# CHAPTER 24
# STRATEGIC PLANNING AND BUDGETING

**Changes from Eleventh Edition**

All changes to Chapter 24 were minor.

**Approach**

The text has very little on the mechanics of budget preparation. Such a description is time-consuming. Other material can be used if the instructor wants to describe the mechanics. Nevertheless, this can be a key chapter. One of the central problems in teaching accounting is that the students learn individual pieces and topics, but fail to see how everything fits together. The budget can be used to illuminate the interrelationships.

It is desirable that the capital expenditures budget be related to the material in Chapter 27. In that chapter the description will focus on the analysis of individual capital investment proposals. Students should understand that these individual proposals are brought together in a package, as described in Chapter 24.

We have used the terms *budgetee* and *superior* (following Hofstede) for the participants in the budgeting process. Some people regard budgetee as an awkward word, but we think it is a useful one. We know of no short alternative that conveys the same idea.

**Cases**

*Body Glove* describes the forecasting, budgeting, and reporting processes of a small manufacturer operating in a competitive, fashion-conscious, seasonal business. It asks students to understand the processes and to suggest possible changes for both the short and long term.

*Waikerie Cooperative Producers, Ltd.* describes the management accounting and control systems used by an Australian citrus growing cooperative.

*Patagonia Inc.* describes the budgeting process of a unique, but successful, clothing manufacturer. It contains many elements of "open book management." This case is new in the Twelfth Edition.

*Borealis* illustrates an alternative ("beyond budgeting") approach to traditional budgeting. It involves the use of key performance indicators, trend reporting, and rolling forecasts.

## Problems

**Problem 24-1: Western Run University Motor Pool**

a.

**UNIVERSITY MOTOR POOL**
**Budget Report for April**

| | Monthly Budget | April Actual | Over* Under |
|---|---|---|---|
| Gasoline | $ 1,500 | $ 1,720 | $ 220* |
| Oil, minor repairs, parts and supplies | 469 | 550 | 81 |
| Outside repairs | 400 | 495 | 95 |
| Insurance | 1,600 | 1,600 | -0- |
| Salaries and benefits | 7,500 | 7,500 | -0- |
| Depreciation | 5,867 | 5,867 | -0- |

| | | | |
|---|---|---|---|
| Totals | $17,336 | $17,732 | $ 396 |
| Number of automobiles | 16 | 16 | |
| Actual miles | 31,250 | 35,000 | |
| Cost per mile | $0.5548 | $0.507 | |

Supporting calculations for monthly budget amounts:

Gasoline: $\frac{31{,}250 \text{ miles}}{25 \text{ mile/gal.}} \times \$1.20 \text{ per gallon} = \$1{,}500$

Oil, et al.: 31,250 miles x $.015 per mile = $469

Outside repairs: $\frac{\$300 \text{ per auto} \times 16 \text{ autos}}{12 \text{ months.}} = \$400$

Insurance: Annual cost for one auto = $18,000 ÷ 15 autos
= $1,200 per auto
Annual cost for 16 autos = 16 x $1,200 = $19,200
Monthly cost = 19,200/12 = $1,600

Salaries and benefits: No change from present budget ($90,000 ÷ 12 = $7,500)

Depreciation: Annual depreciation per auto = $66,000/15 autos
= $4,400/auto
Annual depreciation for 16 autos = $4,400/auto x 16 = $70,400
= 70,400
Monthly depreciation $= \frac{70{,}400}{12} = \$5{,}867$

b. Outside automobile repairs are a function of the use of the automobile over its lifetime. However, these repairs occur irregularly throughout the year and the life of the car. A monthly budget figure based upon a per mile charge becomes questionable. Therefore, the use of 1/12 of the estimated annual outside repair costs adjusted for the number of cars in operation during a month would appear to be more reasonable. But even this amount must be kept in proper perspective; i.e., annual variations will certainly be more meaningful than monthly ones.

**Problem 24-2: Terry's Equipment Center**

Operating Budget

| | 1st Quarter | 2nd Quarter |
|---|---|---|
| Sales | $140,000 | $280,000 |
| Cost of goods sold @ .60 sales | 84,000 | 168,000 |
| Gross margin | 56,000 | 112,000 |
| | | |
| Operating expenses: | 76,075 | 105,475 |
| Operating income (loss) | $ (20,075) | $ 6,525 |

| | 1st Quarter | 2nd Quarter |
|---|---|---|
| Fixed selling expenses | $ 25,000 | $ 25,000 |
| Fixed administrative expenses | 18,550 | 18,550 |
| Depreciation | 3,125 | 3,125 |
| Bad debts @ .02 sales | 2,800 | 5,600 |
| Variable @ .14 sales | 19,600 | 39,200 |
| @ .05 sales | 7,000 | 14,000 |
| Totals, above | $ 76,075 | $ 105,475 |

**Problem 24-3**

a. Cash Budget

| | | 1st Quarter | 2nd Quarter |
|---|---|---|---|
| Collection of receivables: | | | |
| .75 x $140,000 (a) | | $105,000 | |
| .24 x 140,000 | | | $ 33,600 |
| .75 x 280,000 (b) | | | 210,000 |
| Total cash receipts | | 105,000 | 243,600 |
| | | | |
| Cash disbursements: | | | |
| Purchases | .60 x $169,000 | 101,400 | |
| (c) | .40 x 169,000 | | 67,600 |
| | .60 x 289,000 | | 173,400 |
| | | | |
| Selling expenses | 2/3 x 44,600 | 29,733 | |
| (d) | 1/3 x 44,600 | | 14,867 |
| | 2/3 x 64,200 | | 42,800 |
| | | | |
| Administrative expenses | 2/3 x $25,550 | 17,000® | |
| (e) | 1/3 x 25,550 | | 8,500® |
| | 2/3 x 32,550 | | 21,700 |
| | | | |
| Equipment | | | 22,500 |
| Total cash disbursements | | 148,133 | 351,367 |
| Excess disbursements over receipts | | (43,133) | (107,767) |
| Cash balance beginning of quarter | | 14,000 | (29,133) |
| Cash balance end of quarter | | $ (29,133) | $(136,900) |

a. To keep a minimum cash balance of $5,000, the company must borrow $34,133 during the first quarter and another $107,767 during the second quarter.

(a) 1st quarter sales of $140,000 as given in Problem 24-2.

(b) 2nd quarter sales of $280,000 as given in Problem 24-2.

