Budgets and forecasts when moving Beyond Budgeting

When struggling with Beyond Budgeting, the key to success is not whether budgets are used or not, but how they are combined with other systems. The idea is that budgets should be improved in this process rather than abolished. Our research shows how forecasts are used together with budgets in the budgeting process.

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Following dissatisfaction with traditional budgeting, it has been suggested that organizations should abandon the budget. This discontent relates in particular to the inability to capture unpredictable environmental changes, the time required in budget negotiations, and the potential for incentivizing dysfunctional behavior. However, rather than completely abandoning budgets, organizations generally attempt to improve budgeting by complementing budgets with the forward-looking properties of forecasts, relative performance evaluation tools such as internal and external benchmarks, and authority-delegating structures.

Even case studies of organizations claiming to have gone Beyond Budgeting have shown that companies seem to preserve budget-like control elements as primary planning and control mechanisms (e.g. Sandalgaard/Bukh 2014). While budgets remain essential in most organizations, their interrelationships with other control elements may evolve when practitioners attempt to accommodate for their deficiencies.

Firms implementing Beyond Budgeting may reintroduce budgets. This may be more than a "failed" Beyond Budgeting implementation and studying companies that have experienced both situations can provide new insights into budgeting evolution. Consequently, we studied how budgets and forecasts were used in a Scandinavian bank, BankCorp (name disguised), that abandoned and reintroduced the corporate budget within a short period (Bukh et al. 2024). Emphasizing the roles and interrelationships of budgets and forecasts, we resumed the call from Becker et al. (2016, p. 1510) for more studies adopting a broader view of management control systems to examine the fundamental control elements, such as balanced scorecard, benchmarks, and forecasts, often emphasized in Beyond Budgeting studies.

Despite its listing on the stock exchange and demands for predictable financial performance, BankCorp operated without a corporate budget for almost two years. Therefore, during our case study, we were interested in understanding how budgeting changed after the reintroduction. With the reintroduction of the corporate budget, the budgeting process had taken a new form in the bank. Realizing the benefits of the forecasting model, forecasts were used to create the corporate budget, which was established using a macroeconomic projection and decoupled from the decentralized budgets. As a traditional budget, it was fixed for the calendar year and used to control costs. Meanwhile, the forecasting model continued to provide updated information each quarter within the fixed time horizon of the calendar year. It was also used to control revenues.

BankCorp and the change process

BankCorp is a listed Scandinavian bank that offers a broad range of financial services, including loans, pensions, and insurance services, based on serving retail customers as well as small and medium-sized enterprises through personal relationships. The bank has been involved in several mergers and acquisitions and is currently one of the largest banks in the country where it operates. BankCorp has a diversified lending portfolio and a persistently strong credit quality throughout the business cycle. In recent years, the bank has recorded one of the highest returns on equity among the large

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Beyond Budgeting should not be considered a matter of implementing the full package.

banks in the respective country. The business model is based on decentralized decision-making, which empowers managers and frontline employees.

Prior to budget abandonment, the bank already used some control principles associated with Beyond Budgeting, such as benchmarking for performance evaluation purposes. As the budget was abandoned, Beyond Budgeting was a significant inspiration in the change process. Later, when the bank reintroduced budgeting, the forecasting model, initially developed to replace the corporate budget, came to complement the cost-budget.

Table 1 provides an overview of the control element roles during the three phases, emphasizing internal planning and controlling purposes along three dimensions, namely revenue, cost, and profit line items as well as external provision of market guidance at the beginning of the fiscal year and in reports during the year.

Table 1 The roles of budget and forecast during the three phases

Purpose	The three phases		
	Before budget abandonment	**During budget abandonment**	**After budget reintroduction**
Planning	Budget	Forecast	Forecast
Revenue	Bottom-up aggregation of negotiated branch budgets	Statistical projection based on macroeconomic factors integrated with executives' knowledge of decisions influencing financial parameters	Quarterly updated forecasts based on statistical projection
Cost	Bottom-up aggregation of negotiated branch budgets	Judgment by relevant managers	Forecast (based on judgment by relevant managers) fixed for the fiscal year evolves into a budget for control purposes
Profit	Based on the revenue and cost budget	Based on the revenue and cost forecast	Based on the revenue forecast and cost budget
Control	Budget	Forecast	Forecast and budget
Revenue	Variance analysis of budgets compared to actuals	Forecast evaluated quarterly against forecast from last quarter	Forecast evaluated quarterly against budget and forecast from last quarter
Cost	Variance analysis of budgets compared to actuals	Cost projection evaluated against actuals	Forecast evaluated quarterly against budget and forecast from last quarter
Profit	Monthly variance analyses of actual versus budget numbers	Quarterly analyses of actual versus forecast numbers	Forecast evaluated quarterly against budget and forecast from last quarter
Market guidance	Budget	Forecast	Forecast
Yearly	Expected profit reported based on aggregated budget	Expected profit interval reported based on forecast	Expected profit interval reported based on forecast when the annual report is disclosed
In-year	Systematic, quarterly adjustments of expectations accounting for year-to-date actuals	Systematic, quarterly adjustment of expectations accounting for year-to-date actuals	Immediate adjustment of expectations when updated forecasts deviate from present forecast according to legislative requirements

