Palladium
MAKE IT POSSIBLE

Case Study

Blowing Up the Budget & Kicking Out the Calendar:
How Statoil is Redefining How to Manage Organisations

Bjarte Bogsnes
Vice President, Performance Management Development, Statoil, & Chairman, Beyond Budgeting Roundtable

In 2005, Statoil started on a journey of radical transformation. This journey included abolishing traditional budgeting that year and, in 2010, "kicking out the calendar." Both decisions were key steps towards a more dynamic, flexible and self-regulating management model.

Copyright © 2013 Bjarte Bogsnes. Reprinted with permission.

Palladium
MAKE IT POSSIBLE

Headquartered in Norway, Statoil (an oil and gas company with activities in 34 countries, 20,000 employees and 2014 revenues of around $85 billion USD) has always been a values-based and people-oriented organisation.[1] But during the years of growth since its foundation in 1972, traditional management processes were introduced brick by brick, causing increasing bureaucracy and rigidity. The gap widened between what we said in our leadership principles and what we did in our management processes. This gap is poison in any organisation, making the leadership message hollow because the process message is always stronger. What we do always weighs so much more than what we say. *You are all great and the company would be nothing without you, but we still need to control you through detailed budgets, rules and regulations.* It does not help to have Theory Y leadership visions if you have Theory X management processes.[2]

We wanted to close such gaps. We also wanted to find our way back to the agility and flexibility we had had as a smaller company. Of course, a big company cannot be managed exactly like the small company we used to be. But could there be alternatives – ways that better balance the benefits of being big with the benefits of being small?

To answer this question, the budget and the whole mindset behind it seemed a good place to start.

[1]See *Putting People First: How Values Drive Strategy Execution at Statoil*, Palladium case study, James Creelman, Jade Evans, Sebastian Rubens y Rojo. 2015.

[2]According to a theory introduced in 1960 by Douglas McGregor at the MIT Sloan School of Management, Theory Y managers believe that given the proper conditions, employees will learn to seek out and accept responsibility and exercise self-control and self-direction in accomplishing objectives to which they are committed. Theory X managers believe that individuals are inherently lazy and not fond of their jobs. As a result, an authoritarian management style is required to ensure that individuals fulfil their objectives and don't misbehave.

The Problem with Budgeting

Almost everybody complains about the budgeting process – some about all the work involved, some about the gaming and the sub-optimisation, some about the budget being a meaningless yardstick for performance and still others about how it prevents a rapid response to value-adding opportunities. But few understand that these problems are only symptoms of a much bigger and more serious problem, rooted in the entire management model. These are all consequences of a traditional management approach that ignores reality, both inside and outside the organisation – both what motivates the "knowledge worker" and what the implications of a dynamic and unpredictable business environment are.

These are big, hairy issues, and for many hard to grasp or address, so we started out with something more tangible and logical and also less threatening. We simply asked, *why do we budget?*

Why budget?
Most companies make budgets for three very different reasons: target setting, forecasting and resource allocation. But these three purposes can't be handled meaningfully in one process resulting in one set of numbers. A target is what we want to happen. A forecast is what we think will happen, whether we like what we see or not. And resource allocation is about trying to use our resources in the most optimal and efficient way. An ambitious sales target can't at the same time also be an unbiased sales forecast. And you rarely get a good cost forecast if the organisation believes this is their one shot at access to resources for the next year.

Copyright © 2013 Bjarte Bogsnes. Reprinted with permission.

Palladium
MAKE IT POSSIBLE

Overcoming the Budget Problems

Our solution to this serious problem was simple. We separated the three purposes, which made it possible to optimise each one in much more tailored processes. This separation allowed for different numbers, updated on different frequencies and time horizons *(Figure 1)*.

More importantly, the separation was a catalyst for bigger issues that we needed to address. How can we find targets that really inspire and stretch without feeling stretched, while avoiding all the gaming and negotiation that adds no value at all? How can we make simple and unbiased forecasts, free of all the hidden agendas? How can we make people spend money as if it came from their own pocket? How can we move towards a management model that works with human nature rather than against it? How can we be big and small at the same time?

Target Setting
Where possible, we use relative instead of absolute and decimal-loaded targets. Relative targets redefine performance. They address how we are doing compared to others, internally or externally, instead of a myopic focus on fixed numbers.