(c) Purchases:

| | | 1st Quarter | | 2nd Quarter |
|---|---|---|---|---|
| Cost of goods sold: | | | | |
| .60 ($140,000) | $84,000 | | | |
| .60 ($280,000) | | | $168,000 | |
| Ending inventory at 1/3 cost of goods sold of next quarter: | | | | |
| 1/3 (.60 x $280,000) | 56,000 | | | |
| 1/3 (.60 x $325,000) | | $140,000 | 65,000 | $233,000 |
| Less beginning inventory: | | | | |
| As given | | 29,000 | | |
| From 1st quarter | | | | 56,000 |
| Required purchases | | $111,000 | | $177,000 |

| | | 1st Quarter | 2nd Quarter |
|---|---|---|---|
| (d) Selling expenses: | | | |
| Variable: | .14 ($140,000) | $19,600 | |
| | .14 ($280,000) | | $39,200 |
| Fixed: (given) | | 25,000 | 25,000 |
| Total selling expenses | | $44,600 | $64,200 |

| | | | |
|---|---|---|---|
| (e) Administrative expenses: | | | |
| Variable: | .05 ($140,000) | $ 7,000 | |
| | .05 ($280,000) | | $14,000 |
| Fixed: (given) | | 18,550 | 18,550 |
| Total administrative expenses | | $25,550 | $32,550 |

## Cases

***Case 24-1: Body Glove****

**Note:** *This case is unchanged from the Eleventh Edition.*

**Approach**

The Body Glove case was written to illustrate a planning and budgeting system in a small company that has a high need for planning. Body operates in a rapidly growing, competitive industry with fashion conscious customers and significant seasonal sales fluctuations. Students enjoy studying the case both because they know the company and its products and because the company is small enough that they can comprehend the entire entity.

**Suggested Assignment Questions**

Suggested assignment questions are contained in the case.

**Case Analysis**

Before starting discussion of the specific assignment questions, I find it useful to summarize the students' thinking about the company and its industry. Start by asking what the company's critical success factors (CSFs) are. A list will look like the following:

- designs that satisfy customer needs
- produce styles and colors to demand (adequate production capacity, production flexibility)
- react quickly to changing trends
- control costs (manufacturing, inventory)

Then I proceed to question 2 and create a diagram of the budgeting process. I like to diagram budgeting processes using the format shown in TN-1 because it is then easy to compare processes across companies. The Body Glove process is highly condensed. This shows up starkly in the TN-1 diagram. Body Glove managers do not spend a lot of time in formal budgeting processes. This simplicity is consistent with the fact that Body Glove is a small company that didn't even have a budgeting process until the prior year. The simplicity is also consistent with Body Glove's informal culture, evidence of which is easily seen in the company's organization chart shown in case Exhibit 1.

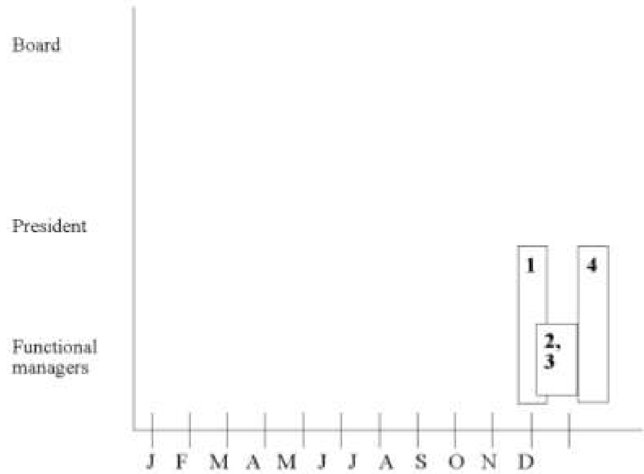
*This teaching note was prepared by Professor Kenneth A. Merchant. 

The Body Glove budgeting process is also unusual in that the board of directors is not involved. Neither is the budget presented to any outsiders; it is strictly for the use of management.

During the year, Body Glove managers make monthly comparisons of budget vs. actuals. At any of these times, the budget numbers can be revised, at the president's discretion. This contingency can be indicated on the timeline, if so desired.

**Figure TN-1**

Time line of Body Glove's budgeting process




**1** = management team estimates total sales growth for following year

**2** = sales manager breaks down total sales estimate by month and by product

**3** = department managers develop monthly projections of key expenses

**4** = presentation to and approval by president

*Question 1: For what purposes does Body Glove use its budgeting system? Which purposes are emphasized?*

The Body Glove budget is used almost exclusively for planning purposes. It helps ensure that the company's level of expenses are low enough, given their sales levels, to generate adequate levels of profit. The budget undoubtedly provides management with some motivation to achieve the numbers they have put together. The budget vs. actuals comparisons is used for performance evaluation purposes, but the budget numbers are not linked formally with incentive compensation. The needed coordination between the functions, particularly sales, purchasing, and production, occurs in processes that lie outside the end-of-year budgeting process.

*Question 3: Can a company function effectively without a budget, as Body Glove tried to do prior to fiscal year 1991?*

The answer is obviously yes. Body Glove was highly successful prior to 1991. Company managers accomplished all the purposes a budget could serve both through exchange of quantitative, but nonfinancial information and frequent informal communications.

Would a budget have helped the company during the early years? Possibly, but the benefits of formal budgeting grows as companies grow and become more complex. Note in Exhibit 3 that Body Glove is no longer a simple organization; it has 10 profit centers! (These are two dive shops, three services (classes, charters, rentals & repairs), one factory, Body Glove wetsuits, Surf 'N Ski 'N Surf, and Accessories.)

*Question 4: What changes to Body Glove's budgeting and review processes would you recommend, if any?*

Look at Exhibit 3, the monthly and year-to-date figures. Body Glove's profits are well below budget; retail sales are essentially flat; and expenses are up. What actions will/should Body Glove managers take as a result?

Students will propose many ideas, including the following:

1. Why have monthly reports? Why not quarterly? Or seasonal? To address this suggestion, consider what decisions might be affected? Might monthly reports affect the commitment of discretionary expenses (e.g., advertising and promotion, hiring) or development of new product ideas, or cash planning (e.g., borrowing)?

2. Why not update the budget more frequently? Most companies do not. They like the annual target to shoot for. But for planning purposes, they may do a quarterly, or less frequent, updated annual "estimate."

3. Why use totally subjective evaluations of performance? The results are affected by many significant uncontrollable factors. Some of these are market uncertainties and fluctuations. Others are caused by departmental interdependency. As Russ Lesser says (not in the case):

   We have somebody responsible for each department, but it is difficult to isolate what one department does. So in doing performance evaluations, we also look at what the company does.

Subjectivity is a simple, inexpensive way to eliminate these distortions from the performance evaluations.