source: Bukh et al. 2024

Phase 1: Before budget abandonment

Before initiating the Beyond Budgeting inspired changes to the budgeting principles in 2016, BankCorp was operating a traditional budgeting process with tight budgetary control. The budget served as the primary planning and control mechanism with detailed follow-ups on aggregated line items, analyses of budget variances, and corrective actions taken to ensure budget goal attainment. The budget resulted from an aggregation of negotiated branch budgets, which consisted of cost-budgets based on traditional line-item budgeting, financial key indicators (e.g. cost-to-income ratio, return on equity, and net interest margin), and non-financial performance measures (e.g. customer and employee satisfaction and sales).

The tightness of budgetary control was differentiated across line items. Cost items were considered highly controllable, while credit losses and revenue items were regarded as less controllable in the short term, as they were highly dependent on macroeconomic factors, competition in the sector, and general market conditions. Still, tight budgetary control based on monthly variance analyses was important because adherence to legislative liquidity and solvency requirements was interlinked with budgets, and because stock market announcements, including disclosure of forward-looking information, were based on the corporate budget. In this way, the budget complemented the corporate financial targets disclosed to the stock market, as shown in the first column of **Table 1**.

Phase 2: Budget abandonment

In 2014, BankCorp decided on a major data restructuring and the implementation of a new data warehouse. Following IT development projects in 2015 and until the actual implementation of the data warehouse in 2016, changes to the budgetary control system were also initiated. In developing the data warehouse, the accounting department realized that the new data structure would inhibit the possibility of establishing a traditional budget for 2017, as no reliable accounting data were available due to a delay in implementing the new data warehouse.

The accounting department also considered the data warehouse restructuring as an opportunity to reconfigure the budgeting process using ideas from Beyond Budgeting. Given the decentralized business model and emphasis on local autonomy, internal benchmarks were deemed relevant for controlling and evaluating performance. As reliable knowledge about financial numbers was mandatory for disclosing forward-looking information and guiding financial analysts, the accounting department also developed a forecasting model based on macroeconomic predictions, which integrated information about planned executive discretionary decisions (e.g. changes in interest and fee structures) that would influence outcomes, to solve this task.

The Board of Directors approved the discontinuation of the corporate budget, and in June 2016, the term "budget" was literally erased from the formal written policies in BankCorp. For instance, the sentence stating that the Board should "review and approve the corporate budget" was removed

For some control purposes, budgets are needed although they may be termed otherwise.

Summary

- Forecasts can be used in combination with budgets as part of the budgeting process.
- Revenue-forecasts are found to complement cost-budgets in fulfilling various budgeting purposes, especially when forward-looking tight control is emphasized to ensure consistency with capital market announcements.
- Management control systems evolve over time when companies implement control elements with inspiration from the Beyond Budgeting model alongside budgets.

from the written instructions, thereby delegating formal decision-making authority from the Board to executives. Additionally, neither branches nor back-office departments formally prepared budgets. Instead, a simple cost projection was made for expected staffing based on historical data.

Emphasizing the need for forecasts to comply with external demands and guide on the performance measures, the bank developed a more elaborate forecasting model with revenue and cost projections based on the macroeconomic factors affecting the banking sector. However, the forecasting model was not simply a statistical model, as it incorporated the executives' professional judgment and information regarding future discretionary actions that would impact financial results.

Forecasting processes can be designed to both complement and substitute budgets.

Even though the forecasts were updated quarterly, they were not rolling with a constant look forward on, for example, twelve or 18 months, as in other case studies of Beyond Budgeting implementations (Henttu-Aho/Järvinen 2013; Valuckas 2019). Instead, the forecasting model provided a statistically projected basis for planning, controlling, and performance evaluation, as delineated by the second column in **Table 1**. While the forecast model was initially developed to provide data for preparing forward-looking information to be disclosed to the capital markets, it ended up replacing the budget because the Board of Directors used it for internal purposes, referring to forecast reports in quarterly meetings and in the strategic planning processes. In practice, their use reproduced the tight revenue and cost control traditionally enforced through budgets.