The power of comparison is fascinating. I have yet to hear a team coming out low (given they find the benchmarking fair and relevant) and announcing that they have no ambitions to climb the rankings. This approach is much more self-regulating than the traditional budget game, which stimulates the very opposite mindset and drives managers to negotiate for the easiest achievable number. As Michelangelo put it, "Our problem is not that we aim too high and miss, but that we aim too low and hit."

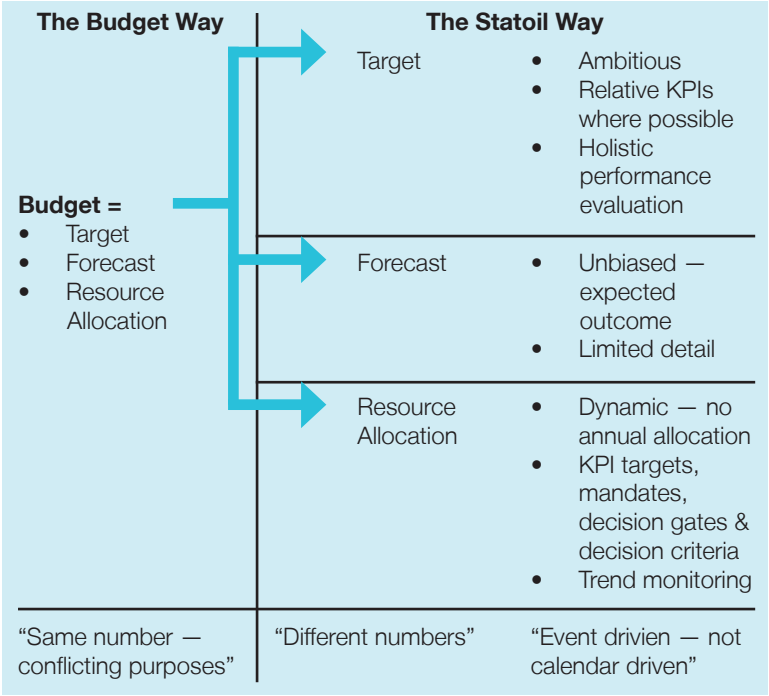

Figure 1: Statoil separated the budget into different numbers for targeting, forecasting and resource allocation.

Statoil's main financial targets are set against a peer group of fifteen other oil and gas companies. We aim to be in the first quartile on Return on Capital Employed, above average on Shareholder Return, and in first quartile on Unit Production Cost. These are the kind of financial targets our Board approves. They do not approve a budget. The two first metrics are also key in our common bonus scheme. Everybody in the same boat; us against the competition.

Copyright © 2013 Bjarte Bogsnes. Reprinted.with permission.

Forecasting
The quality of our forecasting has also improved because we have taken out much of the gaming bias that came from target setting or resource allocation. Our forecasting process is now leaner and much less detailed, although there is room for even more simplification. Some still believe that their cost forecast is their "budget application" for resources. Some also mix targets and forecasts and believe they need to "deliver" on their forecast. What we want to deliver on is our targets, and forecasts are there to help us. They might for instance show that we are heading in the wrong direction, towards places that we absolutely don't want to go.

Dynamic Resource Allocation
We also introduced dynamic resource allocation, which provides much bigger and more flexible decision authorities to local teams and a much more dynamic rhythm. Imagine a bank informing its customers, "We have changed our hours, so if you want to borrow money we are now only open in October." It sounds ridiculous – but isn't this exactly what people in companies experience every year in the budget process?

We want the bank to be open 12 months a year. A funding request might still be refused; we should be just as good at saying no as yes. Cost is of course still very important for us. But why should we make all our cost decisions in the autumn, before we have to? Isn't it better to make them as late as possible, when we have better information – not only about the new project or activity up for decision, but also about our capacity to fund it or staff it?

For operational or administrative cost, with fewer discrete decision points than projects have, we offer a menu of alternative mechanisms for the business to manage its own costs. These include "burn rate" guidance ("operate within this approximate activity level"), unit cost targets ("you can spend more if you produce more"), benchmarked targets ("keep unit cost below our peers' average"), profit targets ("spend so that you maximize your bottom line") or simply no target at all ("we'll monitor cost trends and intervene only if necessary") *(Figure 2)*.