*Question 5: What if Body Glove continues to grow and, perhaps, diversifies?*

Body Glove will almost inevitably grow, and Body Glove managers have considered many diversification options, such as beach apparel or a line of blue jeans that "fit like a glove." As the company becomes larger and more complex, coordination of all the various company elements will become more difficult, and the informal company culture will not satisfy all the communications requirements. The budgeting system will have to involve more people, and the process will have to become more formal and elaborate.

## Case 24-2: Waikerie Cooperative Producers, Ltd.*

**Note:** *This case is unchanged from the Eleventh Edition.*

### Approach

This case was written to illustrate typical issues faced in controlling a cooperative. Cooperatives are an important form of organization. For example, until the recent round of mergers, the second largest bank in the world was a cooperative (Bank Agricole in France). Over 40% of all retail sales in the U.K. are through consumer-owned cooperatives. And in Japan one primary citrus grower producer cooperative has over four million members.

The apparent specific focus of this case is on budgeting. Waikerie managers are having trouble getting good information from their grower-members to allow them to prepare reasonably accurate budgets. But this budgeting issue may not be as important as Waikerie managers seem to think; other things may be more important.

### Suggested Assignment Questions

1. In what ways is management control in a co-cooperative like Waikerie different from that in a typical corporation?

2. Evaluate Waikerie's management control system. What suggestions would you make to Waikerie's managers, if any?

### Case Analysis

*How is management control in a cooperative like Waikerie different from that in a typical corporation? (Question 1)*

The Waikierie cooperative has some important differences form corporations that lead to different management control approaches:

1. In a growers cooperative, like Waikerie, the owners and suppliers are one and the same. Thus the suppliers are the "bosses" of management.

2. The cooperative goals are different from those in a corporation. Profit (or actually net operating surplus) is a constraint, not a primary goal. The primary goals in growers cooperatives like Waikerie, are to maximize the prices paid to the grower-owners and to minimize the hassle associated with packing and selling the product (in other words, provide services to grower-owners). In financial terms the cooperative is really a profit center with a goal to break-even (for long-term survival). A standard corporate financial results control system aimed at Maximizing profits or financial returns is not appropriate.

3. The cooperative must abide by the international principles of co-operation. Most important for management control purposes, it cannot compete aggressively with most local competitors, which are also cooperatives. The private fruit packers have an advantage. The cooperative also has an obligation to educate its members and others about the principles and techniques of co-operation. This education could require the cooperative to incur some extra costs.

The Waikerie Cooperative lacks the degree of power possessed by corporate managers, so it has

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slightly different sources of uncertainty. Like other packers, it had to deal with the inherent volatility in the produce markets. But like other cooperatives, for the most part it had to accept all the fruit grower members wished to send to the cooperative; it had to make its marketing plans available to its grower members, some of whom would inevitably not keep it confidential; and it had to cope with some of the grower members' reluctance to share relevant information.

4. The cooperative cannot decline to pay a dividend or even delay the payment of dividends. It is obligated to pay it and failure to pay a dividend could cause some grower-members to go out of business.

***Evaluate Waikerie's Control System (Question 2)***

The fact that the cooperative has had a negative operating surplus for two years at the same time its members were complaining that the cooperative was not paying a competitive price for produce suggests a strong possibility of problems. Students should be asked to think about the cooperatives critical success factors or key recurring decisions. Here are some areas deserving of investigation by the cooperative (and discussion by the students):

**Pricing**

Paying a competitive price to growers for produce supplied is one of the "four singularly important factors" mentioned at the beginning of the case. Members are complaining but Duncan Beaton is not really sure whether the cooperative is failing in this area. Waikerie should do some market analysis, perhaps by enlisting friendly members to solicit and disclose bids they receive from other packers in the area.

Waikerie might also be well advised to consider its pricing formula. The current market conditions with significant packing oversupply, has created a competitive market. Charging growers the full cost of packing plus a "modest profit margin" might not make sense particularly given Waikerie's strategic error of adding highest automated equipment at a time when less packing capacity was needed.

An alternate pricing formula would have the cooperative charge suppliers for only the variable cost of production plus a profit margin. The cooperative would earn a contribution toward fixed costs on every sale.

Why should the fixed costs be charged to the suppliers? In a prospective sense, the full costs are suspect because they are based on volume estimates with questionable accuracy. But more importantly, these costs are sunk and therefore irrelevant. There seems to be no question but that Waikerie's full costs are not competitive in the market because of high-cost equipment, which may be idle much of the time, and interest incurred to purchase the equipment. Making the suppliers pay for the full costs may allow the cooperative to take advantage of the loyalty of some grower-members for a while, but this pricing strategy will lead to decline in volume at the very time the cooperative needs volume increases.

**Cost Reductions/Accounting**

Waikerie operates in a commodity market. The cooperative is trying to distinguish itself through superior marketing programs or better service to suppliers, but until that happens Waikerie is providing a service that can be provided equally well by many other packers in the areas. In a commodity market, cost control is essential. Management should be working actively to reduce costs both variable and fixed. There is evidence in the case that they are working to this end. To do so effectively, however, management may have to improve its cost accounting system (e.g. rethink it with activity-based



 principles in mind) to know where processes can be improved and where costs can be cut....

Accounting: Text and Cases 12e – Instructor’s Manual Anthony/Hawkins/Merchant was to sell assets in noncore areas. With th...

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 Chapter 24 4. Do group rewards really motivate employees? In the Patagaonia system there is almost...

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# Anthony im 24



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## Anthony im 24

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3. 3. ©2007 McGraw-Hill/Irwin Chapter 24 Problem 24-3 a. Cash Budget 1st Quarter 2nd Quarter Collection of receivables: .75 x
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Cash balance beginning of quarter.......................................................................................................................14,000 (29,133) Cash balance end of quarter.......................................................................................................................$ (29,133) $(136,900) a. To keep a minimum cash balance of $5,000, the company must borrow $34,133 during the first quarter and another $107,767 during the second quarter. (a) 1st quarter sales of $140,000 as given in Problem 24-2. (b) 2nd quarter sales of $280,000 as given in Problem 24-2. (c) Purchases: 1st Quarter 2nd Quarter Cost of goods sold: .60 ($140,000).......................................................................................................................$84,000 .60 ($280,000).......................................................................................................................$168,000 Ending inventory at 1/3 cost of goods sold of next quarter: 1/3 (.60 x $280,000).......................................................................................................................56,000 1/3 (.60 x $325,000).......................................................................................................................______ $140,000 65,000 $233,000 Less beginning inventory: As given.......................................................................................................................29,000 From 1st quarter.......................................................................................................................________ 56,000 Required purchases.......................................................................................................................$111,000 $177,000 3

