case to determine if Handelsbanken adopted different ways to accomplish the same objectives.

Q. What is wrong with traditional budgeting? (10 minutes)

To guide the discussion around this question, the instructor can address some of the problems with traditional budgeting systems that have been identified by the BBRT (Exhibit TN-2). These are discussed in the Libby and Lindsay articles referred to in the Recommended Readings section above. During this discussion the instructor can identify some of the conflicting roles of budgets. These conflicting role roles are summarized in exhibit TN-3. The basic point is that unless the company is operating in a very stable environment, the organization should really choose which role it wishes to focus on and use other mechanisms to achieve the other roles.

One question that works well to prompt discussion at this point is to ask students whether they agree with Wallander's analysis underpinning his decision to scrap the budget.

> A budget will thus either prove roughly right, and then it will be trite, or it will be disastrously wrong, in which it will be dangerous. My conclusion is thus: Scrap it!

The BBRT often presents Exhibit TN-4 to illustrate that predicting events is a difficult task. This Exhibit shows two products—one whose market is declining and another whose market is increasing. The dashed lines show management's forecasts which are far off the mark of what occurred. The powerful point to stress is that this occurred for a number of years.

Q. Let's deal with Nancy's concern that budgets provide organizations with control and that eliminating budgets along with increased empowerment may be a recipe for disaster? So how does Handelsbanken maintain control?

But before we do this, let's define what do we mean by "maintaining control?" (5 minutes)

Possible responses**:**

A. No surprises.
B. You can see if your people are on the right track.
C. The organizational purpose is being achieved.
D. People throughout the organization are focused on implementing the strategy.
E. People are making decisions the boss would make.
F. People are not shirking their responsibilities.
G. Learning when we go off track and why it occurred.
H. The long run is being attended to (not eating your seed corn).
I. You can see if initiatives are being taken.

J. You can see if changes in the market place are being acted upon.

Q. So how does Handelsbanken maintain control? (20 minutes)

The following is a summary list of the elements of Handelsbanken's control system and what it accomplishes in terms of the previous discussion on the roles of budgets. A longer explanation then follows.

1. **Decentralization:** customer focus, adapting to change, improvements
2. **Culture**: unite and focus everyone, direction, motivation
3. **Boundaries**: control
4. **Rolling Forecasts at head office**: planning, cash flow, coordination
5. **Informal Action Plans continuously done at local level**: implementing strategy, resource allocation, learning
6. **Resources on demand**: adapting; innovation
7. **Relative performance measures based on Key Performance Indicators (KPIs):** control, performance evaluation, and motivation, learning
8. **Customer profitability data:** learning
9. **Transfer pricing system for shared services:** resource allocation, coordination and planning/motivation
10. **Presidential visits:** motivation, learning, control
11. **Target setting:** continuous improvement
12. **Profit sharing:** equal amount to each employee if bank's ROE beats average, symbolic; motivation; sharing of learning
13. **Reinvestment of Oktogonen foundation into shares of Handelsbanken**: motivation, sharing of information on learning

<u>Detailed comments</u>

1. **Decentralization:** customer focus, adapting to change, improvements
   - The person closest to the customer is best able to make decisions that respond to customer needs in a timely fashion. By providing the bank manager with customer profitability data, the bank manager was able to weigh the cost-benefit of various alternatives (prices, discounts, products to sell) in dealing with specific customers.
   - Customers receive answers very quickly as they are dealing with the decision maker in many cases.
   - Banking is a relationship and knowledge of the overall relationship is important when dealing with customers.
   - Customers like customized solutions, not one size fits all.

2. **Culture:** unite and focus everyone, direction, motivation
   - There is a high performance climate and people are held accountable.
   - Employees are trusted to do their jobs.

- Purpose (offer better service while using fewer resources).
- Non-branch personnel expected to adopt service mentality.
- Frugal mindset.

Wallander has communicated his firm's core values through his vision of serving the customer by providing a timely, seamless solution to their requests. He has also emphasized thrift in the goal of the most profitable of Swedish commercial banks on the basis of ROE (not necessarily the largest). The success of these two statements is that they are easy to understand, and they are universal responsibilities of every employee in the organization. In two statements Wallander has managed to unite and focus every person in his organization.

3. **Boundaries:** control
   - Provides an empowered employee a governance framework within which to make decisions.
   - Memos and directives were abolished.
   - The cost/income ratio is approximately 40%.
   - There are strict rules as to who owns each client.