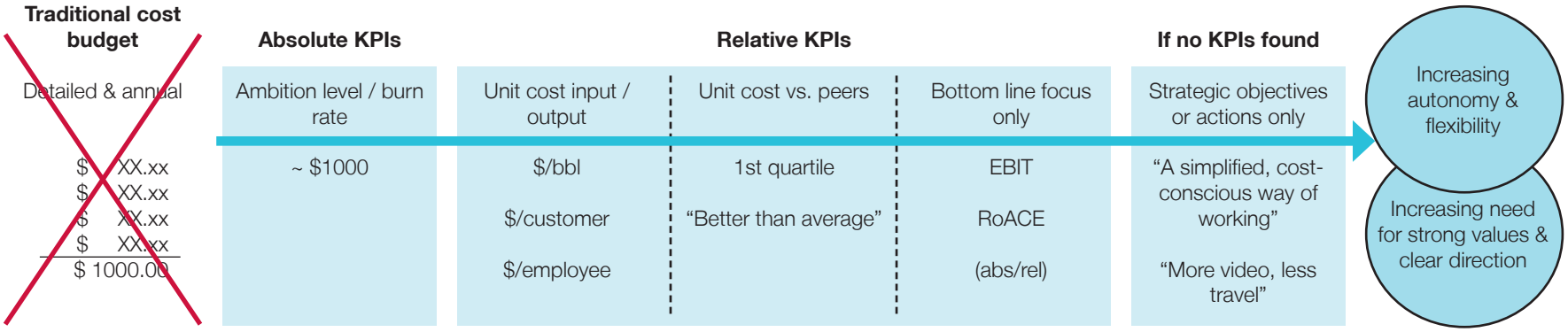

Figure 2: Statoil's cost management menu gives teams greater autonomy and flexibility with regard to resource allocation.

Copyright © 2013 Bjarte Bogsnes. Reprinted with permission.

Palladium
MAKE IT POSSIBLE

Decisions at the Right Time and at the Right Level

In short, we try to make decisions at the right time and at the right level. As a capital intensive and value-chain organised company, every single decision can't be made at each platform or plant. But given this industrial setting, we try to make decisions as far out in the organisation as possible.

Statoil's Chief Financial Officer, Torgrim Retan, comments, "We could easily put in place a cost programme instructing all business areas to reduce costs by a given number. I believe this would work against our intention of building a cost-conscious culture. If we want to become more fit, a crash diet does not work. It takes a change of lifestyle. I believe Statoil is made up of competent, responsible and commercially-oriented people who will make the right cost decisions. This means always working hard to reduce bad cost, while protecting good cost. [They] know better than me what these are and where they are."

The question we want everybody to ask when making cost decisions is not, *Do I have a budget for this?*, but:

- *Is this really necessary?*
- *What is good enough?*
- *How is this creating value?*
- *Is this within my execution framework? (Figure 3)*

In addition, we must always consider capacity, both financial and human. As things look today, can we afford it, and do we have the people to do it? This information would typically come from our latest forecasts.

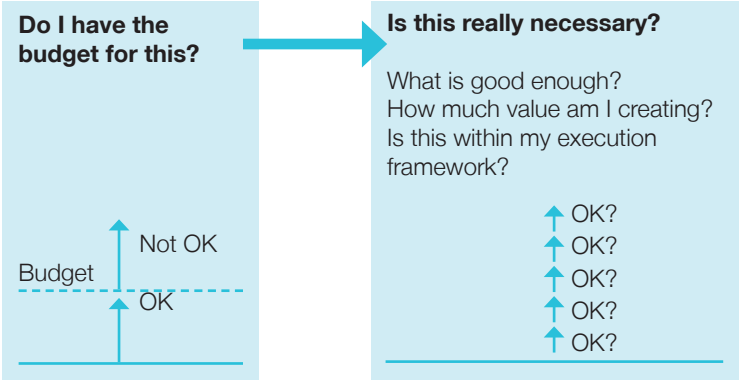

Figure 3: A cost-conscious mindset requires looking at spending decisions in context.

Copyright © 2013 Bjarte Bogsnes. Reprinted.with permission.

Palladium
MAKE IT POSSIBLE

Holistic Performance Evaluation

Last, but not least, we have introduced a more holistic performance evaluation, with hindsight insights as a key component, and with how we have achieved our business results counting for 50%. How can we claim to be a values-based organisation (as we do) if our values and people and leadership principles are completely absent in target setting and performance evaluation?