4. 4. Accounting: Text and Cases 12e – Instructor's Manual Anthony/Hawkins/Merchant (d) Selling expenses: 1st Quarter 2nd Quarter Variable: .14 ($140,000).......................................................................................................................$19,600 .14 ($280,000).......................................................................................................................$39,200 Fixed: (given).......................................................................................................................25,000 25,000 Total selling expenses.......................................................................................................................$44,600 $64,200 (e) Administrative expenses: Variable: .05 ($140,000).......................................................................................................................$ 7,000 .05 ($280,000).......................................................................................................................$14,000 Fixed: (given).......................................................................................................................18,550 18,550 Total administrative expenses.......................................................................................................................$25,550 $32,550 Cases Case 24-1: Body Glove* Note: This case is unchanged from the Eleventh Edition. Approach The Body Glove case was written to illustrate a planning and budgeting system in a small company that has a high need for planning. Body operates in a rapidly growing, competitive industry with fashion conscious customers and significant seasonal sales fluctuations. Students enjoy studying the case both because they know the company and its products and because the company is small enough that they can comprehend the entire entity. Suggested Assignment Questions Suggested assignment questions are contained in the case. Case Analysis Before starting discussion of the specific assignment questions, I find it useful to summarize the students' thinking about the company and its industry. Start by asking what the company's critical success factors (CSFs) are. A list will look like the following: − designs that satisfy customer needs − produce styles and colors to demand (adequate production capacity, production flexibility) − react quickly to changing trends − control costs (manufacturing, inventory) Then I proceed to question 2 and create a diagram of the budgeting process. I like to diagram budgeting processes using the format shown in TN-1 because it is then easy to compare processes across companies. The Body Glove process is highly condensed. This shows up starkly in the TN-1 diagram. Body Glove managers do not spend a lot of time in formal budgeting processes. This simplicity is consistent with the fact that Body Glove is a small company that didn't even have a budgeting process until the prior year. The simplicity is also consistent with Body Glove's informal culture, evidence of which is easily seen in the company's organization chart shown in case Exhibit 1. * This teaching note was prepared by Professor Kenneth A. Merchant. Copyright © 1998 by Kenneth A. Merchant. 4

5. 5. ©2007 McGraw-Hill/Irwin Chapter 24 The Body Glove budgeting process is also unusual in that the board of directors is not involved. Neither is the budget presented to any outsiders; it is strictly for the use of management. During the year, Body Glove managers make monthly comparisons of budget vs. actuals. At any of these times, the budget numbers can be revised, at the president's discretion. This contingency can be indicated on the timeline, if so desired. Figure TN-1 Time line of Body Glove's budgeting process 1 = management team estimates total sales growth for following year 2 = sales manager breaks down total sales estimate by month and by product 3 = department managers develop monthly projections of key expenses 4 = presentation to and approval by president Question 1: For what purposes does Body Glove use its budgeting system? Which purposes are emphasized? The Body Glove budget is used almost exclusively for planning purposes. It helps ensure that the company's level of expenses are low enough, given their sales levels, to generate adequate levels of profit. The budget undoubtedly provides management with some motivation to achieve the numbers they have put together. The budget vs. actuals comparisons is used for performance evaluation purposes, but the budget numbers are not linked formally with incentive compensation. The needed coordination between the functions, particularly sales, purchasing, and production, occurs in processes that lie outside the end-of-year budgeting process. 5

6. 6. Accounting: Text and Cases 12e – Instructor's Manual Anthony/Hawkins/Merchant Question 3: Can a company function effectively without a budget, as Body Glove tried to do prior to fiscal year 1991? The answer is obviously yes. Body Glove was highly successful prior to 1991. Company managers accomplished all the purposes a budget could serve both through exchange of quantitative, but nonfinancial information and frequent informal communications. Would a budget have helped the company during the early years? Possibly, but the benefits of formal budgeting grows as companies grow and become more complex. Note in Exhibit 3 that Body Glove is no longer a simple organization; it has 10 profit centers! (These are two dive shops, three services (classes,

charters, rentals & repairs), one factory, Body Glove wetsuits, Surf 'N Ski 'N Surf, and Accessories.) Question 4: What changes to Body Glove's budgeting and review processes would you recommend, if any? Look at Exhibit 3, the monthly and year-to-date figures. Body Glove's profits are well below budget; retail sales are essentially flat; and expenses are up. What actions will/should Body Glove managers take as a result? Students will propose many ideas, including the following: 1. Why have monthly reports? Why not quarterly? Or seasonal? To address this suggestion, consider what decisions might be affected? Might monthly reports affect the commitment of discretionary expenses (e.g., advertising and promotion, hiring) or development of new product ideas, or cash planning (e.g., borrowing)? 2. Why not update the budget more frequently? Most companies do not. They like the annual target to shoot for. But for planning purposes, they may do a quarterly, or less frequent, updated annual "estimate." 3. Why use totally subjective evaluations of performance? The results are affected by many significant uncontrollable factors. Some of these are market uncertainties and fluctuations. Others are caused by departmental interdependency. As Russ Lesser says (not in the case): We have somebody responsible for each department, but it is difficult to isolate what one department does. So in doing performance evaluations, we also look at what the company does. Subjectivity is a simple, inexpensive way to eliminate these distortions from the performance evaluations. Question 5: What if Body Glove continues to grow and, perhaps, diversifies? Body Glove will almost inevitably grow, and Body Glove managers have considered many diversification options, such as beach apparel or a line of blue jeans that "fit like a glove." As the company becomes larger and more complex, coordination of all the various company elements will become more difficult, and the informal company culture will not satisfy all the communications requirements. The budgeting system will have to involve more people, and the process will have to become more formal and elaborate. 6