4. **Rolling Forecasts at head office**: planning, cash flow, coordination
   - Planning is more accurate because information is up to date.
   - Purpose: liquidity and excess cash can be invested.

5. **Informal Action Plans continuously done at local level**: implementing strategy, resource allocation, learning
   - Up to date planning for coordination purposes, as well as to improve performance. Managers know they will receive a phone call when trends are looking bad.
   - The sharing of action plans with regional managers allows learning to occur based on what the regional manager is seeing in other branches.
   - Implementing strategy.
   - Based on these plans, they are more aware of the demands for resources (e.g., staff hiring).

6. **Resources on Demand**:

   This is an important issue to focus upon because it is important to the BBRT's position. Questions such as the following at some point in the discussion are useful in directing the discussion:

   Q. Who is in the best position to determine adequate resources?
   A. The branch manager who is closest to the customer and understands the local situation best.

   Q. Wouldn't corporate be scared that the manager might spend foolishly?

A. If the branch manager spends foolishly then he will have poor ratios for cost/income, profitability, and customer profitability relative to his peers. Managers are judged by these ratios.

7. **Relative performance measures based on KPIs:** control, performance evaluation, and motivation,
   - No need to set targets.
   - Each branch manager is held accountable for KPIs.
   - Performance league table instilled competition and singled out poor performers (see Exhibit TN-5)
   - Regional managers would share lessons learned with other branches so as to improve overall regional standing (and so would branch mangers). The handicap system kept everyone hungry.

Q. Are the right performance measures being measured for a bank?

Customer satisfaction, costs to income ratio and profits per employee are all being measured. The only thing really missing is the cost to total asset ratio (which appears to be an industry standard). One can only wonder why they are not measuring this at the branch and region level.

8. **Customer profitability data:** learning, implementing strategy, resource allocation, learning
   - Allows more decisions to be decentralized.
   - Easier comparison of costs vs. benefits.
   - Learning why things cost what they do.
   - This allows true costs to be incorporated in decisions regarding products, services, and prices (especially important with shared services being large).

9. **Transfer pricing system for shared services:** resource allocation, coordination and planning/motivation
   - Up to date planning for coordination purposes, as well as to improve performance because they know they will receive a phone call when trends are looking bad).
   - Instilled internal market place for shared services (motivation; coordination).
   - Places demand for improved performance, the service contract provided for coordination (coordination in this company appears to be less onerous than in others).

Exhibit TN-6 illustrates the process.

10. **Presidential visits:** motivation, learning, control
    - Encourages action planning.
    - Encourages setting the bar high (aspirational targets); sharing knowledge.

11. **Target setting:** continuous improvement
    - Builds commitment to the targets as you have set them

- Needs to be understood in conjunction with relative performance measurement that the sky is the limit. Just making your target might not be enough in a good economy as everyone benefits from that as well.
- Leads to constant re-thinking about what targets should be.

12. **Profit sharing: equal amount to each employee if bank's ROE beats average (1/3 of excess amount that ROE beats average)**
    - Gets people to cooperate with others.
    - Employees do well when the bank does well.
    - Reinforces the culture of thrift.

13. **Reinvestment of Oktogonen foundation into shares of Handelsbanken. Action Plans continuously done at local level**:
    - Gets everyone to think and act like owners.
    - Gets people to accept the need to change more readily.

Q. At the end of the day, did the absence of a traditional control system, including the lack of budgets, hurt the company? (10 minutes)

Clearly, the performance data presented in the case indicates that Handelsbanken's performance has simply been outstanding and not due to luck. Consequently, they must be doing something right and we need to learn what it is. The point of this question is therefore to get students to make an evaluation of Handelsbanken's control system.

This should be done in connection with two points:
- What does it mean to be in control (discussed earlier)?
- Are the traditional roles played by budgets still being accomplished?

To wrap this part up, the instructor can recap the difference between the Beyond Budgeting model and the traditional budgeting model.

Exhibit TN – 7

If the instructor wishes the discussion can be tied into Simons' levers of control model. The key point to discuss here is that in addition to performance measures, belief and boundary systems also played an important role in motivating, directing and controlling behavior.

The purpose of belief systems is to obtain commitment to the grand perspective by providing a guiding sense of values underlying people's decisions and actions, along with a vision of what the organization hopes to achieve, i.e., its vision. Boundaries, on the other hand, allow senior management to retain control by specifying the boundaries or context in which lower level management decision-making is to take place.