We also pressure-test measured business results. KPIs are indicators only; they often struggle with telling us the full truth. As Albert Einstein put it, "Not everything that counts can be counted, and not everything that can be counted counts." We therefore use hindsight insights – the wealth of information unavailable to us at target-setting time. We ask, for instance, *Have we really moved towards our longer-term objectives? Was there significant tailwind or headwind that should be taken into account? Are results sustainable; will they stand the test of time?*

These evaluation principles are examples of how we try to address the entire process, not just the finance part. I am based in Finance, but we have worked closely with HR to make it all hang together. This is not always the case. Both Finance and HR would claim to work with performance management, but in many companies they don't talk well together. The two are much to blame for gaps between what is said and done. Finance is pushing management while HR is preaching leadership. Both need to climb out of their silos and start talking with each other and not just about each other.

Ambition to Action

We do all of the above in our management process, "Ambition to Action," which runs all the way from strategy to people, ending up in what we call "People@Statoil". Ambition to Action is based on the Balanced Scorecard (Statoil is a member of the Palladium Balanced Scorecard Hall of Fame for Executing Strategy™), but combined with the Beyond Budgeting principles *(Figure 4),* it becomes a much more robust management model, solving many of the problems that can occur in conventional Balanced Scorecard implementations. Used in the right way, the Balanced Scorecard is a great tool for supporting performance and helping teams to manage themselves. Unfortunately, many scorecard implementations seem to be about reinforcing centralised command-and-control. Alignment is not about target numbers adding up on the decimal; it is about creating clarity about which mountain to climb. Never forget the power of words in making this happen, even if it is so much easier to let the numbers alone do the job.

Copyright © 2013 Bjarte Bogsnes. Reprinted with permission.

Leadership Principles	Management Process
Governance and Transparency 1. Values — Bind people to a common cause, not a central plan. 2. Governance — Govern through shared values and sound judgment, not detailed rules and regulations. 3. Transparency — Make information open and transparent; don't restrict and control it. **Accountable Teams** 4. Teams — Organise around a network of accountable teams, not centralised functions. 5. Trust — Trust teams to regulate and improve their performance; don't micromanage them. 6. Accountability — Base accountability on holistic criteria and peer reviews, not on hierarchical relationships.	**Goals and Rewards** 7. Goals — Set ambitious medium-term goals, not short-term negotiated targets. 8. Rewards — Base rewards on relative performance, not fixed targets. **Planning and Controls** 9. Planning — Make planning a continous and inclusive process, not a top-down annual event. 10. Coordination — Coordinate interactions dynamically, not through annual budgets. 11. Resources — Make resources available just in time, not just in case. 12. Controls — Base controls on fast, frequent feedback, not on budget variances.

Figure 4: Beyond Budgeting principles.

Beyond Budgeting is a coherent set of leadership and management principles. The name is actually misleading because it is about so much more than budgets: it is about taking reality seriously. But changing how we think about management and leadership also requires a radical overhaul of the budgeting process, because it sits at the core of traditional management.[3]

Ambition to Action has three purposes:

- Translate strategic choices into more concrete objectives, KPIs and actions;
- Secure flexibility and room to act and perform; and
- Activate our values and our people and leadership principles.

Almost all our competitors have management systems that in some form aim to meet the first purpose, creating strategic alignment, but so many ignore or forget the other two purposes and lose what is key for success: autonomy and agility, trust and transparency, ownership and commitment. If your own Ambition to Action becomes nothing but a landing ground for instructions from above, both ownership and quality tend to walk out the door.

An Ambition to Action starts with an ambition statement, a higher purpose. Call it a vision, call it a mission. We don't care, as long as it ignites and inspires. The Statoil ambition is to be "Globally competitive — an exceptional place to perform and develop." This statement is translated into different versions across the company. One of our technology teams, for instance, chose, "Execution for today, solutions for the future." In our team, we "...challenge traditional management thinking."

[3]For more information on the Beyond Budgeting principles, see www.bbrt.org.

Copyright © 2013 Bjarte Bogsnes. Reprinted.with permission.

Palladium
MAKE IT POSSIBLE

Ambitions and strategies are translated across five perspectives *(Figure 5)*:

- People and Organisation
- Health, Safety and Environment (HSE)
- Operations
- Market
- Finance (or Results)

We have added HSE to the four traditional Balanced Scorecard perspectives because of the business we are in. In addition, we have switched the order (Finance is typically on top), because we know what happens in business review meetings when the agenda is tight and time is limited: "Let's come back to people and organisation next time." Those are not the signals to send if we claim to be a people-focused organisation, so now People and Organisation sits at the top. Another small gap closed between what we say and what we do.

