

Beyond Budgeting - Strategic and Operative Planning at Borealis

By

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Borealis in Brief

- Established in 1994 by a merger of Statoil's (Norway) and Neste's (Finland) petrochemical divisions
- A polyolefins company with integrated cracker and polymer production
- Producer of environmentally superior polyolefin plastics polyethylene and polypropylene
- The world's fourth largest polyolefins producer
- In addition to products, Borealis offers its proprietary technology to the polyethylene and polypropylene industries under the trademark Borstar.
- Main competitors: Dow, ExxonMobil, Basell (Shell & BASF), Equistar, BP, Du Pont, and AtoFina

For more information, visit us at:

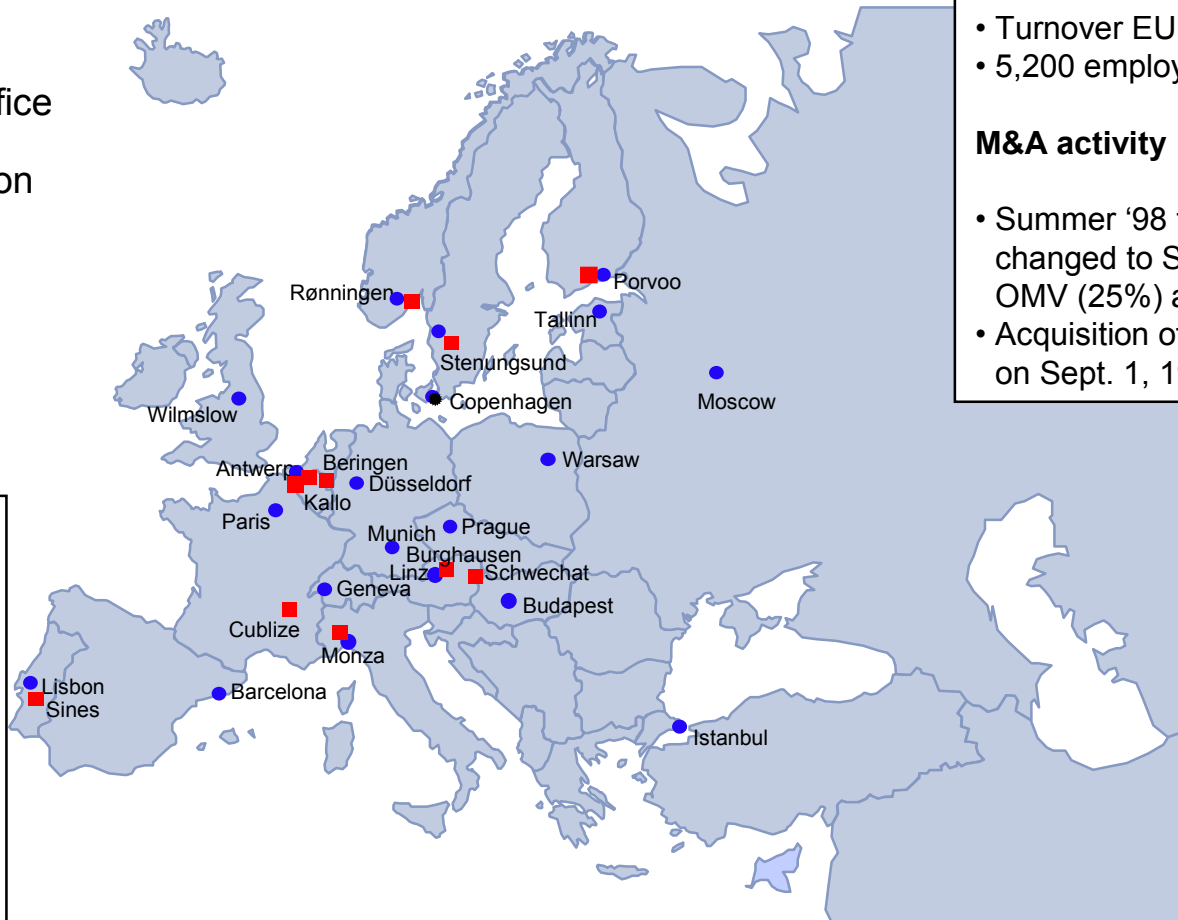
www.borealisgroup.com

The Products Can Be Found in Thousands of Everyday Products Like Diapers, Food Packaging and Housewares to Cars, Trucks, Pipes and Power Cables



