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Management Control without Budgets: A Field Study of 'Beyond Budgeting' in Practice

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ABSTRACT Budgets have long been the dominant instrument for management control. In recent years however, alternative approaches to management control such as the Balanced Scorecard have been launched. It has even been suggested that organizations should drop the budget and move 'Beyond Budgeting' (Hope and Fraser, *Strategic Finance*, 82(4), pp. 30–35, 2000). New approaches to management control attempt to respond to the shortcomings of budgets, such as being time consuming and focused on cost reduction rather than value creation. While the Balanced Scorecard and Beyond Budgeting appear to be more closely connected to firm strategy, we know little about how such alternative management control systems function in practice and potential challenges of these new systems. This study is a first step in that direction. We examine 'Beyond Budgeting' in practice by focusing on how corporate level in a large multidivisional oil and energy company adopted this new approach to management control and how it was implemented in two business units. Specifically we investigate: (a) the rules of action that are developed in the absence of budgets; and (b) how the new management control system is expected to influence interaction patterns. Drawing on agency and resource dependency theory in our analysis, our findings indicate that the means of control that are exercised in the absence of budgets alter the relationship between corporate management and division management and new lines of dependency are created between divisions.

Introduction

Practitioners in Europe have recently proposed a distinct approach to address the shortcomings of traditional budgeting practices – the 'Beyond Budgeting'

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approach (Hope and Fraser, 2003; Player, 2003; Bogsnes, 2009). Although budgeting is described in the literature as one of the cornerstones of management control (Anthony and Govindarajan, 1998), practitioners argue that budgets impede the allocation of organizational resources to their best uses and encourage myopic decision-making and other dysfunctional budget games (Wallander, 1999; Hope and Fraser, 2003). Likewise, researchers have increasingly focused on the shortcomings and challenges of relying on budgets for management control, including their lack of connection with corporate strategy (Lukka, 1988; Hansen *et al.*, 2003; Pfeffer, 2007). This is perhaps not surprising as Anthony's approach (the budgeting approach) is an accounting-based view of control, where strategic planning is viewed as a separate field of study (Hansen *et al.*, 2003). Nevertheless, several large organizations have begun to experiment with supplementing or even replacing the budget with alternative management control systems (Ekholm and Wallin, 2000). Recent models and frameworks, such as Hope and Fraser's Beyond Budgeting approach (1997, 2000, 2003) and Kaplan and Norton's Balanced Scorecard framework (1996, 2001), have contributed to this line of thinking. The Balanced Scorecard specifically links performance measures with espoused strategy in order to reduce de-coupling between strategy and operational management (budgeting and action). Simons' 'levers of control framework' (1995) also combines a focus on strategy with a wider view of the control mechanisms that can be utilized to implement strategy.

Whereas we are beginning to obtain more systematic insights into the critiques of budgets and a number of alternative tools have been presented (Hope and Fraser, 1997, 2000, 2003; Wallander, 1999), which widen the management control process to also include non-financial measures (Kaplan and Norton, 1996, 2001), we lack a deeper understanding of the practical implications of removing budgets.

One reason for this may be that organizations have not come far in their attempts to remove or replace budgets. Another reason is that the accounting research has emphasized one innovation practice at a time, such as activity-based costing (ABC), balanced scorecard (BSC) and value-based management (VBM). With the implementation of Beyond Budgeting, organizations are facing a whole system of controls, similar to what Malmi and Brown describe as 'control packages' (2008). They argue that there has been too little explicit theorizing and empirical research on the topic (ibid.). However, a growing body of literature focuses on companies that not only are using management control systems in a traditional way, but instead are discovering new ways of using control systems. Some researchers are even arguing that management control systems can assist and even promote entrepreneurship and innovation (Davila *et al.*, 2009). For instance, Bisbe and Malagueno (2009) explore the relationship between interactive control systems and the different innovation modes that companies can adopt. In their study they explore whether the 'fit' between management control systems and innovation management modes helps to moderate undesirable effects of innovation momentum (Bisbe and Malagueno, 2009).

Revellino and Mouritsen's study shows how a control system is used to cope with critical business and organizational challenges. They highlight the interrelationship between the managerial purpose and the choice of control systems (Revellino and Mouritsen, 2009). These studies contribute to the growing body of literature that attempts to understand different ways of using management control systems. With this as a background we argue that there is a demand for more systematic knowledge among practitioners and researchers as the ideas of moving Beyond Budgeting are continually being developed and applied in organizations.

The worldwide think tanks the 'Consortium for Advanced Manufacturing – International' and the 'Beyond Budgeting Roundtable' have worked on establishing the principles they call Beyond Budgeting. These are divided into leadership principles and process principles. The leadership principles are: focus on customer outcomes, organize as a network of lean accountable teams, enable everyone to act and think like a leader, give teams the freedom and capability to act, govern through a few clear values, goals and boundaries and finally, promote open information for self-management. The process principles are: set relative goals for continuous improvement, rewards should be shared, success based on relative performance, planning should be a continuous and inclusive process, controls should be based on relative indicators and trends, resources should be available as needed and finally, coordinate interactions dynamically.

While the consortium members are clear on the principles for moving Beyond Budgeting, we lack systematic empirical research which documents how corporations implement these new ideas. We address this issue by studying the early implementation phases of 'Beyond Budgeting'. The focus of our study is to explore how organizations approach the task of moving Beyond Budgeting and introducing new management control systems. Based on a study of the adoption of 'Beyond Budgeting' ideas in a large multinational oil and energy company we examine how corporate 'users' of these new ideas apply them first by interpreting the ideas at corporate level and then by putting them to practice in two divisions. Through examinations and comparison of three key activities: target setting, planning and resource allocation, we identify: (a) the rules of action that the organization develops in the absence of budgets and (b) how removal of budgets is expected to influence the interaction patterns in the organization.

In order to understand new rules of action and altered interaction patterns we draw on agency theory (Jensen and Meckling, 1976) and resource dependency theory (Pfeffer and Salancik, 1978). As opposed to theory testing, we apply these theories to understand and make sense of our qualitative data. Agency theory focuses on the relationship and interaction between a principal and the agent and the mechanisms through which the principal can exert control over the agent's behavior. This is an essential issue when budgets, that have previously been one of the main mechanisms for controlling behavior, are removed. Indeed, agency theory has been the basis for much of the recent critique against budgets. The resource dependency perspective draws our attention to the dependencies on resources and how these might shift with the removal of budgets. In combination, resource dependency theory and agency theory will thereby enhance our understanding of emerging interaction patterns and dependencies in the absence of budgets.

Our findings indicate that in this organization, targets appear to become more closely aligned with strategy but this leads to an externally oriented and top driven target setting process. At the same time middle and lower level managers gain autonomy in terms of how they reach targets. Finally, dependencies between divisions are created through the corporate (rather than business unit) perspective in the resource allocation process.

In the next section, we present the theoretical background and establish our research agenda. We then describe the methodological approach for our study and introduce the organization and the two divisions. We present our findings in two parts. We first describe each of the cases and how in practice they have approached target setting, planning and resource allocation in the absence of budgets. We then analyze cross-case applying agency theory and resource dependency theory to interpret and explain our findings. The final section concludes the discussion, outlines the study's limitations and suggests avenues for further research.

Background and Theoretical Perspectives

Budgeting is traditionally described in textbooks as a common accounting tool that organizations use for implementing strategy (Horngren *et al.*, 2005). The budget is described as an integral part of management control systems that aims at promoting *coordination and communication* among sub-units within the company, provides a framework for *judging performance* and finally *motivating managers* and other employees (Horngren *et al.*, 2005). However, budgets have been criticized for being too time consuming; imposing a vertical command-and-control structure; creating centralized decision-making; stifling initiative; and focusing on cost reduction rather than value creation (Wallander, 1999; Hansen *et al.*, 2003; Hope and Fraser, 2003). In addition, it has been argued that budgets create vertical command-and-control systems which are incompatible with flat, network or value-chain-based organizational designs with empowered employees (Wallander, 1999; Hansen *et al.*, 2003; Hope and Fraser, 2003).