Phase 3: Budget reintroduction

In 2017, the corporate budget was reintroduced as a formal control system. Initially, the accounting department felt enthusiastic about minimizing resource consumption and reducing tensions between budgets and disclosed corporate targets. However, it was also recognized that establishing Beyond Budgeting as an effective control system required more than changing labels in written reports. Accordingly, the actual use of the control elements and cultural changes were crucial.

When the forecasting model was integrated into the existing planning and control system, most of those involved in the budget-related processes realized

Figure 1 Headlines in quarterly reporting

20X0	20X1					
Actual	Actual Q1	Budget	Most recent forecast	Updated forecast	Variance between budget and updated forecast	Variance between most recent and updated forecast

source: Bukh et al. 2024

there was no point in distinguishing the term budget from the forecast in the company policies. Although the corporate budget was restored, it was given a new role, and the forecasting model was not only regarded as an improvement to planning, but it was also integrated with controlling and performance evaluation. Especially forecast reports continued being an important point of reference in meetings between the Board of Directors and the executives when planning, controlling, and evaluating performance. As a result, more weight was given to the forecasts than the budgets, especially for planning and controlling revenues.

While the forecasting model was updated each quarter, a forecast detailing revenue and cost items for the fiscal year was turned into a corporate cost-budget by the end of the third quarter. The cost-budget was fixed for the fiscal year once settled. However, the revenue-forecast for the fiscal year was only deemed relevant for planning until quarterly updated forecasts became available, as shown by column three in **Table 1**.

The statistically projected forecasts were used during the year to identify gaps between forecasted outcomes and corporate targets. In this way, it was determined whether the budget should be revised in the planning process. The Board of Directors evaluated the bottom line from the financial plan in their quarterly follow-ups, considering both revenue-forecasts and the fixed cost-budget. Traditional variances between budgets and actuals were no longer emphasized. Instead, the quarterly reports contained information about variances between budgets and forecasts, as shown in **Figure 1**. In essence, the organization went beyond traditional, backward-looking budget variances. Instead, the idea was to focus on forward-looking variances.

For listed companies, forecasting processes are important for aligning financial performance with market guidance.

Implications for corporate budgeting

Budgeting can be a comprehensive and challenging process, and no matter how much time is invested, there is no guarantee that the budget will be ad-

Methodology

In our empirical study (Bukh et al. 2024), data were collected through semi-structured interviews and documents related to the budgeting process. Some documents, like annual and quarterly reports, were publicly available on the company webpage, whereas other documents were shared with us by the interviewed people.

We talked with managers and employees from various back-office departments, including accounting, internal auditing, and risk management, as well as branch managers and frontline employees. In total, 25 people were interviewed, each for 0.5 to 1.5 hours. The semi-structured interview guide was organized around broad themes related to management control systems and budgeting in particular.

All interviews were tape-recorded and transcribed, preserving all the data as written documents. The initial coding was done using broad, descriptive codes; subsequently, inferential codes were used. We started by focusing on broad categories related to the budgeting process, identifying control elements such as "annual budget", "forecasting" and "internal benchmarking" to establish the characteristics and purposes of individual elements. Hereafter, we based the coding on the chronological structure of the changes experienced by the case company to understand the development of the interrelationships between budget-related control elements.

hered to. The assumptions underlying a budget will always change to some extent. Therefore, it is not surprising that many firms have been inspired by Beyond Budgeting's promises of a simpler, more dynamic, and adaptive budgeting process.

Nonetheless, it is difficult to operate without a budget – or at least to avoid addressing the tasks that the budget is meant to solve. As a result, some companies that have attempted to implement Beyond Budgeting have been impelled to abandon it. Our study of BankCorp shows that it is not necessarily important to focus on whether Beyond Budgeting is fully implemented – or even implemented at all. It is more important to focus on the specific management tasks that need to be addressed within the company and how a combination of control elements can be tailored to achieve this.

When it comes to planning and coordination tasks, as well as dynamic follow-ups in response to environmental changes, forecasting can serve as both a replacement for and a supplement to budgeting. However, budgets and forecasts are not fixed, predefined concepts. Therefore, both the budgeting and forecasting processes must be designed to align with each other and suit the company's needs.

The experiences of BankCorp demonstrate that forecasts may complement budgets by technically enabling the establishment of a reliable corporate budget and by managerially reinforcing profit planning and control. Still, forecasts may also replace budgets, as these two control elements are interchangeable for revenue and cost line items.

Control element relationships, whether these are between budget and forecasts, performance measures, incentive programs, benchmarking, or other techniques, are not predetermined. The study emphasizes the importance of considering if techniques are replacing or complementary.

Moreover, firms must establish which control problem the management control system aims to resolve. The effectiveness of the control system can be conceptualized as upward accountability or revenue generation, but considering other control problems, such as ensuring accountability towards the financial market, may imply that control elements should be configured differently.

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