Exhibit TN – 8

Q. Arne Mårtensson stated that the bank replaced the budget with "an excellent accounting system" that permitted honest and frank discussions to occur. What do we learn about what makes an excellent accounting system? (10 minutes)

The case provides considerable detail about key aspects underlying the success of their accounting system.

- Timely reporting of information
- Performance reports only measure what people can *influence* (fair)
  - otherwise difficult to become involved
- Information reported reflects critical performance variables which are linked to Handelsbanken's strategy (goal congruence)
  - customer acquisitions, defections, customer profitability; cost/income

- Reporting of trends (highlight impending problems)

- Charge people for services that they utilize

- Information has to report "the truth" in order to be accepted by people
  - openness and transparency of data
  - relative performance data does not allow you to hide behind each nook and cranny
  - no arbitrary allocations

  The key to instilling accountability was for the performance indicators to be accepted and trusted by employees by being consistent, reliable, and quickly and easily accessible. In this way the figures would speak for themselves and there would be no scope for sweet-talking away bad results.

See Exhibit TN-9 and 10 for a summary of the discussion.

Q. Why would information sharing and assistance occur given the use of performance league tables? (5 minutes)

- Observers struggle to understand how branches both compete and cooperate with each other at the same time. One of the secrets was that while Handelsbanken managers strove to be the best at achieving low costs and high profits, they *did not compete for customers*. Each customer belonged to a specific branch, and all transactions (no matter where they took place) were routed back to that branch's profit and loss account.

- The possible motivation not to share information is overcome by the belief system that views one another as support systems in serving the customer.

- There is no reward for being at the top except pride which was delivered through peer recognition and praise.

- Bigger competition was among regions.

- The profit sharing bonus, which is based on the results of the entire company, gives an incentive to cooperate.

Q. Let's move to the issue of incentives. Do you agree with Wallander's quote in the case? (10 minutes)

The quotation is reproduced in Exhibit TN-11

A lively discussion will no doubt ensue. Many students will find this discussion troubling as they take it for granted that external rewards are necessary to motivate high performance. At this point it is enough to leave some doubt that high powered reward systems are necessary.

A helpful reading which supports Handelsbanken's position on this matter is by Jeffrey Pfeffer, *The Human Equation*, 1998, Ch. 7. The takeaway points are given on Exhibit TN-12.

Q. Is the success of Handelsbanken's management system tied to the right match of cultural environment? For example, will it work in North American companies? (10 minutes)

OPTIONAL

This question is getting at the issue of whether Handelsbanken's model is transportable to other cultures and companies. Among others, two main points can be drawn out in the discussion which is sufficient to make students realize that this model may be transportable to other companies.

- Handelsbanken's executives believe that their model is based on managing with human nature rather than against it: people like to be involved and have challenging work. Robert Simons in his textbook entitled *Performance Measurement and Control Systems for Implementing Strategy* (Prentice Hall, 2000) discusses this point at length and shows how *organizational blocks* prevent people from following their innate "programming" and becoming cynical (see TN-13 and 14). In some ways this case may be seen as a form of human emancipation.

- There are many successes in North America with employee empowerment and lack of individual rewards. Jeffrey Pfeffer discusses these at length in his book entitled *The Human Equation*.

It is also worth emphasizing that since 2002 the BBRT has been promoting their message to North American companies. As of 2006, the BBRT claims that Southwest Airlines, Guardian Industries, American Express, Wachovia, Charles Schwab, and CIBC are following precepts of their model or are making concentrated efforts to move in that direction.

Wrap Up

A good way of concluding this case and setting the scene for a discussion of the Codman & Shurtleff case immediately following Handelsbanken (highly recommended) is to simply conclude with outlining the fact that a controversy exists in the literature concerning the virtues of budgeting. This debate is nicely illustrated by the opposing quotations contained in Exhibit TN-15 and 16. The instructor can let students know that the Beyond Budgeting movement is largely European, although the BBRT is now in North America, having held its first conference in March 2002.