Proponents for alternative management control systems argue that behavioral consequences of relying solely on budgets include: (1) failing to create a high performance climate based on competitive success because a fixed target is the definitive measure of success; (2) failing to make people accountable for satisfied customers because financial performance measures dominate; and (3) failing to empower people to act by providing them with resource capabilities because resources have been committed for the budgeting period (Hansen *et al.*, 2003). The above critique against budgets is particularly relevant for organizations in a rapidly changing environment (Bescos *et al.*, 2003).

As a consequence of the critique, alternative ways of budgeting have emerged such as activity-based budgeting (Hansen *et al.*, 2003). In addition, new forms of planning devices have been developed such as 'Beyond Budgeting principles' that can be understood as a new form of management control or a new mix of different controls. Beyond Budgeting consists of similar activities as budgeting, such as target setting, forecasting and resource allocation, but no budget is allocated in advance and the processes are separated in time. The main differences between budgets and beyond budgeting are illustrated in Table 1.

While newer approaches to management control systems are quick to point out the weaknesses of solely relying on budgets, we have limited knowledge about the potential challenges and weaknesses of the new and more broadly focused approaches, such as Beyond Budgeting. The table shows potential challenges, but most of these are only speculations and have not been documented or tied particularly to the Beyond Budgeting approach. However, some of the previous studies on management control practices focus on the effects of strategy on management control (Govindarajan, 1984, 1989; Govindarajan and Gupta, 1985). Modern management control characteristics are likely to increase jurisdictional

Table 1. Key differences between management control systems with and without traditional budgets

	Budget (simultaneous process)	Beyond Budgeting (separate processes)
Target	• Reachable targets	• Stretch target
Planning	• Reactive • Yearly • Detailed	• Proactive • Flexible/quartely • Aggregated
Resource Allocation	• Statical • Yearly	• Dynamic • Continously
Challenges	• Gaming • Conflict between target setting and forecast • Inflexible resource allocation process • False perception of knowing the future • Time consuming process • De-coupled strategy – budget process • Reduce creative thinking • Often obsolete data	• New games? • Handle cost control? • How to handle liquidity? • A model for good times? • Short time focus? • Jurisdictional ambiguity? • Decisional ambiguity? • Undermines the link between formal responsiblity and controllability?
Benefits	• Overall cost control • Motivation	• Dynamic and flexible • Holistic • Tightly coupled with strategy

and decisional ambiguities (see, for example, textbooks in strategy; Coulter, 2005; Carpenter and Sanders, 2007). Furthermore, these management practices, while important to the strategic forceful roles managers may be expected to perform, nevertheless serve to undermine the link between formal responsibility and controllability.

Agency Theory and Resource Dependency Theory

In order to analyze the data we will use two theoretical perspectives: agency theory perspective and the resource dependency perspective. As described earlier, there has been a substantial change from the 1950s to the 1960s in terms of management accounting techniques, particularly in understanding them as an effective means of organizational coordination and control (Anthony, 1965). Previously, budgets were given a great prominence and prestige as the practical and effective toolkit for implementing strategy. More recently management control systems have become more strategic in their nature, focusing more on external dimensions, such as suppliers, customers and the competitors. Some chose to call this strategic management accounting (Lord, 1996). Agency theory and resource dependency can shed light on the consequences of these developments within management control systems.

Agency theory has often been applied to understand and explain the relationship and need for control between different organizational levels. Agency theory helps us to understand the traditional relationship between a principal and an agent. An agency relationship exists when one or more individuals (the principal(s)) hire another individual (the agent) to perform services on their behalf (Jensen and Meckling, 1976). In an organizational context, the principal is often the owner (or alternatively corporate management) while the agent is often defined as the CEO (or alternatively divisional or lower level management). Assuming that both the principal and the agent seek to maximize their own utility, there are reasons to believe that the agent will not always act in the best interest of the principal. Furthermore, assuming information asymmetry there is a problem of verifying the agent's actions. The principal does not always know whether the agent is acting in the interest of the principal or out of self-interest. Divergence of interest, in combination with imperfect information, gives rise to the post-contractual agency problem known in the literature as moral hazard. In other words, the agent may have an incentive to act inappropriately (from the principal's viewpoint), if the interests of the agent and the principal are not aligned. Budgets are, in addition to implementing incentive systems, a common way of handling the principal–agency challenge and the threat of moral hazard. Budgets allow the principal to control the agents' use of resources.

Removing the budgets is therefore likely to affect the relationship between the principal (corporate management) and the agent (division management). However, we have little knowledge about how the relationship changes when taking budgets away. When focus of the management control system is changed from an internal to an external focus other actors are likely to become involved. Previously a main challenge consisted of asymmetric information. In more modern management control systems, it is not clear who sets the goals and whether these are primarily steered by internal principals or external actors. The agency perspective helps to understand the more formal relationship between the principal and the agent. The formal relationship is mirrored in the link between formal responsibility and controllability. This can be related to Roberts' individual form of accountability (1991), that is, when responsibility is individualized rather than based on the collective. In addition, new rules of action are likely to take the place of budget-based rules of action. In this study, we examine which rules seem to emerge and are expected to guide behavior in the absence of budgets particularly during target setting, planning and resource allocation activities.

The resource dependency perspective, on the other hand, directs our attention to the informal dimensions such as perceived dependencies and the interaction, dialog and other forms of knowledge sharing that result. This can be related to Roberts' collective form of accountability (1991). Resource dependency theory argues that organizations seek to manage their dependency of the environment for resources (Thompson, 1967; Pfeffer and Salancik, 1978). The theory also emphasizes the middle managers' level, saying that they must mediate between the relatively open institutional level and the closed technical level. Effectively doing so requires the flexibility that is associated with the less formalized and more political activities depicted by the natural system theories. The resource dependency perspective can be applied internally in an organization to understand the dependencies between different levels and units within particularly large multidivisional firms. Resource allocation processes create dependencies within an organization. The new management control models seem to create new roles and new power constellations in the organizations. Previous studies show, for example, how management accountants get a new role (Burns and Baldvinsdottir, 2007), that the management control system has to handle both horizontal and vertical relations (Rowe *et al.*, 2008) and need for more lean accounting (Hansen and Mouritsen, 2007). When budgets are replaced with more dynamic resource allocation processes, the interaction patterns and dependencies are likely to shift, yet we know very little about how this plays out within a context of more broadly based management control systems.

With this as a background, we analyze if and how corporate and division management adopt and implement Beyond Budgeting and assess the extent to which their application of these new ideas is likely to contribute to overcoming the challenges and shortcomings of budgets.

Methods

The empirical study is set in the context of a multidivisional company implementing Beyond Budgeting practices. The study is the first in a series of studies within a large research program focusing on Beyond Budgeting and its implications for management control. The case study is exploratory, which implies a description and analysis of the practices and use of management accounting systems, techniques and procedures (Ryan *et al.*, 2002). Beyond Budgeting is a new way of conducting management control and it is therefore important to report on research within this area at an early stage.

We chose to collect data in a large Norwegian-based multinational oil and energy company (Oilco), where management decided to abolish budgets completely in 2005 and to introduce Beyond Budgeting. The company initiated what they refer to as the new performance measurement system using pilot sites to test the system. These pilot sites volunteered to participate as early implementers of the new system.

Data collection took place at two different points in time in 2006–2007 and consisted primarily of semi-structured interviews and a number of secondary data sources. The interviews aimed at gaining in-depth knowledge of how corporate level managers interpreted and internalized Beyond Budgeting techniques as well as canvassing a somewhat broader view of how these ideas have been implemented in practice in two divisions within the corporation. We also probed how the organization's past and ongoing work with developing such techniques had evolved over time. To this end, we depended on identifying informants with thorough insights into the organizational processes involved in the adoption and implementation of the new techniques. Our initial contacts with the organization indicated that these processes had primarily been driven by headquarters staff. Hence to understand the efforts made at corporate level to put Beyond Budgeting to use, we started our more systematic data collection by several interviews with the person responsible for the implementation situated at headquarters.