Borealis in Europe

- Head Office
- Production
- Sales



Key figures (2000)

- Turnover EUR 3,7 billion
- 5,200 employees

M&A activity

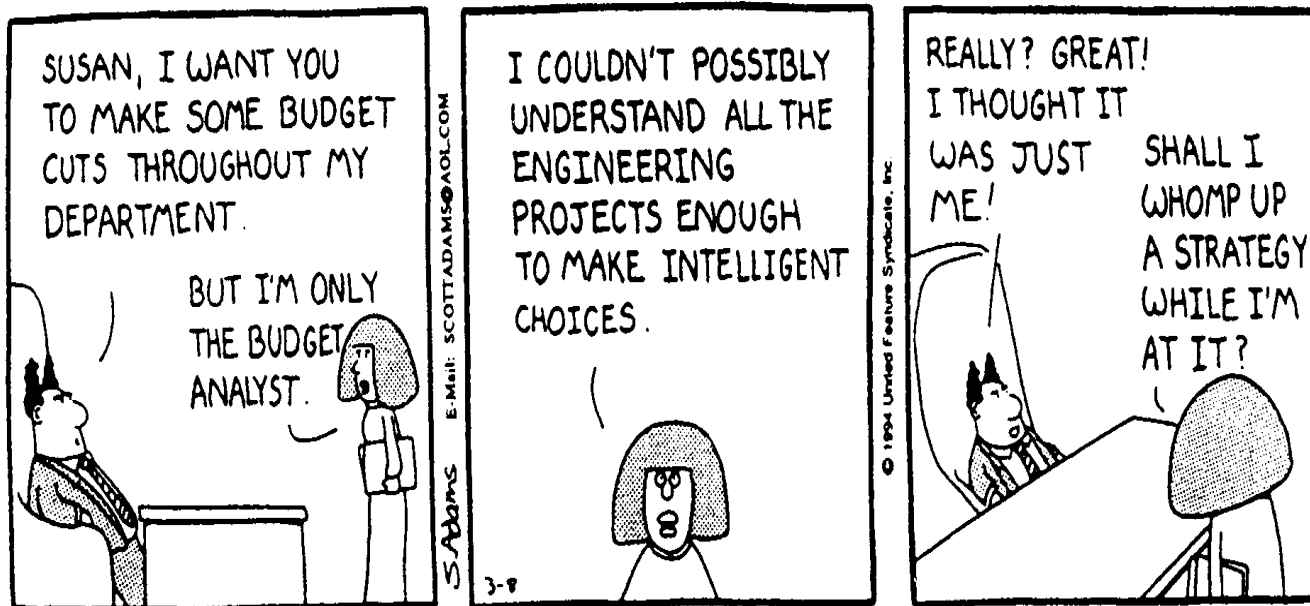
- Summer '98 the ownership changed to Statoil(50%), OMV (25%) and IPIC (25%)
- Acquisition of PCD Polymere on Sept. 1, 1998.

Outside Europe

Joint ventures:
 Borouge (Abu Dhabi),
 Borealis-OPP (Brazil),
 Nova-Borealis (USA)

Sales:
 Singapore, Hong Kong
 and China

Dilbert Logic on Budgeting and Strategy



Why Did We Abolish Traditional Budgeting?