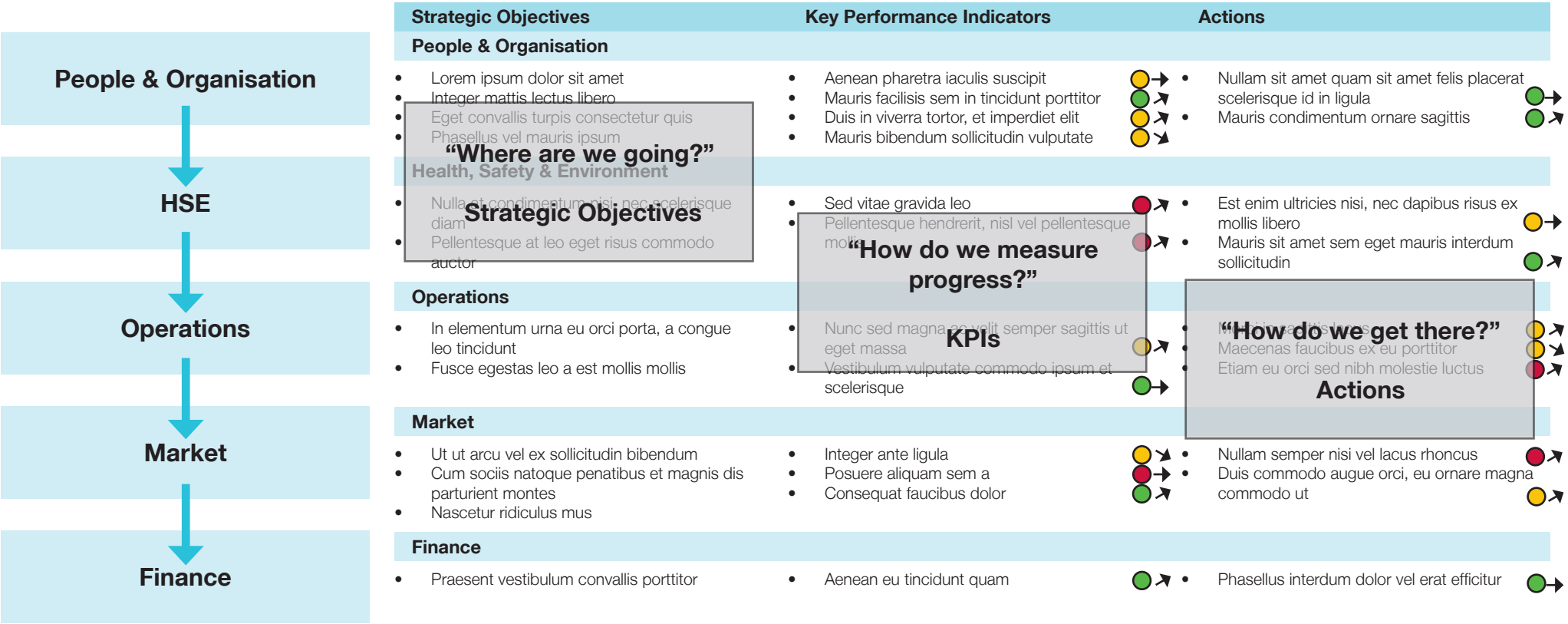

Figure 5: An "Ambition to Action" is a variation on the Balanced Scorecard, with objectives, measures and initiatives across a set of perspectives.

Copyright © 2013 Bjarte Bogsnes. Reprinted with permission.

Translation, not Cascading

Today, we have around 800 Ambition to Actions across the company. We try to connect and align all these through translation (each team translating relevant Ambition to Actions, typically the one above) instead of cascading (corporate instructing). *What should our Ambition to Action look like in order to support the Ambition to Action(s) above? What kind of objectives, KPIs and actions do we need? Can we use those above, or do we need something sharper because we are one step closer to the front line?*

There are, of course, situations where instructions and cascading from above is necessary, but this should be the exception and not the rule, which makes it more acceptable when it happens. In the rare instance when a translation goes wrong, it does need to be addressed.