In the second round of data collection (late 2006 and early 2007), we conducted semi-structured interviews at divisional level with respondents from three of the pilot projects (three divisions). In each pilot project we interviewed the division manager, the controller and one employee. In this study, we draw on data from two of these pilots, as the third site had not come far enough in their implementation of Beyond Budgeting to assess how it was put into practice. The interviews typically lasted between one and two hours. All interviews were taped and transcribed. The interview transcripts and additional feedback were analyzed based on a grid technique whereby data were coded and explanatory patterns were mapped across various themes (Yin, 2003).

Interviews were supplemented with a range of documentary material. Internal planning documents and descriptions of the organization were of greatest importance for this study in order to understand the Beyond Budgeting practices in this company. We also had access to presentation material used for internal promotion of these techniques and were able to observe several presentations of the ongoing work with developing the Beyond Budgeting technique by the project manager for the implementation.

Throughout the research process, we had several opportunities to communicate informally with our key informants. As a final means of validation, we sent all the interviews back to the informants for feedback. They had comments on some of the facts and also provided us with more background to some issues discussed in the interviews. However, the fact that the divisions volunteered to participate in Beyond Budgeting may have created a bias where our respondents were more positive towards these new ideas than divisions in general.

'Beyond Budgeting' in Corporate Oilco

Oilco is a large Norwegian oil and energy company with approximately 30,000 employees worldwide. It is partly owned by the Norwegian state and its main activities include exploration and production of oil, gas and other energy sources. These activities demand good liquidity, involve high financial and technological risk, and require extensive collaboration with suppliers and contractors. Due to the high prices of oil the company has enjoyed excellent profitability.

Oilco aims to increase efficiency by integrating HR and finance activities. A performance measurement system was already used in the company in the form of a balanced scorecard. However, the focus of the managers had previously been on the budget. In addition, the performance measurement system was mainly handled by the finance function when it concerned financial measures and by the HR function for more 'soft' measures, such as employee satisfaction. The intention with introducing Beyond Budgeting in 2005 was to change this and to integrate all control systems into a more holistic system, where all elements supported the same management philosophy in a consistent way. Below, we present how corporate level management interpreted Beyond Budgeting and developed this into a new management control system within Oilco.

At corporate level, five issues were presented as the benefits and goals of the new control system. First, Beyond Budgeting was expected to solve the conflict between target setting and forecasting. Second, the budget process was known to create a budgetary game when it came to resource allocation, which was expected to be eliminated when the budget was removed. Third, the budget was perceived as inflexible, and in that sense not useful in a rapidly changing environment characterized by extensive and expensive offshore exploration activities. Fourth, the budget made the managers believe that the future was manageable, which created a false perception. Fifth, the budgeting process was a time-consuming process and in that sense deemed by many managers as an expensive and inefficient process.

The organization was characterized by ambiguous goals that were at times conflicting because they came from different divisions (Finance and HR). As a consequence, the company decided to develop a tighter connection between the strategy, consisting of financial, HR and other goals, and the management control process. Instead of two separate processes where strategy was first decided and the budget decisions followed, these were combined into what was called the 'from ambition to action' process, where the strategy is implemented more rapidly. Corporate management furthermore introduced five key principles: first, performance should ultimately be about outperforming peers. Second, employees and managers should do the right thing in the actual situation, guided by the Oilco booklet,[1] 'Ambition to action',[2] a set of decision criteria and authorities and sound business judgment. The third principle was that resources should be available or allocated case by case. Fourth, business follow-up should be forward-looking and action-oriented and finally, the fifth principle was that performance evaluation should be a holistic assessment of delivery and behavior.

These principles were translated into practice by introducing three separate processes: target setting, planning and resource allocation (see Table 2). The budget was removed, but the activities that had been performed through the budget process remained with some important distinctions. Target setting and planning were separated in time; target setting was now scheduled to take place in the spring while planning would occur in the autumn. This is a maximum time separation of the two processes, which is done so that there is a minimum of interaction between these two processes. The idea behind this innovation is to avoid the previous 'gaming' that occurred in the budgeting processes (where target setting and planning took place at the same time). The resource allocation was converted into a more dynamic and continuous process.

Target setting process. The target setting process addresses *where* the company is headed. It is argued that this process should be an ambitious, outside-in process based on the external expectations and competitor performance. In that way the targets become ambitious. The target setting process is separated from the planning process and focuses only on the targets and not on how to reach them or the necessary resources. For example, in an oil exploration department

Table 2. Oilco's three processes as viewed by corporate management

Three processes	As interpreted and described by corporate management
Target setting	*Where is the company headed?* √ *Ambitious* √ *Outside-in* √ *Based on external expectations*
Planning	*How to reach targets?* √ *Action-oriented* √ *Realistic* √ *Bottom-up and based on business unit/divisional plans*
Resource allocation	√ *Continuous allocation* √ *Self-regulating process* √ *Monitor actual cost trends* √ *Interventions when necessary*

the target might be unit cost (USD/new barrel found), a volume target on new resources and new licenses and the basis for target setting might be license commitments, the requirements for the company, historical trends and rule of thumb.

Planning process. After the target setting process, the planning process takes over addressing *how* to reach the ambitious targets. Plans are developed based on business unit (or divisional) plans and the goal is to be action-oriented but realistic on expected consequences. The planning process is normally bottom-up but can also be a top-down approach focusing on drilling (realistic number of completed wells per region), seismic (license commitments and trends) and exploration costs (organic growth, license commitments, trends) and new licenses.

Once target setting and planning has been completed, it is possible to get an overview of all strategic goals and the actions as well as who in the organization is responsible for each action. This is done to follow the transparency principle in the Beyond Budgeting philosophy. The transparency is believed to create increased learning between departments. In addition it works as a control mechanism by creating peer pressure.

Allocation of resources. Resources to the business units or divisions are no longer allocated on a yearly basis, but rather continuously and dynamically based on the mechanisms above. The overall financing issue was previously handled by detailed pre-allocations in yearly budgets. This has changed to a more dynamic, continuous and self-regulating process. New mechanisms include unit cost targets (either a specific unit cost target or a targeted 'league table cost position'); dynamic project approvals in a continuous approval process based on common criteria; overall cost frames where the mechanisms mentioned are less applicable; and finally monitoring of actual cost trends, with intervention where and when necessary only. There are two proposed benefits with dynamic resource allocation. First, managerial focus is continuously aimed at getting good projects. As long as the overall financial capacity is in place (determined by the group's latest financial forecast) a project will not be turned down due to budgetary constraints, which has traditionally been a common reason for turning down project proposals. The second benefit is that the resource allocation process directs the financial resources to the overall best projects. Instead of as before when the best projects within each department or business unit were supported rather than the best projects within the whole organization.

The above description rests on an important assumption of financial capacity which begs the questions: (1) how does Oilco handle the overall financing and (2) how is long-term financing put in place to meet forecast needs? The overall financing is divided in two categories: (a) areas that are not directly linked with production, such as support cost where it may be more difficult to measure unit costs, and (b) operations (such as exploring for, or producing, oil) where it is easier to identify and control unit costs. The first category may have (but not necessarily) a pre-defined overall (and not detailed) limit driven by the forecasted financial capacity, while the second category is subject to more self-regulating mechanisms driving the overall spending, like exploration or production cost, where higher absolute spending is accepted if driven by higher volumes, meaning that unit cost targets still are met. When the continuously updated financial forecast reveals lower financial capacity, then targets on unit cost or volumes can be adjusted, or the criteria for starting a project might be tightened. This can be done either centrally or locally.