7. 7. ©2007 McGraw-Hill/Irwin Chapter 24 Case 24-2: Waikerie Cooperative Producers, Ltd.* Note: This case is unchanged from the Eleventh Edition. Approach This case was written to illustrate typical issues faced in controlling a cooperative. Cooperatives are an important form of organization. For example, until the recent round of mergers, the second largest bank in the world was a cooperative (Bank Agricole in France). Over 40% of all retail sales in the U.K. are through consumer-owned cooperatives. And in Japan one primary citrus grower producer cooperative has over four million members. The apparent specific focus of this case is on budgeting. Waikerie managers are having trouble getting good information from their grower-members to allow them to prepare reasonably accurate budgets. But this budgeting issue may not be as important as Waikerie managers seem to think; other things may be more important. Suggested Assignment Questions 1. In what ways is management control in a co-cooperative like Waikerie different from that in a typical corporation? 2. Evaluate Waikerie's management control system. What suggestions would you make to Waikerie's managers, if any? Case Analysis How is management control in a cooperative like Waikerie different from that in a typical corporation? (Question 1) The Waikierie cooperative has some important differences form corporations that lead to different management control approaches: 1. In a growers cooperative, like Waikerie, the owners and suppliers are one and the same. Thus the suppliers are the "bosses" of management. 2. The cooperative goals are different from those in a corporation. Profit (or actually net operating surplus) is a constraint, not a primary goal. The primary goals in growers cooperatives like Waikerie, are to maximize the prices paid to the grower-owners and to minimize the hassle associated with packing and selling the product (in other words, provide services to grower- owners). In financial terms the cooperative is really a profit center with a goal to break-even (for long-term survival). A standard corporate financial results control system aimed at Maximizing profits or financial returns is not appropriate. 3. The cooperative must abide by the international principles of co-operation. Most important for management control purposes, it cannot compete aggressively with most local competitors, which are also cooperatives. The private fruit packers have an advantage. The cooperative also has an obligation to educate its members and others about the principles and techniques of co-operation. This education could require the cooperative to incur some extra costs. The Waikerie Cooperative lacks the degree of power possessed by corporate managers, so it has * This teaching note was prepared by Kenneth A. Merchant. Copyright © by Kenneth A. Merchant. 7

8. 8. Accounting: Text and Cases 12e – Instructor's Manual Anthony/Hawkins/Merchant slightly different sources of uncertainty. Like other packers, it had to deal with the inherent volatility in the produce markets. But like other cooperatives, for the most part it had to accept all the fruit grower members wished to send to the cooperative; it had to make its marketing plans available to its grower members, some of whom would inevitably not keep it confidential; and it had to cope with some of the grower members' reluctance to share relevant information. 4. The cooperative cannot decline to pay a dividend or even delay the payment of dividends. It is obligated to pay it and failure to pay a dividend could cause some grower-members to go out of business. Evaluate Waikerie's Control System (Question 2) The fact that the cooperative has had a negative operating surplus for two years at the same time its members were complaining that the cooperative was not paying a competitive price for produce suggests a strong possibility of problems. Students should be asked to think about the cooperatives critical success factors or key recurring decisions. Here are some areas deserving of investigation by the cooperative (and discussion by the students): Pricing Paying a competitive price to growers for produce supplied is one of the "four singularly important factors" mentioned at the beginning of the case. Members are complaining but Duncan Beaton is not really sure whether the cooperative is failing in this area. Waikerie should do some market analysis, perhaps by enlisting friendly members to solicit and disclose bids they receive from other packers in the area. Waikerie might also be well advised to consider its pricing formula. The current market conditions with significant packing oversupply, has created a competitive market. Charging growers the full cost of packing plus a "modest profit margin" might not make sense particularly given Waikerie's strategic error of adding highest automated equipment at a time when less packing capacity was needed. An alternate pricing formula would have the cooperative charge suppliers for only the variable cost of production plus a profit margin. The cooperative would earn a contribution toward fixed costs on every sale. Why should the fixed costs be charged to the suppliers? In a prospective sense, the full costs are suspect because they are based on volume estimates with questionable accuracy. But more importantly, these costs are sunk and therefore irrelevant. There seems to be no question but that Waikerie's full costs are not competitive in the market because of high-cost equipment, which may be idle much of the time, and interest incurred to purchase the equipment. Making the suppliers pay for the full costs may allow the cooperative to take advantage of the loyalty of some grower-members for a while, but this pricing strategy will lead to decline in volume at the very time the cooperative needs volume increases. Cost Reductions/Accounting Waikerie operates in a commodity market. The cooperative is trying to distinguish itself through superior marketing programs or better service to suppliers, but until that happens Waikerie is providing a service that can be provided equally well by many other packers in the areas. In a commodity market, cost control is essential. Management

should be working actively to reduce costs both variable and fixed. There is evidence in the case that they are working to this end. To do so effectively, however, management may have to improve its cost accounting system (e.g. rethink it with activity-based 8