To help the translation, there is full transparency around all Ambition to Actions. With a few exceptions of sensitive information related to share price, everything is open for all. In most ERP systems, transparency is reserved for the top. They boast about fancy drill-down functionality, allowing senior executives to monitor the smallest local detail. But why should these guys spend time investigating travel and entertainment cost in every local team? What we need is much less of such drill-down, and much more of drill-across (what are those guys doing?) and drill-up (what was that strategy again?). Note that Transparency International has named Statoil the most transparent listed company globally.[4]

In short, we want Ambition to Action to be something that helps local teams to manage themselves and perform to their full potential, while we at the same time secure sufficient alignment.

This means using a different type of glue, and smaller doses: translation instead of cascading. We have a management model that is well suited to dealing with turbulence and rapid change. It enables us to act and reprioritise quickly so that we can fend off threats or seize opportunities, which is much more difficult in a traditional budget world.

The years following our 2005 decision to "blow up" the budget was a period of experimenting and learning. Moreover, in 2007 we merged with a competitor (Hydro). It was a very successful merger and we are absolutely a stronger company today, but it meant starting over again. Still, the number of Ambition to Actions kept increasing, despite not being mandatory. Not mandating adoption was a conscious decision, driven by our obsession with making Ambition to Action something that primarily helps teams to help themselves. You can't make that mandatory.

We had some simple implementation principles:

- Design to 80% and jump. Not everything can be planned or fully designed upfront. Get started, experiment, learn and improve.
- Make sure the case for change and the problems with the old way are well understood before talking about the new way.
- Go for pull, not push. We have no detailed roll-out schedule. People are fed up with being on the receiving end of corporate "roll-outs" again and again. Instead, we focus on teams that invite us. Not once did we put our foot in the door because "this is decided." It takes longer, it looks messier, but change becomes real and sustainable.

[4]For more on Transparency International, see www.transparency.org.

Copyright © 2013 Bjarte Bogsnes. Reprinted.with permission.

Kicking Out the Calendar

Despite some obstacles, we kept moving on. In 2010 we were ready for the next step: escaping the calendar straightjacket. The purpose was to make Ambition to Action even more useful and relevant for all our business teams.

In April that year we went to the Executive Committee with our proposal to "kick out" the calendar. We got a strong and clear green light. January to December is an artificial construct from a business point of view. For some it is too short, for others too long. Even when a business has seasonal rhythms, the winter season is cut in two because we pass year end. Imagine a finance guy meeting a fisherman and asking him about the rhythm of his work. "Well," the fisherman replies, "I am at sea for five months, and then I am home for five months." "So what do you do then the rest of the year?" the finance guy wonders. Something is wrong, right? Absolutely, but maybe more in the head of the finance guy than in the working rhythm of the fisherman.

Our statutory accounting and our communication with external parties and the capital markets will of course still need to be calendar oriented, but our internal processes could still have more natural rhythms. We want to free ourselves from the artificial, annual "stop/start/stop/start." We want to give our teams the opportunity to run their business more continuously, with update frequencies, time horizons and evaluation points driven by their own business flow.

The main principles in our new and fully dynamic process are as follows:

- **No annual versions** of Ambition to Action. Strategic objectives, KPIs, KPI targets and forecasts can be changed when deemed necessary by teams themselves.
- **Event-driven changes**, not calendar-driven. Events can be external or internal, and the definition is simple: Whatever is important for your team.
- **Simple change and coordination controls**. Big changes should be approved one level above; for smaller changes, they need only be informed. Big or small, always inform other affected units if necessary. Teams sort out among themselves what is big and what is small.
- **Target and forecast horizons** should reflect lead times, urgency, uncertainty and complexity in the different businesses.

Copyright © 2013 Bjarte Bogsnes. Reprinted with permission.

Dynamic Forecasting
The dynamic forecasting we have introduced is different from rolling forecasting. A rolling forecast is done on a fixed frequency and on a fixed time horizon across the company, often quarterly and five quarters ahead. We want forecasts to be updated when something happens, and as far ahead as relevant for each unit. For some that could be short, for others long. If a unit one level up needs a forecast with a longer time horizon, it is their responsibility to fill the gap with a "good enough" forecast. Why must all teams look ten years ahead (in aggregate, a relevant time horizon for an oil company)? For our oil trading people, anything beyond three weeks can be quite foggy, while three years is very much on the short side for those bringing new oil and gas discoveries into production.

Targets can also have shorter or longer time horizons, from months to years, again driven by lead times and complexity. Note that "dynamic" doesn't necessarily mean more often. It means at the right time. For some it could actually mean less often.