The second question concerns financial resource control of large capital projects. Also here, a dynamic resource allocation takes place. The control of the *portfolio* takes place through a continuous overall optimization based on criteria like financial capacity, strategic fit, profitability and others. *Individual projects* are then processed through the 'Capital Value Process', which have clear decision criteria as projects are matured through different decision gates. A project is finally approved and resources released at a decision gate. Three different cost numbers are then approved. The first is the *expected cost* of the project (e.g. 100), which also is the basis for the decision. Secondly, a more ambitious *cost target* (e.g. 95) is established, against which the project team's performance will be evaluated. Finally, a more robust *resource allocation* number is set, representing the formal authority limit to incur cost. This is set higher (e.g. 105) to avoid that on average every second project formally has to ask for more money. The target which performance is measured against is still 95. The control is still about trying to deliver at 95, while at the same time being open for sensible scope adjustments which increases the value of the project. To support this, a *holistic* performance evaluation is established. In such an evaluation, performance against cost target represents a starting point and not necessarily the final conclusion. Wise and value adding decisions might have been taken, although these in isolation represent a cost overrun. Hence, Beyond Budgeting is less about changing the control of ongoing projects and more about how to select new projects.

The five principles and three separate processes presented above describe how corporate level interpreted the ideas within Beyond Budgeting and how they presented the new management control system to the rest of the organization. We now turn to the divisions to see how they took these ideas further into practice.

Implementation of Beyond Budgeting in the Global Exploration Division

The Global Exploration Division (GEX) is responsible for worldwide exploration of oil and gas. GEX consists of several sub-units: the Africa segment, Asia segment, Former Soviet Union/Europe and New Opportunities. Approximately 300 people are employed in the division. Worldwide exploration of oil and gas implies working with large projects. The main focus has to do with generating new projects. A key challenge entails increasing the number of wells on a yearly basis. Wells can be acquired through licenses, direct investments or exchanges and/or alliances with others in the oil business.

Below, we describe how Beyond Budgeting was put into practice within GEX. We divide our presentation into the three new processes that were put in place instead of the budgeting process: target setting, planning and resource allocation.

Target Setting

Within GEX, the new target setting process is described as involving: (1) bottom-up to 'need-based' processes and (2) a change of focus from own division to the corporation.

From bottom-up to outside-in processes. Our key informants in GEX explain that once budgets were removed, targets were developed in a different manner. Previously, the process started at the sub-division level, where managers calculated the financial resources necessary to be able to succeed with their plans. The manager at GEX describes the previous target setting as follows:

> *. . . in the past . . . , it has been a very bottom-up exercise, where the front line managers or exploration managers in our group put together their 'wish' lists of what kind of program they wanted, how many wells they wanted to drill, how much seismic etc, and then the figure is always too big.*

With Beyond Budgeting, the focus of the target setting process is described as outside-in. This means that the starting point is no longer at the sub-division level, but rather based on the strategic ambition and an assessment of what is needed to reach that ambition. The controller describes the change as follows:

> *If we say that GEX should be among the top-ten exploration companies it means something and the target has to be set out of that ambition.*

Strategic ambitions are now based on market opportunities and competitor movements. So in essence, target setting has come to depend more on the market and the competitors' actions. Different criteria are used as the basis for the target setting process. These criteria are linked to previous history, trends and rule of thumb. According to the controller, this results in more realistic targets in contrast to the bottom-up approach. She expresses it in the following way:

> *We use rule of thumb, statistics and trends and this makes us better able to predict something that is realistic for the future in a different way compared to when we used the bottom-up approach that created a focus on the details.*

Focus changed from their own division to the corporation. The second theme highlighting changes in the target setting process is the change in focus for the leaders. Previously, the managers focused only on their own division. Now the focus is increasingly directed to the whole corporation.

In the Beyond Budgeting approach, the targets (in the form of ambitions, strategic long-term goals and short-term key performance indicators (KPIs)) are decided at the top level of that division and not by each sub-unit within GEX. The different segments receive indications on what they are supposed to deliver during the year, but the target is only for the whole GEX division. This means that the leadership group has autonomy to prioritize between the different sub-units during the year. The controller expresses it as follows:

> *What is important in relation to reach the target is that GEX is managed as a group. That has something to do with the dynamics in the leadership group when they prioritize resources during the year.*

In addition, the dynamics in the management group have increased based on the information available from the IT system showing 'from ambition to action'. Previously management had access to the ambitions, strategic targets and KPIs, but not within a single system. The controller argues that it is much easier now:

> *I think that just putting things together makes it clearer for people involved in these processes and that contributes to seeing the big picture.*

Increased focus on the management team means however, that the lower level does not have budget responsibilities and no longer participates in the management team, hence their influence in the planning process is perceived as reduced.

Based on these descriptions, it appears that Beyond Budgeting has changed the target setting practice in GEX in two major ways: from 'bottom-up to outside-in processes' and from 'focus on own division to corporate focus'. The division management team interprets the change as providing more autonomy and improved information, while employees express some concerns about the new system. The employees fear that they will get less information and have less influence.

This has consequences for the interaction patterns between managers at different levels in the organization. The sub-division managers are forced to interact more frequently with the other sub-managers since the dynamic resource allocation demands this. In addition, the corporate managers have more continuous contact with the division managers (such as the GEX leader) as compared with previously when they had brief, but intensive contact during the budgeting process. The target setting process can be described as moving from a focus on resource allocation to a focus on benchmarking against competitors.

Planning

Below we describe two substantial changes in terms of how planning is performed: (1) planning has changed from fixed measures to relative measures and (2) planning now has a reduced gap between target and plan. This is expected to create more realistic forecasts.

From fixed to relative criteria. In the previous control system, the operative targets, KPIs, were fixed figures, which did not provide sufficient information about the capability to reach goals. If the division did a poor job and failed to deliver according to the plan, then they would actually succeed in obtaining lower costs compared to target costs. Hence, there were skewed incentives built into the budget model they used. Instead of securing incentives for value creation, the control system rewarded cost reductions – sometimes at the expense of value creation.

When using the Beyond Budgeting approach, targets are described as relative rather than fixed. The goal is to find relative KPIs that measure the real value creation. This means that not only costs are in focus but also the revenues. For example, rather than targeting and planning the exploration cost, the divisions are measured in relation to unit cost. The idea is to secure a good connection between input and output. In addition, benchmarks are used to assess and evaluate if the relative measure is good or not.

Reduce gap between target and plan – realistic forecasts. Since the target process is completed prior to planning, the targets have been identified and the focus in the planning process centers on how to reach these targets. The idea with the new approach to the planning process is described as twofold: first, to identify actions needed to deliver strategic objectives and KPI targets, second, to assess expected consequences of these actions, expressed as forecasts, either against KPI targets or other financial or operational areas without targets (Bogsnes, 2009). Planning is no longer about target setting, and some of the managers describe the differences in the planning process as follows:

> *... before ... people budgeted with too high costs in order to create autonomy. That game is now gone. We use the time to do the job instead of using resources on the budget work at home.*
>
> *... now we change ... as we make decisions it changes, as situations arise. I had one, it was 25 wells until few weeks ago and now it's 24 because we worked a rig swap with XXX in one year, which in the very last hour, so to speak, fell apart ... an example of a change in forecast (snap) like that. It happens all the time. So Beyond Budgeting really makes it more flexible.*

Focus in the planning process is now described as doing something about the gap between targets and plan, instead of as before to hide the gap by using unrealistic plans. The controller describes how the gap was handled earlier:

> *Earlier the gap was hidden because the leaders were so concerned about showing that the organization reached their targets, even if this was not realistic.*

Focus on realistic plans/forecasts is described by middle managers as implying a mental change. The idea of identifying gaps between targets and plan is to initiate corrective activities. In this way, learning is emphasized rather than covering up gaps. Previously the focus was on avoiding gaps. Beyond Budgeting also resulted in closer and more frequent contact with the controller for the leaders of the sub-entities. One of the leaders of the sub-entities said:

> *. . . the controller has a very important role . . . we have daily contact . . . the Beyond Budgeting approach forces people to work together and communicate better . . . I think.*

Our key informants describe the main changes in the planning process as (1) relative measures have replaced fixed measures and (2) more realistic and action-oriented forecasts are used in the absence of budgets. Due to the changes in the planning process, learning is emphasized in order to find solutions to gaps between plan and outcome. In addition, the incentives are said to become more appropriate in the sense that it is beneficial to create value instead of reducing costs.