9. 9. ©2007 McGraw-Hill/Irwin Chapter 24 principles in mind) to know where processes can be improved and where costs can be cut. Planning and Budgeting Waikerie's management is troubled it they cannot get good crop forecasts that would enable its managers to prepare reasonably accurate annual financial plans. To some extent, its goal for accurate forecasts will never be realized. For example, the navel orange season runs from April to September, and the cooperative is asking for the estimates in November. Given the inherent uncertainty the growers face, these estimates cannot be reliably accurate. But how important are accurate estimates and accurate annual financial plans? Planning financial resource needs (e.g., borrowings) is important. The case does not provide much information in this area, but if contributions are not large enough to service the cooperative's debt, management may have to restructure the debt, or cease operation. Having reasonably accurate numbers that can be used to commit to prices for grower members is also important, although this probably does not vary much form year-to- year. The primary advantage of accurate volume forecasts seems to be for scheduling resources-primarily labor. The cooperative has more than enough packing equipment to service foreseeable volumes. With only labor as a concern, the cooperative seems not to have a great need for an annual forecast. If growers can give the cooperative accurate one-month supply estimates, cooperative management should have enough lead-time to schedule the needed labor. If growers still will not cooperate, perhaps the cooperative could offer rebates to those growers who provide accurate estimates. Incentives Many students will point to the need for formal measurements and incentives tied to the critical success factors. This cooperative is small, so Duncan Beaton may be able to keep all of the relevant data in this head. But formal incentives might provide impetus for managers at various levels to be creative and to improve performance in the areas the cooperative most needs. Students will have a number of ideas for incentives. They might usefully be based on, for example, cost reductions, marketing program successes, services provided to grower-members (e.g., solving problems), grower-member satisfaction, percent returned to grower-members, and number of new grower-members. Each of these alternatives should be evaluated in terms of links to critical success factors, coverage of critical success factors, feasibility, and cost/benefit. Students will also have to consider how to measure individual employee's performances or how to share the rewards among groups of employees whose joint efforts led to the success. Depending on their choices, they may also have to consider how to eliminate the distorting effects of uncontrollable factors (e.g. by using flexible budgets to eliminate the uncontrollable negative effect of a drought). Subsequent Events The Waikerie Cooperative suffered large losses in 1993 (approximately $1 million), and subsequently, all of the top-level managers were replaced. At the same time, the primary lender to all the Riverland cooperatives, the State Bank of South Australia, was pushing/forcing a merger of cooperatives, a "rationalization process." Waikerie explored merger possibilities, but pulled out. The Waikerie board thought that the Bank was seeking to reduce its exposure and was not addressing the significant operating problems the cooperatives were facing. Still Waikerie's board recognized that the cooperative had lost its ability to control its own destiny unless it 9
10. 10. Accounting: Text and Cases 12e – Instructor's Manual Anthony/Hawkins/Merchant was to sell assets in noncore areas. With the "gun to its head," new management at the cooperative had to develop an alternative. After considerable uncertainty and some delay, they were able to refinance the debt with another bank. The refinancing required both the raising of funds from members and to consider future conversion to an unlisted public company. In 1993, a total of $680,000 was raised from members through two-year interest-bearing deposits. In 1994, members were asked to support the conversion to an unlisted public company, with $1 shares in the cooperative being worth approximately $38 (The cooperative's largest asset was it's equity in Berri Holdings Ltd. which holds 54% of Berrivale Orchards Ltd., Australia's largest fruit juice processes and marketer.) Those involved expected members to support the conversion. But they then worried that a number of shareholders would want to "cash out" rather quickly. The majority of the shares value would be derived from Berrivale which was paying relatively low prices to the producers of Australian citrus. Case 24-3: Patagonia, Inc.1 Note: This case is new in the Twelfth Edition. Purpose of Case This case was written to illustrate the details of a budgeting process that embodies the values of an "open book management" process. Open book management (OBM) is a process designed to involve employees in the business. The goal is to get the employees to understand the "big picture" and to see how each individual's efforts relate to overall corporate performance. In other words, the goal is to get the employees to think like owners and to move beyond a "wage level mentality." OBM involves: 1. regular sharing of the company's financial information and any other information that will help the employees work together with management to help the organization succeed; 2. training, so that employees understand both what that information means and how they can contribute to company profits (value creation); 3. rewards linked to company performance (e.g., profit sharing plan, employee stock ownership plan); 4. if necessary, a change away from a top-down culture to ensure that employee ideas are both encouraged and considered fairly. What Patagonia calls its "Workbook Process" embodies all four of these OBM elements. Because the core elements of the Workbook Process involve planning and budgeting, the case can also be used to motivate a discussion of such processes. It can be particularly useful in illustrating a more informal, or "loose," approach to planning and budgeting, which can be contrasted with some of the highly formal and elaborate processes used in many large corporations. The case is also interesting because it illustrates the Patagonia management system. Primarily because of the values of its founder, Patagonia is an unusual company. Consequently, the case can be used to raise issues about corporate objectives (should maximization of value really be the primary objective?), 1 This teaching note was written by Kenneth A. Merchant. Copyright © 2003 by Kenneth A. Merchant. 10
11. 11. ©2007 McGraw-Hill/Irwin Chapter 24 management style, and organizational culture. It can be used as an illustration of a company that makes heavy use of "cultural control." In most situations, instructors can serve both purposes—cultural control and planning and budgeting/OBM in a single class. Even if the focus is on planning and budgeting systems and/or open book management, students can and should study the details of the Workbook Process and draw judgments as to whether the process is aiding or harming the company's cultural control system. Suggested Assignment Questions For a class focused on planning and budgeting processes and/or open book management systems, the following assignment questions are appropriate: 1. Evaluate Patagonia's Workbook Process. Would you recommend to Patagonia's management that they continue the process? Why or why not? 2. If you recommend continuing the process, what changes would you suggest, if any? 3. If you recommend discontinuing the process, what would you substitute instead? Discussion It is useful to have the students identify some of the factors that are unusual at Patagonia. These include: 1. mission and values. The corporate mission and values are shown in Exhibit 3 of the case. Corporate

profits are a constraint or a secondary, rather than a primary goal. Yves Chouinard even sees growth above a minimal level, as an evil. 2. high quality, long lasting products. But Patagonia managers hate a term that critics sometimes used to describe their products, which are not low-priced: "Patagucci." 3. concern for employees 4. flat organization 5. low bureaucracy/informal operating style 6. open culture 7. distrust of bonuses, perhaps because the company does not have a good measurement system 8. distrust of bankers/accounting people. Only two of the eight people on the Patagonia top management team have a business background. 9. scars left by the 1991 crisis/layoff If the focus is on cultural control, the instructor can pose the second question in the cultural control assignment and the discussion should flow easily. If the students are critical of Patagonia, the instructor can point out that while Patagonia is not committed to profits as an overriding goal, it is one of the most profitable firms in its industry. 11

