

The Vanguard Method and Beyond Budgeting

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There are few who would extol the virtues of budgeting; it is treated as a necessary evil. Complaints about budgeting range from the excessive time it consumes, the gaming (cheating) it engenders and its lack of connection to the purpose of the enterprise, hitting the budget target but missing the point.

What we have learned is that the problem with budgeting or, more correctly, budget-management is more insidious. Budget-management makes performance worse.

With every new idea in management, we have learned to ask: Who invented this? What problem was he or she trying to solve? And do I have that problem?

Budget-management – the cascading of financial targets down divisions and hierarchies – was invented by James McKinsey almost a hundred years ago. It solved a problem for Alfred Sloan. He was running General Motors which at that time was an amorphous mass of operations and McKinsey's innovation solved Sloan's problem of the need for order. In doing so it solved a further problem, how to ensure that operations met the requirements of the financial plan.

If only management was that easy.

Budget-management quickly became the norm. But while it may have solved a problem, it also introduced a disease. It was Deming who first observed that driving any arbitrary number into a system can only sub-optimize performance. The evidence is easy to see: time-limits on activities in service organisations means customers don't get their problem solved and that, in turn, creates more work (or loss of customers). The focus on unit costs in manufacturing means making things you store rather than sell. Forced with the choice of solving customers' problems, or only making what customers want to buy, and complying with budgetary targets, managers do the latter. No amount of argument for the former beats the need to be on budget.

Budget-management is an impediment to knowledge. The arguments for meeting customer needs need airing and solving. While focusing on giving customers what they need may increase the costs in one transaction in a service organisation, it removes the costs from other transactions in that they are rendered unnecessary; thus total costs fall. While manufacturing only the things customers want to buy might mean higher unit costs, again, the total costs of operations fall. It is a simple principle: anything a system does for its customers goes across the system, budget-management drives the focus away from this perspective, with damaging economic consequences.

In Vanguard we have been learning about this dysfunctional phenomenon in service organisations. John Darlington, a long-term collaborator with Vanguard, has been illustrating

the same in manufacturing organisations. In our programme of work with the Beyond Budgeting Round Table we will be researching and disseminating examples of the relationship between measures, particularly budget, and operational performance. It is to assert that the priority for managers ought to be improving operations over being slaves to the budget. When that is the case, how should budget-management or budgeting support rather than hinder operations?

The programme of work is as follows:

- (a) How to study a customer-facing service, process or manufacturing activity, in order to learn how current measures sub-optimize performance and how measures related to purpose tell a different and compelling story.
- (b) Designing a way of working and managing using only the better measures; when the new design is stable, establish the relationship between the new (better) measures and the old (usually lagging) measures.
- (c) Re-conceiving the budgeting processes to fit with and maintain this better design

Vanguard and Darlington both begin any improvement work by studying, getting knowledge; rejecting the notion that managers know what problems they need to solve. The first step above always reveals the dysfunctional consequences of conventional measures; it represents an 'unlearn' step in making a change.

Establishing more useful measures always begins with thinking about the purpose of operations from the customers' point of view. Using these real rather than arbitrary measures to understand and improve operations always has a dramatic impact on performance and from that position of strength it becomes legitimate to re-think measurement, particularly budget management.

Examples of these steps applied to both service and manufacturing systems will be published in the members' area of the BBRT web site and presented at BBRT events.

John Seddon is the leader of the Vanguard organisations, currently operating in nine countries, helping service organisations change from a conventional 'command-and-control' design to a systems design. John has received numerous academic awards for his contribution to management science and won the first Harvard Business Review / McKinsey Management Innovation Prize for 'Reinventing Leadership' in 2010.

Vanguard is the Beyond Budgeting Round Table's UK partner.