Resource Allocation

The resource allocation process is described as having changed in two ways with the removal of budgets: (1) a set of qualitative and quantitative criteria create the basis for resource allocation and (2) a dynamic process that can happen any time during the year depending on whether sub-groups come up with a good project as opposed to the previous static process happening once a year. The implication of this is that the budget is no longer possible to use to obtain legitimacy – instead the strength of the project has to be used.

Use of criteria instead of budgets. In the absence of budgets, projects are judged against the investment criteria (such as expected net present value (NPV), probability of drilling success, different measures). In addition, management considers if GEX (the division) has enough human resources to accept a drilling project. This is expected to lead to increased autonomy for division management. However, large projects are elevated to the business area (International Exploration: INT), the CEO or sometimes even to the Board in the same way as before the Beyond Budgeting was introduced.

Dynamic resource allocation. Assessing drilling projects on a rolling basis keeps the employees' and managers' focus on finding oil and gas. Some of the respondents express the change as follows:

> *We do not talk about budgets any more – instead we talk about what we are going to do.*

> *Now there is much more focus on the professional part of the job . . . I am a geophysician.*
>
> *I have more time to be creative, and to go out and have contact with the rest of the world and try to find possibilities . . .*

Also, while the budget was sometimes used to legitimize that drilling activity could *not* be pursued; the dynamic process means each project proposal has to be assessed on its own merits, against quantitative and qualitative criteria rather than against budget constraints.

The resource allocation process thus seems to have changed the static process to a more dynamic process since resources are now allocated based on project assessments rather than budgetary constraints. Managers are expected to become more market-oriented and less planning-oriented since they are continuously benchmarked against other divisions and other oil companies. In addition GEX has developed a more flexible way of selecting projects.

We have described how the removal of budgets and the introduction of Beyond Budgeting have changed activities related to target setting, planning and resource allocation, and how dependencies and interactions are affected by such changes. We turn now to a description of how Beyond Budgeting is interpreted and implemented in the second division.

Implementation of Beyond Budgeting in the Global Business Services Division

As a part of the Corporate Center, Global Business Services (GBS) provides services to the rest of the organization, such as within IT, finance, HR, procurements, office and real estate. GBS was previously a cost center, but since 2006, with its 1,700 employees, it has received expanded responsibilities and now functions as a profit center selling services to internal customers. Once budgets were removed within GBS, target setting, planning and resource allocation took on a different form, with a different focus and based on new forms of interaction. Below, we present what our respondents perceive to be the most substantial changes in practice in target setting, planning and resource allocation after the removal of budgets.

Target Setting

While goal-steering had been in focus for many years in the company, it was not until the budgets were physically removed that goals (and target setting) became the real focus of attention. In the absence of budgets, goal attainment became the indicators to follow up instead of deviations from the budget. More strategically oriented targets were coupled with a more centralized level of target setting, as compared with the previous (somewhat) tedious processes of budgeting at all organizational levels. The more centralized process can be understood as negative, but it is argued by managers as necessary since the strategic goal is to be among the top-ten oil companies.

From cost focus to value creation. While targets were previously set based on the allocated budget, with a primary focus on targeting costs, the focus is described as having shifted towards value creation. Respondents describe that targets are now set through a process of breaking down strategic goals into KPIs on scorecards. Scorecards consisting of defined goals are developed at three different organizational levels and several managers are responsible for the results (this is referred to as 'owning' the scorecard). A number of different dimensions are measured in the scorecards using different indicators (KPIs).

> *. . . we have several goals, one is tied to per unit costs . . . another to indicator of effectiveness, and this is a relative measure, and we measure level of service, and I think these three goals are central in Beyond Budgeting.*
>
> *The scorecard [KPIs] consists of the colours red, green and yellow. Red means something is not right . . . so this is where we focus first in our monthly follow-up meetings. We discuss the corrective actions that have been made . . . the balanced scorecard works at three levels in GBS: GBS total, profit centre and sector level . . .*

The goals are tied to meeting strategic goals rather than budget restraints. The focus in terms of targets and perceptions about success thereby seems to have shifted from what several respondents described as an exaggerated and detailed emphasis on costs towards progress and goal attainment.

> *We are following progress. It becomes very clear what you are supposed to do and it is easy to follow up if you are on track or not . . . the KPIs measure if you are successful in what you are doing . . . we had scorecards before as well, but then the goals were linked to the budget and business plan, whereas here they are tied to our ambitions and strategic goals.*

Centralized power, decentralized action. While action plans are developed at lower levels in the organization, the scorecards and KPIs are determined at higher levels in the organization (however, there are some differences between different divisions). Setting targets based on corporate strategic goals requires knowledge and understanding of the corporate strategy. The respondents at GBS describe how decisions on high-priority targets have been centralized, and performance indicators (KPIs) are now more difficult to affect and change. Hence the decision-making power for targets seems to have moved upward in the organizational hierarchy, while at the same time, lower level managers and employees have gained influence in decisions related to action plans.

> *It's not easy to change a KPI, I don't think it's very likely that a KPI will be discarded, but it's probably easier to add a KPI than to remove one. Changing the scorecard, the KPIs and the strategic goals requires a management decision . . . but the action plans are dynamic.*

Hence the responsibility for breaking down strategic goals is higher in the organizational hierarchy, but the means for reaching goals (action plans) have been decentralized and are more flexible.

Target setting in the absence of budgets thus seems to have shifted the focus toward value creation rather than costs. Targets are now set at a higher level in the organization, which in itself can be perceived as increased control and less autonomy; however, at the same time the means for reaching targets have become decentralized providing more autonomy within the boundaries set by the targets.

Planning

In terms of planning, the removal of budgets is perceived as resulting in more focus on continuous improvements and quality deliveries (products and services). Forecasting, which is perceived as a much more proactive form of governance, has become a key activity and forecasting as well as following up is facilitated by new technology. We elaborate on each of these three points below.

From controlling costs to controlling action. The previous one-sided focus on costs, based on a system of lump-sum (fixed budget) has changed into a more comprehensive focus on costs, volume and quality. Respondents express relief about not having to spend their allocated resources within a certain timeframe and they no longer have to play budgetary games. Instead they can focus their attention on value creation. While there are some concerns about maintaining control, in general, respondents report that the organization is pleased with the expanded and comprehensive goals.

> *Nobody gets a lump sum of money to spend during a year any longer.*
>
> *. . . the old problem of 'having to spend the budget' and 'risking getting less next year' . . . getting rid of this is just fantastic . . .*
>
> *There used to be an extreme focus on costs . . . people were asking where is the value; why don't we focus on value creation and the things we actually produce, and use the resources necessary to reach those goals . . .*

Target goals and the plans for reaching goals (the action plans) are entered into an IT system. This facilitates reporting, documentation and following up. It also makes results transparent, and one respondent argues that the transparent system makes goal attainment extra motivating:

> *This is the scorecard for GBS 2007 [on the computer]. As you can see, it's possible to click on each element. The ambition is on the top 'World class provider of business services within 2010.' Then you have the strategic goal and the KPIs and the actions here. Behind each action there is a table showing what should be done, who is responsible and deadlines for delivery. Then you plug in the status as you go along. This document is followed up in management meetings.*
>
> *What we do becomes very transparent. Everyone in the organization can monitor our KPIs . . . everything is open access . . .*

The respondents argue that the scorecard has become more important after introducing the Beyond Budgeting principles. Before the budget was the main controlling system and the scorecard had lower priority.