12. 12. Accounting: Text and Cases 12e – Instructor's Manual Anthony/Hawkins/Merchant The first question in the planning and budgeting/OBM assignment asks for an evaluation. To me, the word evaluation asks the students to identify and discuss the pros and cons of the system. Pros: 1. The goals of an OBM system are to create: a. better communication of the corporate goals throughout the rank and file; b. better understanding as to how each employee's actions affects the corporation's financial results; c. incentives for employees to behave in the corporation's best interest; and d. incentives and opportunities for lower-level employees to make useful suggestions for improvement. At least to some extent, Patagonia's system seems to have achieved each of these goals. 2. The OBM system provides a way to motivate employees to serve corporate interests even in the absence of good measurement systems (which the CFO admits they don't have). 3. Many employees expressed dissatisfaction with their lack of knowledge of the company's and other departments' plans and their lack of involvement in the planning processes. The OBM process directly addresses those concerns. 4. The OBM process is well organized (steps, timing), and it was pilot tested. 5. The OBM process is consistent with important aspects of the corporate culture—respect for employees and concern for employees' quality of life. 6. Most employees have favorable reactions to the process (see the quotes toward the end of the case). Cons: 1. The Workbook Process is heavily financially oriented. Perhaps the "Process" does not fit well in an organization for which financial goals are not paramount. 2. Some employees do not participate. Just because the company says it has a highly participative system does not mean that it is getting participation. Some employees do not yet seem to understand what the financial figures mean or how to write good objectives. This could perhaps be solved through more and better training. But more importantly, some employees seem not to want to participate. Can you have a good OBM system if 1/3 of the department heads (and perhaps more of the lower-level employees) are indifferent or hostile? Should you exclude or ignore the non-participants? How can you exclude a department head? How can top-management motivate their participation? 3. Significant costs in time and paperwork. The "bureaucracy" associated with the system is inconsistent with the corporate culture—for example, see a quote in the case ("The company culture favored minimum bureaucracy and maximum informality"). 12
13. 13. ©2007 McGraw-Hill/Irwin Chapter 24 4. Do group rewards really motivate employees? In the Patagaonia system there is almost zero link between a person's efforts and the rewards s/he earns. Shouldn't rewards be at least somewhat based on individual, or at least, workgroup achievement of objectives? 5. A lot of the enthusiasm is dampened because the actuals come out two months late. 6. The enthusiasm for the process seems to be decreasing over time. Might it be said that the costs are linear, but the benefits are declining? 7. The quality of the plans varies. Some departments have too many objectives and most have some poorly written objectives. 8. The OBM process is quite short-term oriented. Are longer-term considerations captured in this system? 9. Where is the strategic planning at Patagonia? They don't seem to do much of it. In fact, it is questionable as to whether Patagonia has what one would call a well-defined business strategy. Other Questions After the students evaluate the Workbook Process, I look to them for a judgment as to whether Patagonia managers should attempt to fix the problems or dump the system. I think that good students can take either stance. Students should identify some alternatives and then choose one, with a persuasive, well organized justification of their choice. If students argue in favor of keeping the OBM system, then they need to address each of the "cons" listed above. Which ones can be fixed, and how? Which ones should merely be tolerated in exchange for the benefits the system provides? If the students argue in favor of discontinuing the Workbook Process, then what should the company do? How can the company replicate the "pros" of the OBM system using a different system? For example, can Patagonia create a process or culture that leads to a natural sharing of information and some motivation to achieve good results without the structure that some find onerous? What happened subsequently? If instructors desire, toward the end of class they can provide students with an update on Patagonia. The update will surprise most of the students. Not long after the time of the case, Patagonia abandoned the Workbook process. The process did not make its third year. Karyn Barsa (CFO) explained: There is no question but that there was tremendous enthusiasm from a lot of people the first year. People were curious about the financial statements. They liked the "brain food" classes. But it's a temporary high you get from getting involved in all this. Problems showed up at end of the year. A lot of objectives were not met. Finger pointing started, and it became very destructive. 13
14. 14. Accounting: Text and Cases 12e – Instructor's Manual Anthony/Hawkins/Merchant In the second year [for FY 1998], people gamed the system. Many units set objectives that were easy to accomplish, such as "turn the compost heap." Karyn's conclusion was: A collaborative process works well when a company is small. It is tougher when the company is complex. Shortly after the time the case was written, a new CEO, Dave Olsen, was hired. Dave was an outsider who had a business background. He did not think that the Workbook Process was moving the company forward. The company's markets were becoming more competitive. He attributed much of Patagonia's early growth to its near-monopoly position. Now the company was up against significant competition, and Dave did not think that the Workbook Process was the best way to respond. Yvon Chouinard was sympathetic to Dave's concerns. Problems at Apple Computer, in particular, scared Yvon. Yvon viewed Apple as a product-focused company that was in many ways similar to Patagonia. However, the 2/3 of the Patagonia employees that bought into the Workbook Process were very disappointed. Dave had to give them something else. He started by trying to change the culture. In particular, he wanted to try to find a better way to make the whining productive and to help employees understand that what people do really matters. To that end, he hired some "culture change" consultants. They employed a number of exercises to try to convince employees to follow two behavioral rules: (1) Turn complaints into requests, and (2) Listen before you speak. The goal was to build a more collaborative culture. Another part of the culture was a greater interest in having the company grow. Dave tried to convince employees that growth is good because it provides Patagonia with the means to spread the environmental message, in particular through the giving away of more money. In the late 1990s, company growth was good. Sales in FY 1998 were approximately $180 million, up 14% from 1997,

and the company was growing to an 800-person organization. In this period, Dave Olsen set up seven separate entrepreneurial product development teams (e.g., paddle sports, alpine). These teams were asking questions like "Do we need tights for every purpose?" But management of these teams was quite complex. Each must carry the Patagonia message. Coordinating the efforts of these teams requires more leadership. In 1999, Patagonia still did not have an incentive system. As Karyn Barsa explained, "Money is still a bit dirty at Patagonia. People want more money, but in salary. They don't want to earn higher bonuses than their co-workers." Karyn predicted that Patagonia would not go public or sell stock through an ESOP until, perhaps, the Chouinard's estate has to be settled. The strong Patagonia culture lives on. Employee turnover within Patagonia is still less than 4% per year. Most employees have been with the company more than 10 years. Patagonia management still prefers to hire "dirtbags." Their philosophy is that "You can teach a dirtbag about business, but you can't teach a "greaseball" [a business person] about the environment." The strong culture spits deviants out. 14