Exhibits

The roles budgets play

1. ***resource allocation***
2. ***planning*** what management wants to accomplish and how; evaluating alternative courses of action, implementing strategy
3. ***coordinating*** various organizational units
4. ***communicating*** objectives
5. ***control*** signals remedial action may be necessary
6. ***motivating*** individuals (through linking rewards to accomplishments vis a vis budget)
7. ***performance evaluation*** of managers

Exhibit TN-1

Problems with traditional budgeting

- Budgets as a fixed performance contract lead to games being played
- Changes in environment can render a fixed budget useless and even act as a constraint against adaptiveness (If it's not in the budget …)
- Budgets, as financial representations of operational details, are not explicitly linked to strategy implementation; thereby, people at lower levels don't know how their work fits in with achieving strategy
- Follows hierarchical rather than process view
- Budgeting is expensive: 4 to 5 months to complete; occupies 20 – 30% of senior executives' time
- Conflicting roles of budgets
- Undermines empowerment because it reaffirms centralized control

Exhibit TN-2

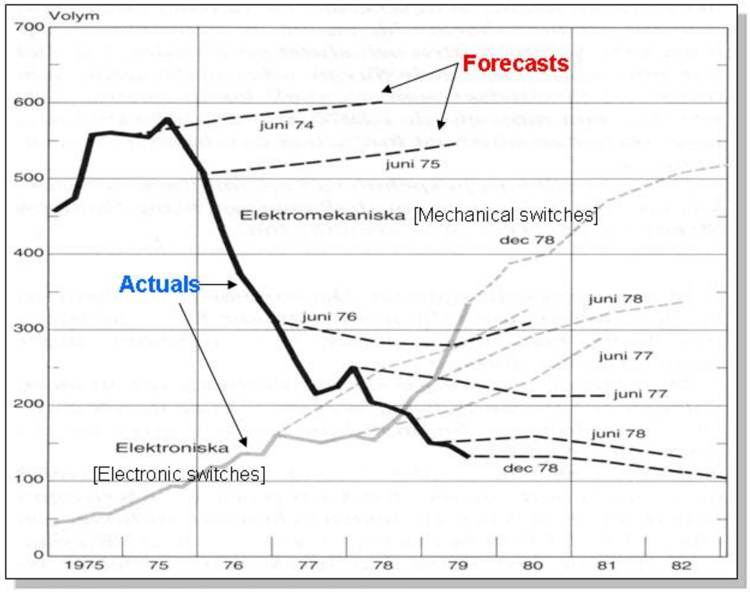
Conflicting roles of budgets

– motivation: challenging but attainable targets, commitment (great deal of psychological evidence)
- Planning and coordination: most realistic
- Evaluation: what should performance be given we know the values of key contingencies?
  - But does this mean we change the budget after the fact
  - Isn't this subjective?

Surprisingly little advice in the literature or textbooks on HOW to deal with these conflicts!

Exhibit TN-3

"Predict and control" doesn't work



Source: Jan Wallander, Budgeten – ett onödigt ont, 1994, p24

Exhibit TN-4

Performance league tables

Bank to banks

(R

1.	Bank D
2.	Bank J
3.	Bank I
4.	Bank B
5.	Bank E
6.	Bank F
7.	Bank C
8.	Bank H
9.	Bank G
10.	Bank A

Region to regions

(RoE)

1.	Region D
2.	Region J
3.	Region I
4.	Region B
5.	Region E
6.	Region F
7.	Region C
8.	Region H
9.	Region G
10.	Region A

Branch to branches

(Cost/Income etc.)

1.	Branch D	28%
2.	Branch J	32%
3.	Branch I	37%
4.	Branch B	39%
5.	Branch E	41%
6.	Branch F	45%
7.	Branch C	54%
8.	Branch H	65%
9.	Branch G	72%
10.	Branch A	87%