From reactive to proactive planning. It is argued that shifting from budget control to scorecards and KPIs has made forecasting into a central activity. Forecasting makes it possible to follow up and monitor effects. This is described as much more proactive as compared with reactive measures taken after actual results (costs) have been compared with budgets. Hence, with KPIs, the organization does not need to see the actual figures (on costs and such), instead they can compare planned action, with what has actually been done, incorporate new information and adjust their action plans accordingly.

> *. . . now the focus is on forecasting . . . when we get forecasts, we report and follow up, partly based on 2006 accounting.*
>
> *We wanted an action-based organization, focusing on actions and prognosis, solving problems before they occur, instead of always looking in retrospect at the result.*

The respondents in the GBS division perceive planning practices in the absence of budgets as more focused on action and being proactive, while they perceive much less focus on costs and reactive behavior. The main planning device has become the scorecard and with its transparency through the IT system, control becomes very explicit.

Resource Allocation

The criteria for allocating resources in practice, without budgets, are based on a rule of big numbers. Respondents describe this as a dynamic (rather than a priori and set) allocation of resources. This makes the timing of decision-making more pertinent and relevant.

From details to the rule of big numbers. When describing the previous system for resource allocation, it becomes apparent that the budgets involved assessments at a very detailed level which was time consuming and uncertain because of fast changes. Several measures were taken within GBS to facilitate and pave the way for moving away from such a detailed level of reporting. More aggregated packages of products and services were developed and the time available for budgeting was substantially cut. When budgets were removed, the focus on big numbers rather than details was eased into the mind-set of people.

> *Previously we spent several months on the budget process . . . while now we gather input to define scorecards and this process is at a higher level and less detailed, so the big numbers rule and it's working.*
>
> *Previously we sold man labour year or hours; we sold components at a very detailed level instead of selling a service and a product at a more aggregated level . . . this change clarifies what it is we deliver in terms of services to our customer.*

From set a priori allocation to dynamic allocation of resources. The possibility of allocating resources throughout the year was perceived as considerably more flexible as compared with the system based on yearly a priori estimates of resource needs. In addition, respondents described that this could trigger more creative solutions and discussions at lower levels within the organization, thus contributing to empowering lower level employees. However, empowerment was also described as bringing responsibilities and another effect of removing budgets was that managers could no longer point to budget constraints in order to effectively stop ideas that appear mid-year.

> *You need to have control, but a lump-sum for a year or so can hinder discussions about what to put priority on.. . . Beyond Budgeting provides more flexibility for new action plans and creative solutions can be put into action sooner.*
>
> *For people at lower levels in the organization with responsibilities for delivering services, it might have been safe to have a set budget . . . when someone came in and tried to make changes, then you would have a document to put on the table showing that changes could not be made – this is my budget, this is the plan . . . and then it's possible to reject based on previous decisions. But sometimes such changes mid-way will be smart, and now it becomes more difficult to say no, because there are no budgetary limitations.*

Respondents describe that a more dynamic resource allocation process leads to more relevant timing of decision-making. Decisions were previously made in relation to a pre-decided cost level: whereas without budgets, decisions are now made independently of the budget and the price per unit is decisive. This means that decisions can be made in a more timely manner, by incorporating real-time information, and making action plan decisions more flexible. This also changes the responsibilities of controllers and middle managers as they have less control of the scorecards and targets that are set, but more influence on the actions chosen to reach those goals. Finally, this also creates more pressure to secure action.

> *... the timing of decision-making is more relevant in relation to the progression of things. We are no longer forced to make decisions far in advance ... You still have to think long-term; you make forecasts for 12 months ahead. You know how you are doing based on historical data, but you have to force yourself to think ahead at how this will develop during the next 12 months and incorporate this in your management/steering.*
>
> *There is not increased flexibility at lower levels in the organization, but there are strong forces that encourage discussions about whether what has been planned is the right thing to do, perhaps it was the right thing to do previously, but not any more. If so, then we will change our plans based on a new element [information]. Beyond Budgeting creates more room for these types of discussions, which previously would be killed by putting the budget on the table.*

Our data on how resource allocation in GBS has changed with Beyond Budgeting indicates that time-consuming and detailed measures are no longer expected to be in focus. There is little reflection on potential loss of valuable information and the focus on the bigger picture seems inherently positive among our respondents. In addition, it is expected that resources will be allocated on a more dynamic basis, which is also described as positive although it could also lead to challenges in the face of limited resources.

Cross-Case Analysis

In the previous section we illustrated how organizational members described and experienced the removal of budgets in practice. Our focus is on how these theoretical and general ideas are adopted and interpreted by organizational members at both corporate and division level. Since we have limited empirical evidence on the effects of removing budgets in organizations, we have attempted to capture the rules of action that are developed when a well-established management control system such as the budget is replaced with a new control system. At the corporate level, the new control system leads to the introduction of three separate processes: target setting, planning and resource allocation. Activities are to be measured using scorecards based on a balanced scorecard approach, with multiple indicators and not just financial ones. The new control system requires changes in how organizational members think about and practiced control and performance measurement. The changes in practice that were uncovered based on interviews in two divisions – GEX and GBS – are summarized in Table 3.

In this section, we draw on agency theory and resource dependency theory to discuss the new rules of action that were formed and expectations in terms of new interaction patterns that will be established in the absence of budgets. Agency theory is used to analyze the individual aspects while resource dependency theory is used to analyze the organizational or unit level.

New Rules of Action

Based on the descriptions in the two divisions we studied, three new rules of action seem to have emerged after the budgets were removed: (1) goals should be strategic and based on ambitions, (2) focus should be on the big picture rather than details, (3) focus should be on possibilities and flexibility rather than constraints.

Action rule 1: goals should be strategic and based on ambitions. When budgets are the basis for target setting, it becomes almost unavoidable that targets are constrained by the budgets. Separating target setting from planning and resource allocation made it possible to set targets irrespective of available resources. Hence the new rule of action was to *set ambitious goals* and to focus on value creation and strategic action rather than cost targets. The backside is of course if there is lack of resources.

The other main reason for separating target setting from planning and resource allocation was to ensure that forecasts were made independently of available

Table 3. Oilco's three processes as viewed by the individual divisions

Three processes	GEX Global Exploration Division	GBS Global Business Services Division
Target setting	• From bottom-up to outside-in • From focus on own division to corporate focus	• From cost focus to value creation • Centralization of power, decentralization of action
Planning	• From absolute to relative goals • Realistic forecasts	• From controlling costs to controlling action • From reactive to proactive planning
Resource allocation	• Use of criteria instead of budgets • Dynamic allocation of resources	• From details to rule of big numbers • From set and a priori allocation to dynamic allocation

resources. Forecasting simultaneously with the planning process had previously led some sales managers to forecast numbers similar to the target, making the target low in order to get the bonus. The company had similar experiences in terms of estimating costs. The expected level of resources and the cost budget for the next year were sometimes set at the same level. As a consequence, the estimated costs were set too high. Finally, similar figures were sometimes used for forecasting, which created a polluted forecast.

The shift from cost to value focus was enabled by moving target setting responsibilities upward in the organization, and this can explain some respondents' description of a deterministic process. Instead of formulating plans based on management's expectations, competitors and external factors now influence ambitions. Hence target setting was performed at a higher level in the organization than when compared with the budgetary control system. While managers previously had autonomy to set targets (within the budgetary constraints), targets are now seen as increasingly determined by the environment, such as by market expectations and by the cost level of competitors. The targets are not only based on absolute numbers, but instead also relative to a number of factors such as: expectations, competitor achievements and so on. In this sense, targets have become more dynamic and they better incorporate the fact that competitors are not static, but also pursue different strategies. However, the level of control over targets is described as decreasing, and one might question if budgetary constraints have been replaced with external constraints. This might indicate that Beyond Budgeting fits better in some industries then others. One might also ask how external constraints are determined, that is, who in the organization interprets signals from the market and how objective are these externally determined constraints?