15. 15. ©2007 McGraw-Hill/Irwin Chapter 24 Pedagogy The structuring and timing of the discussion of this case depends on the instructor's purpose(s) for the class, the position of the case in the course syllabus, and the students' backgrounds. Many useful contrasts can be drawn between other companies' practices and Patagonia's. The discussion of this case flows easily because most students have heard of Patagonia. Even if they had not previously known of the company's management philosophies and practices, they find them interesting. For example, it is easy to stimulate a heated debate about Patagonia's objectives between some "conservative, hardcore capitalists" and some "liberal environmentalists." Case 24-4: Borealis1 Note: This case is unchanged from the Eleventh Edition. Purpose of Case Companies have traditionally used budgets for planning, monitoring, and evaluation. Some companies, however, believe that budgets are inadequate in today's competitive environments, that budget processes require too much time and resources, and that the budgets themselves are inflexible and get quickly out of date. A movement that encompasses these ideas has been popularized under the rubric "Beyond Budgeting." A Beyond Budgeting Roundtable is a discussion group that meets with CAM-I. One or more of the Beyond Budgeting articles can usefully be assigned for students to read in conjunction with the Borealis case.2 Borealis, which is a Beyond Budgeting company, abandoned its budgeting system and replaced it with four targeted management tools. The main question to be discussed is: Will these tools accomplish managerial objectives more effectively and efficiently than the budget they replaced? Teaching Approach 1. Why do companies use budgets? Students can be asked to assemble a list of purposes, which include the following: • to make strategy operational • to control spending (permission to spend) • to provide point estimates of spending by department (by what / by whom) • to facilitate better evaluation of decentralized managers by senior management • to communicate important information within the organization, both bottom-up and top-down • to enhance motivation and accountability 2. What is Borealis' business strategy? • High quality provider. • More flexible plastic based on proprietary formula. Licenses Borstar technology in recent years. Research and development is important. • Note that Borealis was quite profitable (refer to the income statement). 1 This teaching note was written by Kenneth A. Merchant based partly on notes provided by Robert S. Kaplan. 2 For example, J.Hope and R. Fraser, "Beyond Budgeting," Strategic Finance 82, no. 4 (October 2000), p. 33 or J. Hope and R. Fraser, "Beyond Budgeting: Pathways to the Emerging Model," Balanced Scorecard Report (May 15, 2000). 15
16. 16. Accounting: Text and Cases 12e – Instructor's Manual Anthony/Hawkins/Merchant 3. What was wrong with Borealis' budgeting process? • Its budgets served too many different purposes; e.g., both forecasting and target setting. Quote in case: "Forecasts should be realistic, targets should be challenging" (stretch). • Borealis used budgets to control spending, but Borealis did not flex the budget. Borealis had a broken MCS. • Quote in case: "Budgets not only set a ceiling on costs, but also a floor." The floor means that managers will spend all they are allotted. • The budget constraints hindered decentralized decision-making. • Once established, the budget quickly became out-of-date because so many planning assumption variables changed quickly. They were also out of management's control, so the variances were meaningless. (See quotes in the "Budgeting Process" part of the case) • It was a lot of work. 4. Why was Borealis having trouble with its budget, while other companies don't? • Problem in the way that management used the system. • Design of system: fixed vs. flexed in highly volatile market where Borealis, despite its size was probably a "price-taker." "What if we didn't do budgets at all?" The Emperor's New Clothes – individually, each manager expressed frustration and dislike of budgets and the budgeting process, but collectively they felt a need for budgets. Budgets provided a (false) sense of control since Borealis faced uncontrollable volatility in its feedstock costs and product prices. The board of directors gave approval as long as management could design a faster, simpler process. 5. What modifications would have made the existing system more useful? • Flex the budget to make it more useful and dynamic. • Beyond the need to flex for volume, Borealis needed to flex for changing input prices and changing product prices, which were uncontrollable by management. • Note how Borealis does a variance analysis to explain its YTY profitability (Exhibit 2C) • Develop new standards (e.g., compare actual to actuals to achieve continuous improvements or use external benchmarking, "best in class"). 6. What changes were instituted? And how did management expect the new measurement and control systems to help? Borealis managers set objectives to be achieved by the new measurement and control systems: • Improve financial management and performance measurement • Decentralize authority and decisions • Simplify the budgeting process • Reduce the resources used in the process 16
17. 17. ©2007 McGraw-Hill/Irwin Chapter 24 Several new tools were needed to replace the budgeting process and its two primary functions: financial planning and performance measurement (see Ex. 4): • Rolling Financial Forecasts • Balanced Scorecard • Key performance indicators • Relative Financial Performance • Activity Based Costing • External Benchmarking • Trend reporting • Decentralized Investment Management 7. What are the strengths and weaknesses of each of the new measurement and control system? A. Rolling Forecasts • goal was to achieve a simple and accurate picture of expected financial performance. • similar to a flexible budget permits incorporation of dynamic states of the world. • used the most objective data available. • spent less time explaining deviations from budget. • This system could also be gamed, but Borealis did not tie compensation to achieving the forecasts, so there was little incentive to game. If some resources are variable (flexible) with respect to volume and mix, when the company has updated and more accurate forecasts, it can do better short-term resource budgeting (authorize spending on direct, capacity, and support resources based on anticipated volume and mix of products and customers). This requires activity-based budgeting and would tie back to capacity planning (investment management). B. Balanced Scorecard–communicate strategic objectives and measures to employees and encourage them to set personal objectives that would be linked to corporate strategy. C. Relative Financial Performance (RFP) – to further distinguish between forecasting and performance measurement. The RFP was the

correct flexible budget for Borealis. One that flexed for input prices and product prices as well as volume. Borealis' financial performance was much more affected by external margin changes (changes in the spread between input and product prices) than by actual internal process performance. • important to achieve a balance and a focus on key performance indicators (KPI) without overwhelming managers with metrics galore. • Introduced small incentive plan between 3,000 and 8,000 Kronor ($500 to $1,000) based on 12 KPIs from the BSC. D. ABC – to track and record costs by activities which create them, to develop cost information that was much more intuitive and understandable to plant employees. E. External Benchmarking – used to set performance targets for VC, FC and operating margins by benchmarking against competitors (see Ex. 5). These targets were 17

18. 18. Accounting: Text and Cases 12e – Instructor's Manual Anthony/Hawkins/Merchant considered tougher, but the absence of budgets gave managers increased freedom for spending $$ to reach the targets. • Trends: measure and graph activity and process costs over time. • Removed gaming; Nobody wanted to be a 'laggard.' • Spent less time negotiating targets. • Rates were determined using maximal usage of capacity. Variances arose because not all fixed costs were allocated to products. The cost of unused capacity was assigned to profit centers based on differences between capacity planned and used. F. Decentralized Investment Management – to put decision-making and control with plant managers and employees who were closest to the marketplace and customers - collection of decision rights and specific knowledge needed for the best decision making, proximity to customer and markets. 8. Should compensation be tied to KPIs presented on the BSC? How will this affect validity of data reported or aggressiveness of target setting? What other processes can management use to offset the information distortion when targets are established for performance measures? The KPIs are not about strategic uncertainties. The KPIs are about measurement of outcomes from a well-defined process – the production of little plastic pellets. If so, then it seems OK to tie compensation to KPIs. In fact, without this reinforcement, the targets may have little motivational impact. 9. Is the Borealis new system for everyone? Why would it not be "universal medicine"? Empirical evidence suggests that Borealis' system is not for every company, as most companies continue to use budgets. Every company has tension in the design and use of MCS. These systems are used both to inform and to motivate. Using one system to do both is likely to result in the introduction of manipulation. There is no one way to address this tension. Some companies, for example, set top-down budgets or use tight supervision or truth-inducing incentive systems. One problem with the Beyond Budgeting approach is feasibility. Every company must have performance standards. Borealis replaced its internally negotiated (budget) standards with benchmarked standards. This is not feasible for every business, as many companies guard their internal data on costs and margins very carefully. Why do we observe the innovations suggested by the Beyond Budgeting Round Table (BBRT) being implemented primarily in Europe, and not in the US? In Scandinavia there are multiple examples of companies that have followed this strategy. Most notable is Svenska Handelsbanken, which has consistently been the most profitable Scandinavian bank over the last 20 years. Employees' views seem to be different in different cultures. So what works for Borealis may not work in the US – as suggested by the quote by Bogsnes in the case. In Borealis, decentralization seems to be a substitute for budgeting. This decentralization is motivated by the unpredictable price variability in Borealis' environment (prices, costs). 18

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