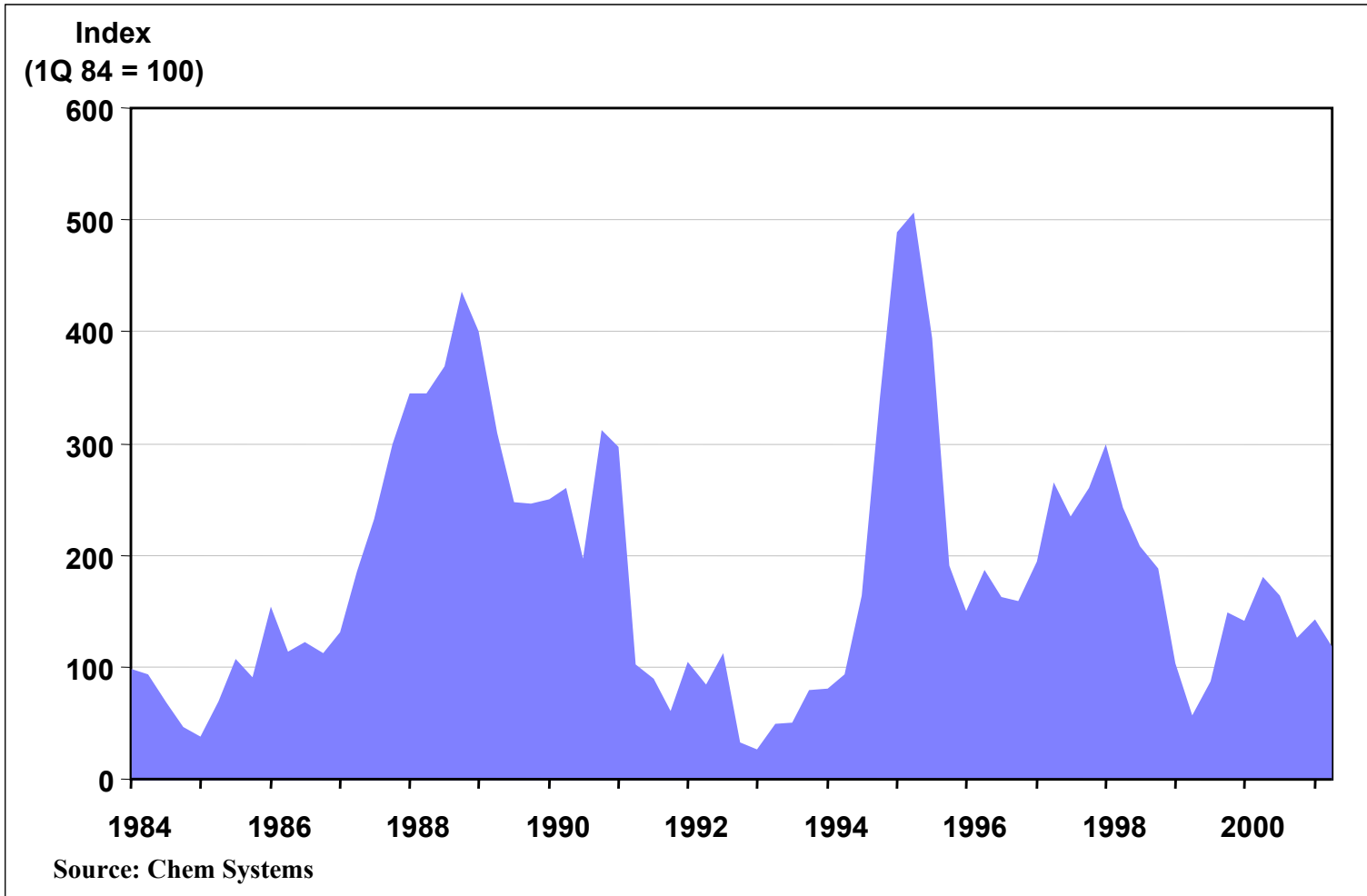
We wanted to:

- Improve our financial management and performance measurement
- Decentralise authority and decisions
- Simplify the budgeting process
- Reduce the resources used in the process

Traditional Budgeting Has Many Weaknesses....