Action rule 2: focus on the big picture. Focus on the big picture can contribute in reducing sub-optimalization between divisions. One of the key challenges of the budget was the lengthy process (in terms of time and resources spent) and the level of detail involved, particularly in terms of cost estimates. Once budgets were removed, the rule was to focus on the big numbers instead of details and this was secured in part by substantially shortening the time available for decisions on resource allocation. The criteria for allocating resources also forced organizational units to look beyond their own unit and focus on the big picture, meaning the whole organization, rather than their own business unit or division. Investment decisions were made across divisional sub-units, not once a year, but on a flexible basis, and resources were allocated based on a set of criteria and not by allocation of a lump sum once a year for each division. Hence, there is no longer any reason for gaming, where those with budget responsibilities focused on setting targets low to show goal achievement and estimating costs high, to keep within budgets. However, it is difficult to say if the new control system leads to a different kind of game than the budget game. A game where members of the management group attempt to influence each other, perhaps through horse-trading, in order to get their projects pushed through in the decision process. Not all criteria are objective, which makes it possible to play when it comes to the subject criteria.

Action rule 3: focus on possibilities and flexibility. Separating resource allocation from target setting and planning and making resource allocation dynamic also means that it is no longer possible for managers to refuse an investment proposal based on budgetary constraints. Dynamic resource allocation implies that any project that meets the criteria (given that capacity constraints through forecasting do not stop it), regardless of timing, will always receive the necessary resources. This makes the control system more flexible and it can lead to a more efficient use of time.

If we link these three new rules of action to agency theory (Jensen and Meckling, 1976), it becomes evident that the principal's mechanism for controlling agency behavior has changed. Strategic goals and action are now the basis for control. While the goals are rather rigid and set by the principal (i.e. top management) they are based in part on relative and externally determined factors, such as benchmarking. The agent (each division management) has more flexibility in terms of how to reach goals. A traditional cost budget is a total number split into more details. It provides limited freedom and flexibility. When the budget is replaced with Beyond Budgeting principles, the planning never becomes that detailed. Instead, the principal can control the agents' behavior more readily because of easier access to more relevant and timely information, through the balanced scorecards. While some employees describe this as motivating, the transparency and accessibility may become perceived as more negative if achievements are poor or depending on the context. However, this study was done in the oil and energy sector which had very good trade conditions at the time.

Beyond Budgeting appears to empower employees by providing more freedom in terms of how to reach goals. The increased accessibility to control action, with KPIs, comes hand in hand. Instead of having detailed budgets based on a rigid system for how to reach goals, the employees can use their creativity to come up with ideas about how to reach goals. Hence, organizational members have more autonomy. However, expectations and responsibility for showing results simultaneously increases. The principal has replaced budgets with other forms of control, which are easily accessible and quite detailed, but focus on action and KPIs, rather than focusing predominantly on costs.

The incentives for agents to act in the interest of the principal have also changed. One of the challenges in using a budget was that the agent had an incentive to play budgetary games, such as by estimating higher costs than expected in order to show good results and secure next year's allocation (Wildavsky, 1975). The three separate processes have made this less likely. Goals are set without reference to budgets and costs. More ambitious goals are thus expected. However, as organizational members become familiar with the new control system, we may see other games appearing, for instance, in terms of setting the criteria for investments, interpreting and applying criteria, particularly when assessing more subjectively oriented criteria (such as country risk, image, etc.).

The principal's mechanisms for controlling agent behavior have shifted from detailed costs to detailed action control. This is however also possible if the company uses activity-based budgets but Beyond Budgeting moves one step further in focusing on action control (Hansen *et al.*, 2003). As a result of this, the relationship between the principal and agent has also changed. This leads us into our second research question concerning new patterns of interaction.

Expectations of New Patterns of Interaction

Drawing on our two case descriptions, we find that interaction within the organization is expected to change and new roles are likely to evolve in the following ways: more horizontal interaction between sub-managers, less vertical interaction between division manager and sub-managers, the controller takes on a more strategic role and the power balance has shifted. We discuss each of these in more detail below.

More horizontal interaction between sub-managers. Targets and goals are set by the division management team (for instance, for all of GEX) and not for the individual sub-unit (such as Africa, Asia, Russia). At the divisional level, a cross-division management team makes investment decisions, forcing this team to always consider where the invested money will generate the greatest returns – across units, rather than focusing within the unit and on unit performance only. This team is measured on the goals for the whole division and this is expected to contribute to generating greater cooperation across divisions. It is difficult at this point in time to assess whether removal of budgets in fact facilitates cross-divisional cooperation. Furthermore, the management structure and divisional goals will not be able to abolish inter-unit competition. These changes do, however, provide a focus on good projects and value-generating activities, rather than gaming for the largest share of a given lump of resources.

As discussed previously, the question remains whether the new control system leads to development of new kinds of games. Our data give no indications of this as Beyond Budgeting had just been introduced. New games are likely to appear after some time and once the new principles have become institutionalized. Possible new games might for instance be linked with increased interaction (perhaps in the form of negotiations) concerning the criteria by which project proposals are assessed and/or negotiations about how to interpret the criteria for resource allocation. Project selling can also be perceived as a competition between different divisions.

Less vertical interaction between division manager and sub-managers. When budgets were used, the relations between the division manager and the sub-unit managers (responsible for Africa, Asia and so on) were based on frequent interactions. After the introduction of Beyond Budgeting, the contact has changed. The main meeting arena is now the sub-manager meeting. Instead of discussing with the division manager, the sub-unit division managers now have more contact with their controller and with the other sub-unit managers. One implication of less vertical interaction is that the strategy implementation is based more on the KPIs instead of vertical dialog and interaction. This can be a risk when changing the strategy rapidly (see Tuomela, 2005, arguing that it is important with interactive control systems). Strategy implementation to a great extent depends on how sub-unit managers interpret the KPIs.

Controllers have a more strategic role. The controller's role has changed with the removal of budgets. Less focus on controlling the accounts has shifted the main task of controllers toward strategic issues and controlling if the strategy is being implemented. Fulfilling this role requires a broader set of skills than accounting and numerical proficiency. The strategy-focused controller needs skills in analysis and forecasting. With the new control system, the controller is perceived as more central in terms of his/her affiliation and support to the division management and the sub-unit manager. This indicates that to effectively apply Beyond Budgeting controllers need broader skills and the capability to make more ad hoc analysis.

Shift in power balance. Along with changes in interaction and roles, the power balance has shifted somewhat. Top management has increased its power in terms of goal setting since the goals (or targets) are set outside-in, that is, targets are set by the relative benchmark of other oil companies. However, division management and lower level managers and employees have increased power in terms of the means for reaching strategic goals, hence there is increased freedom to act, alongside more severe (or at least noticeable) consequences if they fail to reach goals. There is no experience yet in terms of the consequences of not meeting targets and strategic goals, hence it is difficult to say if the consequences will be more severe in practice. This depends on how the shift in power balance will be exercised. Previously, division managers with large budgets had power, whereas in the new system, 'good projects' according to the new criteria will generate funding. Hence power will more likely be linked directly with good projects.

Resource dependency theory suggests that organizations depend on the external environment for resources (Pfeffer and Salancik, 1978). Likewise, divisions and units within a multidivisional firm depend on the corporate environment for resources. A common tool for allocating resources has been the budget, and some managers have become experts at securing their division's resources by playing the budgetary game. When budgets are removed, however, interaction patterns change in the organization and different dependencies appear to be evolving. Division management no longer receives a lump sum of financial resources, but have to apply for funding, project by project on a rolling basis. As long as they have good enough projects, the autonomy will benefit them, but this depends on their ability to sell projects. Controllers play a key role in helping sub-divisional management to 'sell' projects to division management. While the idea is to facilitate coordination and cooperation across different units, and secure the best use of resources for the whole organization, the long-term consequences and implications of removing budgets can only be seen in a situation of scarce resources.