Performance Reviews
Performance against Ambition to Action is reviewed monthly or quarterly in business review meetings. An individual performance evaluation will still take place at year end. Some would then look back on a very dynamic Ambition to Action, others on the opposite. A log in Ambition to Action (which is actually an internally developed web interface sitting on top of a global SAP solution) keeps an overview of changes made.

Some question this review frequency. Why is once a year in January always the natural point for evaluating performance? Is it only because of the link to pay? Is that a good enough reason? Are there alternatives, again driven by more natural business milestones?

We hope our new and more dynamic process also will make the current autumn planning much leaner and one day even obsolete. This planning work, which is not about budgets but about action planning and understanding the consequences of actions through unbiased and expected outcome forecasts, is still too time consuming. Our goal is a more of a "living" forecast where those needing forecast information can tap into the latest information available, which could be done both regularly and ad-hoc.

Getting out of the calendar year takes time. The calendar is not just hardwired into our brains, it is also still highly present in a number of other processes in the company, which must also be addressed. Some of these will need to continue on an annual cycle, with our statutory accounting as the obvious example. But this is not a showstopper.

Copyright © 2013 Bjarte Bogsnes. Reprinted.with permission.

Key Messages

We have spent countless hours in management teams and on leadership training, helping Statoil managers reflect on the leadership implications not just of leaving the calendar year but of all the other steps taken on this journey. Our key messages include:

- You have more autonomy and flexibility, but also higher accountability for results.
- Use your autonomy; don't delegate upwards – and let it pass on to your teams.
- Don't give up when trust is abused, but react firmly to those who do.

Overcoming Resistance to Change

Of course there are sceptics. They come in two groups. The first is the biggest, but also the one that concerns us the least. These are managers who simply are confused. They probably learnt very much the opposite during their business studies, and they might have honed these practices over many years. It can be painful to change old ways and your belief system, and we need to respect this. These guys just need time, and we give them time. Being confused is part of real change. We are challenging accepted truth and entering unfamiliar territory, which actually is one of the Statoil values, and my favourite!

The second group is smaller, and this is where we find the real sceptics. They are not confused. They fully understand what this is all about, and they don't like it. This is so much against everything they believe in. Some may also pay lip service to the new principles, so you can't even engage in a discussion. This group still exists but is getting smaller and smaller. Some leave, some retire, and every day that passes makes it more difficult for those still with us to abort the journey.

No Going Back

Our discussions are not about going back, they are about how to make it all work even better. Of course we have our dark days, when we hear words or observe behaviours echoing the past that we are trying to leave. However, we have an effective medicine for those days. We just think back on where we were five or ten years ago and note what has been achieved. Our firm intention is to make similar advances over the coming years.

Copyright © 2013 Bjarte Bogsnes. Reprinted with permission.

Palladium
MAKE IT POSSIBLE

About the Author

Bjarte Bogsnes has had a long international career, both in Finance and HR. He is currently heading up the Beyond Budgeting implementation at Statoil, Scandinavia's largest company. Bjarte is a popular international business speaker and winner of a Harvard Business Review/McKinsey Management Innovation award. He is the author of "Implementing Beyond Budgeting – Unlocking the Performance Potential," published by John Wiley (2008, with a second edition presently being prepared). This article is based on a work first published at Management Innovation eXchange (MIX), an open innovation project aimed at reinventing management for the 21st century.

He has spent half his career outside Norway, including several years in the European petrochemicals company Borealis as vice president for corporate control and later for human resources. At Borealis (an early inductee into the Palladium Balanced Scorecard Hall of Fame for Executing Strategy™) he also headed an initiative to manage the company without a budget. He graduated from the Norwegian School of Economics and Business Administration in 1983, joining Statoil in the same year. Follow Bjarte on Twitter at: @bbogsnes

Copyright © 2013 Bjarte Bogsnes. Reprinted.with permission.

Palladium develops and delivers solutions that create positive impact for communities, businesses, societies and economies.

We transform lives and create enduring value by working with governments, corporations and non-profit organisations.

Palladium is built on the idea that progress is supported by four key pillars:

- International Development
- Strategy Executing Consulting
- Impact Investment
- Training and Events

We create positive impact through more than 100 current projects with more than 2,000 employees operating in over 90 countires.

www.thepalladiumgroup.com