Exhibit TN-5

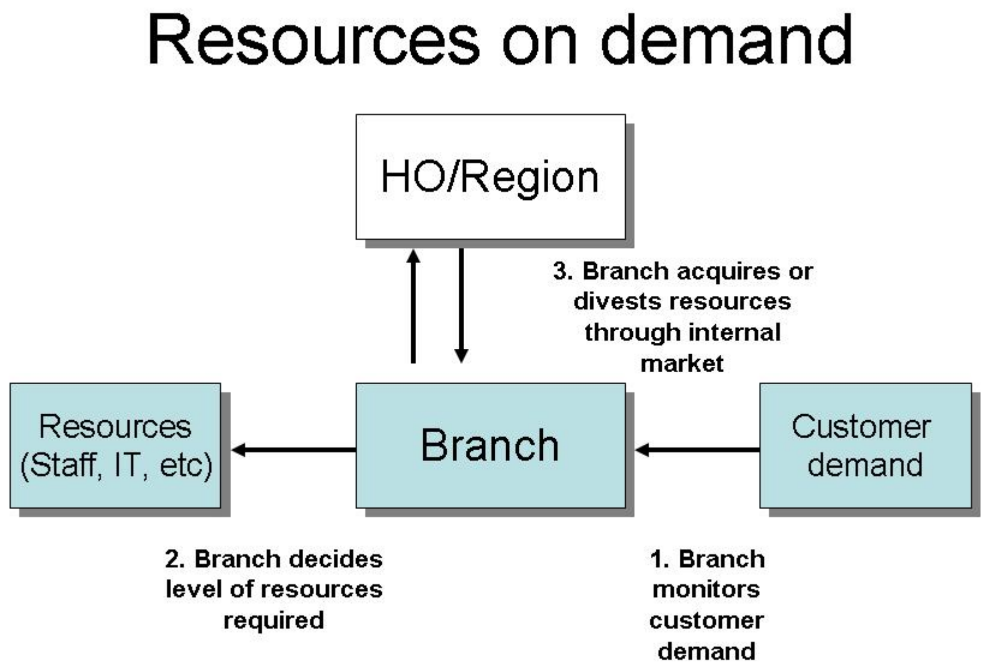

Resources on demand
HO/Region
3. Branch acquires or divests resources through internal market
Resources (Staff, IT, etc)
Branch
Customer demand
2. Branch decides level of resources required
1. Branch monitors customer demand

Exhibit TN-6

Traditional vs. Beyond Budgeting

Command & Control	Sense and Respond
1. Targets: Negotiate absolute targets	1. Targets: Set aspirational relative targets (trends, benchmarks)
2. Planning: top-down annual event	2. Planning: a continuous and inclusive approach
3. Resources: allocate in advance	3. Resources: available as required
4. Coordination: annual planning	4. Coordination: dynamic coordination according to prevailing demand
5. Controlling performance: annual financial budget	5. Controlling performance: multi-level, multiple, relative performance measures