While the new forms of allocating resources have created new interaction patterns, we have limited information on how new interaction patterns and dependencies are exercised. For instance, what happens to free-riders when resources are scarce? What happens to low-performing units in terms of status, willingness to invest for the long term when short-term profits might suffer? Hence, while evolving action rules and patterns of interaction can be identified uncovering long-term implications requires a longer timeframe and good projects actually have to be turned down because of limited resources.

Conclusions

This study reports on a large multinational and multidivisional corporation's early attempts to move Beyond Budgeting. We have examined how a popular management control innovation or 'idea' such as Beyond Budgeting is adopted by corporate management and implemented at divisional level. Despite the increasing interest and application of Beyond Budgeting principles in organizations, no studies have documented how Beyond Budgeting actually is applied in organizations. Our study documents the rules of action that are expected to emerge in the absence of budgets, and how removing budgets is expected to influence interaction patterns in the organization. This study contributes to a practical understanding of how a new management control philosophy, Beyond Budgeting, is adopted in an organization. Our study illustrates both intended and unintended consequences of moving Beyond Budgeting.

We have argued that three new rules of action are expected to emerge in the absence of budgets. First, *targets are expected to become more strategic and based on high ambitions*. In the previous control system, the strategic targets were constrained by the budget. Separating target setting from planning and resource allocation made it possible to set targets irrespective of available resources. Hence, the new rule of action was to set ambitious goals and to focus on value creation and strategic action rather than cost targets. Second, a *greater focus on the big picture* has become important. The budget-based control system resulted in budget games. The game has been eliminated now that credit is given to the whole group instead of to the different divisions. This is described as increasing the level of decentralization when it comes to how to reach targets. However, this can also be understood as an increased centralization regarding target setting. The third rule of action is perceived as an *increased focus on possibilities and flexibility*. This rule is based on the new dynamic resource allocation. Instead of allocating resources once a year, Beyond Budgeting employs a dynamic resource allocation process and the division obtains financial resources continuously as long as they present projects that meet the criteria.

Four different patterns of interaction were identified as likely to appear with the removal of budgets. First, Beyond Budgeting is expected to lead to *more horizontal integration* because the sub-division managers have more contact with each other and because of the dynamic resource allocation. Second, we found that there was *less vertical integration* once budgets were removed. This was because the previous resource allocation process had created a link between the division manager and the sub-division manager, but with Beyond Budgeting the relationship shifted to division manager and the controller; hence the sub-division manager now had less contact with division management. Third, *the controller is perceived to have become more powerful*. This is a result of the new relationship established between division management and the controllers. Fourth, *power has shifted upwards* with the increased centralization of target setting, although there has simultaneously been increased decentralization regarding how divisions and sub-division managers should reach the targets.

The Beyond Budgeting approach has moved the focus from reaching the budget goals to being best on the ranking list. In order to create the competitive feeling, the different divisions are compared with others (benchmarked) and this benchmark is supposed to create both transparency and trigger competition. The competition is both within the company and between companies. One risk with ranking inside the company is that the managers do not want to share knowledge with other leaders. This risk is sought reduced by also having external benchmarks.

Finally, to what extent does Beyond Budgeting resolve the challenges and critique against budgets (Hansen *et al.*, 2003, p. 102)? This remains to be seen once new management control systems such as Beyond Budgeting have become institutionalized. Based on the descriptions and expectations of corporate level management and division management we are able to make some predictions however. The traditional budget has been criticized for *failing when it comes to creating a high performance climate based on competitive success* (Hansen *et al.*, 2003). Our study indicates that empowerment can be effective when accompanied with a shift from results control (the cornerstone in traditional budgetary controls) to controls based on corporate visions and values and codes of conduct. Second, traditional budgets fail to *make people accountable* for satisfied customers because financial performance measures predominate (Hansen *et al.*, 2003). Our findings indicate that the managers expect to have more time to spend on solving the problem instead of focusing on if they are within the budget limit. Third, traditional budgets *fail to empower people* to act by providing them with resource capabilities because resources have been committed for the budgeting period (Hansen *et al.*, 2003). Our findings suggest that dynamic resource allocation empowers people since the focus is on getting new projects all the time. However, we know little about how Beyond Budgeting might empower people to creatively secure their own projects.

This study represents an early stage of implementation which has not yet sufficiently uncovered the consequences of eliminating budgets. Replacing budgets with a Beyond-Budgeting-based control system can lead to difficulties. There are at least three challenges organizations that are considering removing budgets should be aware of: (1) the ambition problem, (2) the sub-optimalization game problem and (3) the employee exchange problem. First, the ambition is set by competitors (league table) in the new model instead of by the decentralized managers. This is done to be sure of being as good as possible (high ambitions). However, this can also lead to top managers pushing the division managers excessively. Instead of setting realistic bottom-up ambitions and securing ownership at lower levels, the ambitions risk becoming the unrealistic dreams of the top management. Second, the game problem refers to potential new games that will emerge with the new conditions. Even if the traditional budget game has disappeared, new games around the dynamic resource allocation can appear. One example is if the criteria used for accepting projects involve subjective dimensions that are open for interpretation. Future studies should examine potential new games that emerge, for instance, in connection with project assessments. Finally, the employee exchange problem refers to a situation where a division risks not getting any projects. Employees within that sub-unit then need to be transferred to units with higher levels of activity, and this requires highly flexible employees and competencies that can easily be mobilized for different purposes.

In addition, some researchers have pointed out the importance of taking organizational and national context into account when studying management control and performance measurement systems. Although our data suggest that Beyond Budgeting ideas are so far well received in the organization we studied, such new approaches to management control systems may depend on contextual factors. Oilco is an organization with a history of ample resources and sound financial results. In this organization it was possible to implement a new management control tool incrementally in the sense that the balanced scorecard first was implemented and then the traditional budgets were removed. In another context the financial situation might be more restricting and the shift towards newer control systems might be more radical, which naturally can affect how the systems are adopted.

Focusing on a national and more ideological level, Nørreklit *et al.* (2006) show that new human resource management models (mostly coming from the USA) such as the learning organization, the balanced scorecard and performance measures are becoming key tools for disciplining the individual and creating social order. Further on they conclude that in the encounter between, on the one hand, the Danish ideological tradition and, on the other hand, high modernity and globalisation, control models have emerged, which are they describe as not effective and which can have serious dysfunctional socio-psychological effects'

(Nørreklit *et al.*, 2006). In other words, they raise the issue about how different ideologies in different countries interpret control systems differently. In Nørreklit *et al.*'s terms, Beyond Budgeting can be understood as a change from a Scandinavian decentralized ideology to a more centralized contract-based ideology expressed through targets and resources. Although the organizational members we interviewed expressed no such concerns, perceptions of ideological clash may appear later in the implementation process, when the implications of the new system become more evident. Such issues are also more likely to appear in divisions that have not voluntarily implemented Beyond Budgeting. Future research should therefore probe organizational and contextual factors that might influence early adoption of Beyond Budgeting.

Another area for future research is to study the next step of the implementation. In this case we have described how Beyond Budgeting in an early phase has been successfully adopted at the central level of the organization, but what will happen when it is decentralized and everyone in the organization is supposed to act according to the Beyond Budgeting principles? This is especially interesting when financial crises hit the organization and cost control becomes a main focus of the organization. As we gain more experience with these new systems later stages in the implementation process and more long-term consequences of attempting to control without budgets must be documented as well.

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Notes

[1]The Oilco booklet is a corporate handbook describing corporate values and norms such as ethical guidelines, strategy process, etc.

[2]'Ambition to action' is the company label for the new management control process: target setting, forecasting and dynamic resource allocation.

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