Exhibit TN-7

Levers of Control

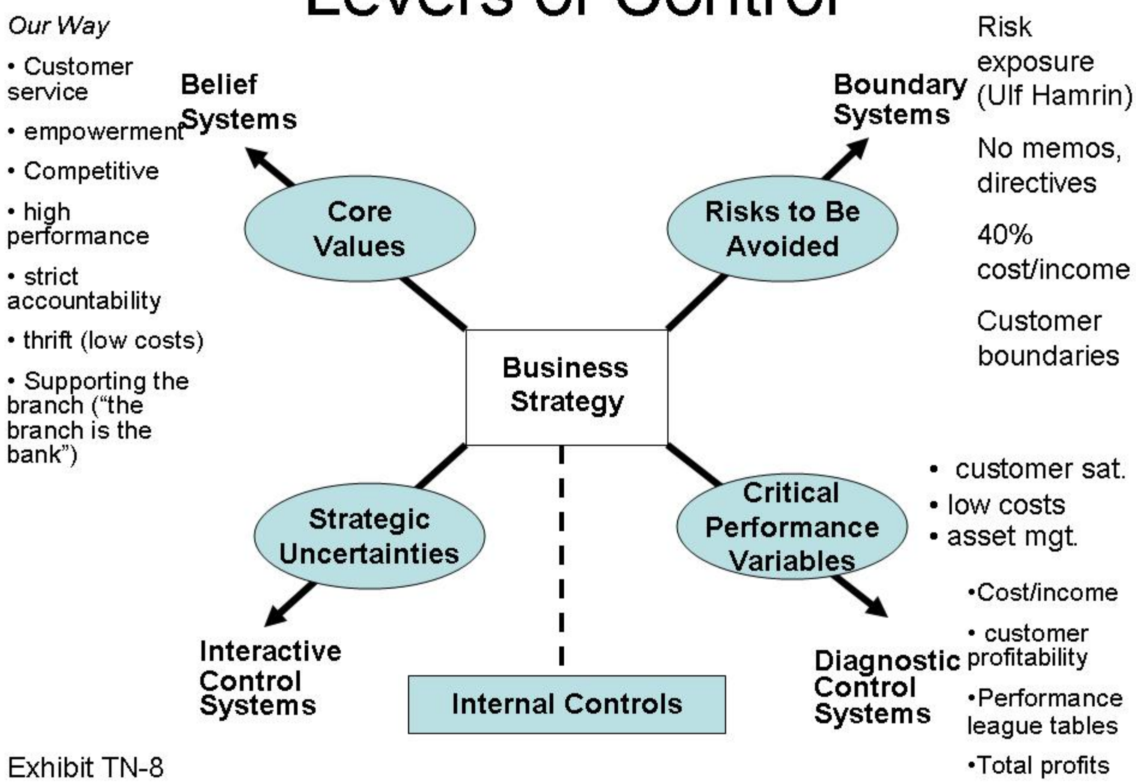


Exhibit TN-8

What makes for an "excellent" accounting system

Radical decentralization can only work with fast and open information systems that provide effective multilevel controls. We are quick to spot any changes in trends within regions and branches and this leads to searching questions being asked on the telephone. Problems are transparent; they are not hidden within the nooks and crannies of management layers and allowed to fester.

- Arne Martensson

Exhibit TN-9

Decentralized decision making

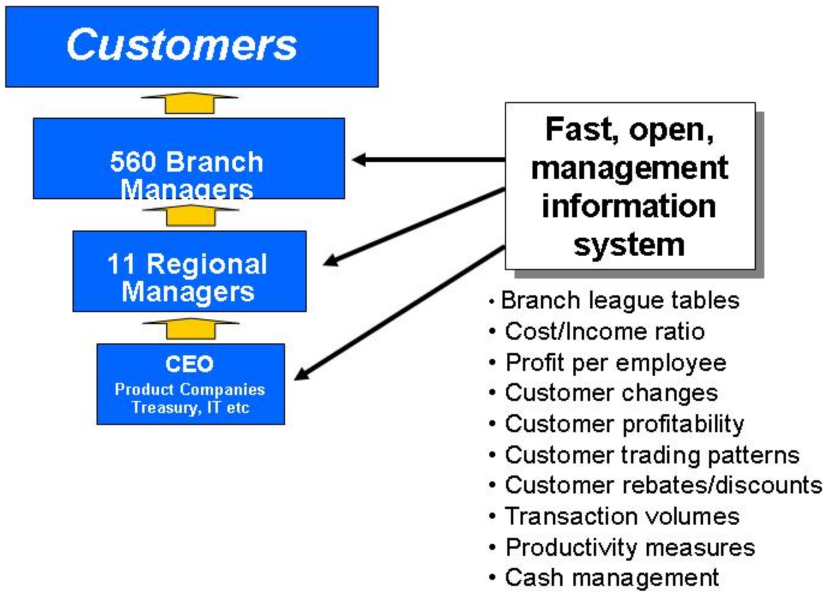


Exhibit TN-10

Beating the competition or one's peers is a far more powerful weapon than financial incentives. Why do people need cash incentives to fulfill their work obligations to colleagues and customers? It is recognition of effort that is important. Managers will only strive to achieve ambitious goals if they know that their 'best efforts' will be recognized and not punished if they fail to get all the way.

- Jan Wallander

Exhibit TN-11

The case for companywide profit sharing

Building a high commitment culture

- Equity: why should only the top levels be rewarded when *we* have worked hard too.
- Pay can send an important signal about the value the organization places on its people

Building Team Work

- Without teamwork there can be no quality and no real organization-wide productivity
  - Individual incentives can erode teamwork and trust; they can set people against one another
- *Shaping* people's motivation and the social context by building a common identification with the total organization's success
  - Is individual motivation a *given*, determined exclusively by forces outside the organization? Can't peer support and group membership be a valuable reward?
  - Pay systems are an important determinant of a company's culture

Exhibit TN-12

Source: Jeffrey Pfeffer, *The Human Equation*, 1998, Ch. 7

Simons' Assumptions about Human Behaviour (Motivation)

- People want to *contribute*
- People generally want to *do what is right*
- People strive to *achieve*
- People like to *innovate*
- People take *pride* in their work and want to do a good job (*competency*)

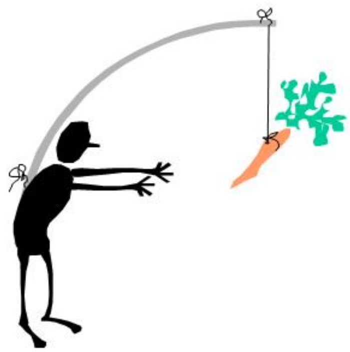


Exhibit TN-13

Simons' perspective on the role of management control systems

Management control systems should attempt to remove *organizational blocks* that prevent people from following their innate "programming" (to do right, contribute, innovate …)

Exhibit TN-14