- Conflicting purposes - target setting versus financial forecasting
- Not only a ceiling - also a floor for costs
- Promotes centralisation of decisions and responsibility
- Inflexible to changes in planning assumptions
- Absorbs significant resources across the organisation
- Tends to make financial control an annual autumn event

Petrochemical Industry Profitability Index in W Europe



We Achieved What the Budget Did in a Simpler Way

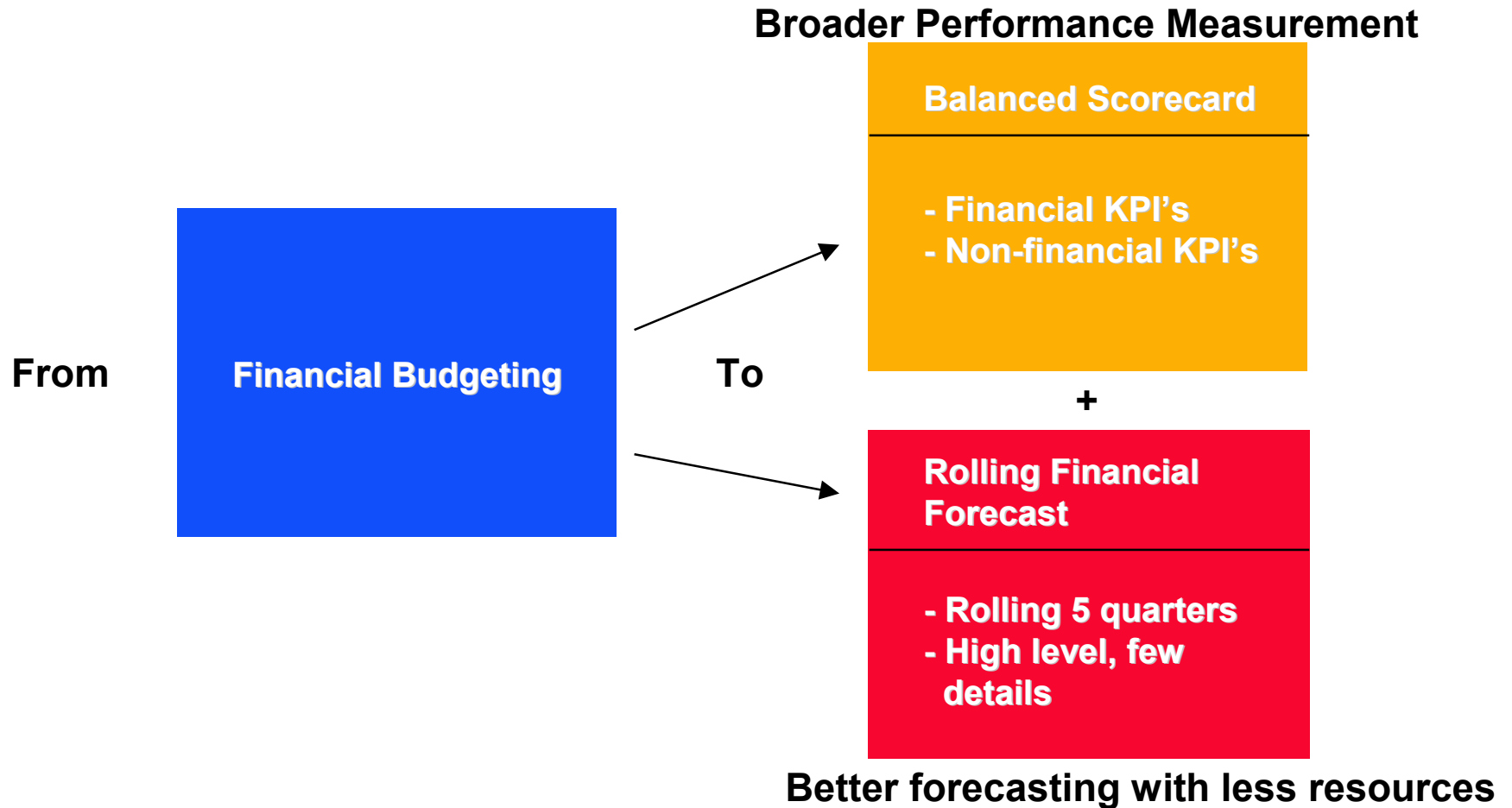
The budget was used for:

- High level financial and tax planning
- Target-setting
- Controlling fixed costs
- Prioritising and allocating investment/project resources
- Delegation of authority

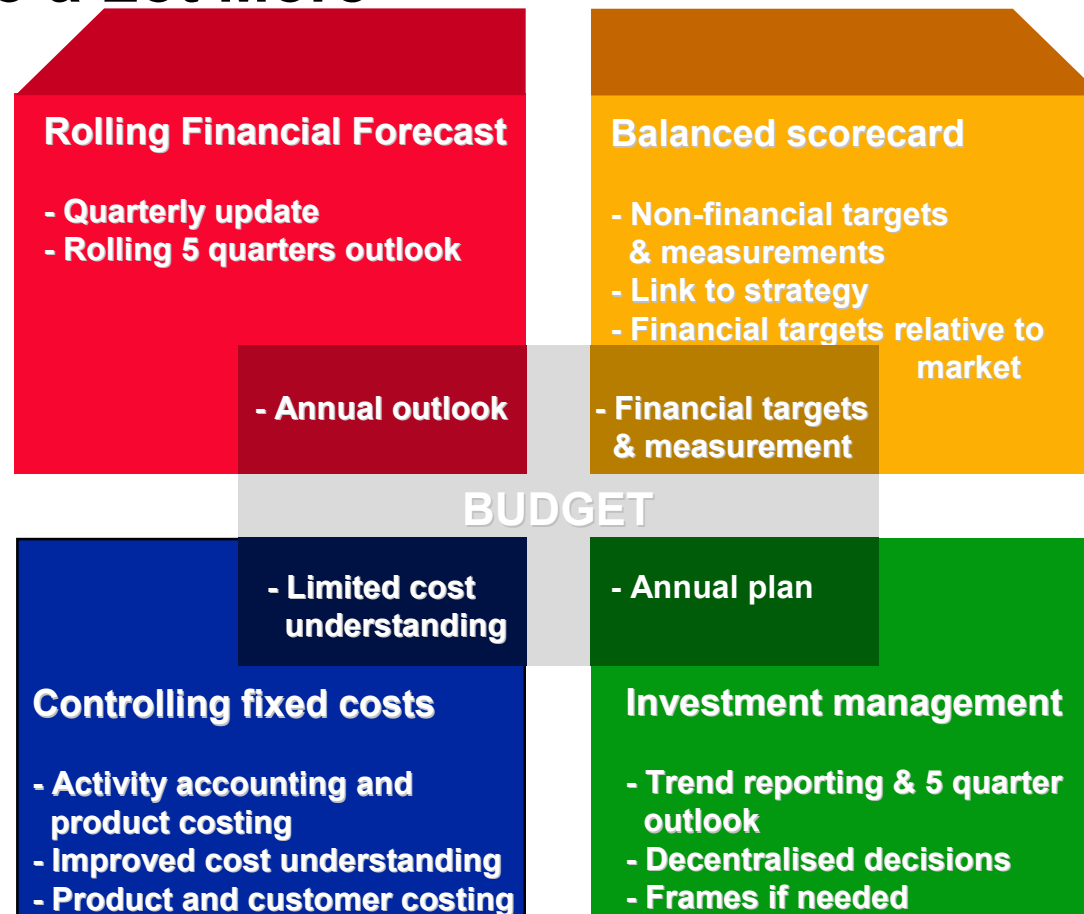
We achieve the same through:

- ✓ Rolling financial forecasts
- ✓ Balanced Scorecard
- ✓ Trend reporting
- ✓ Cost targets where and when needed
- ✓ Activity approach
- ✓ Small projects - trend reporting
- ✓ Medium - Varying hurdle rates
- ✓ Major strategic projects - Case by case, the budget was never a tool ...
- ✓ Use existing mandates/authority schedules

We Have Separated Performance Measurement From Financial Forecasting



The New Tools Cover What the Budget Did, but Also a Lot More





Rolling Financial Forecast and Trend Reporting



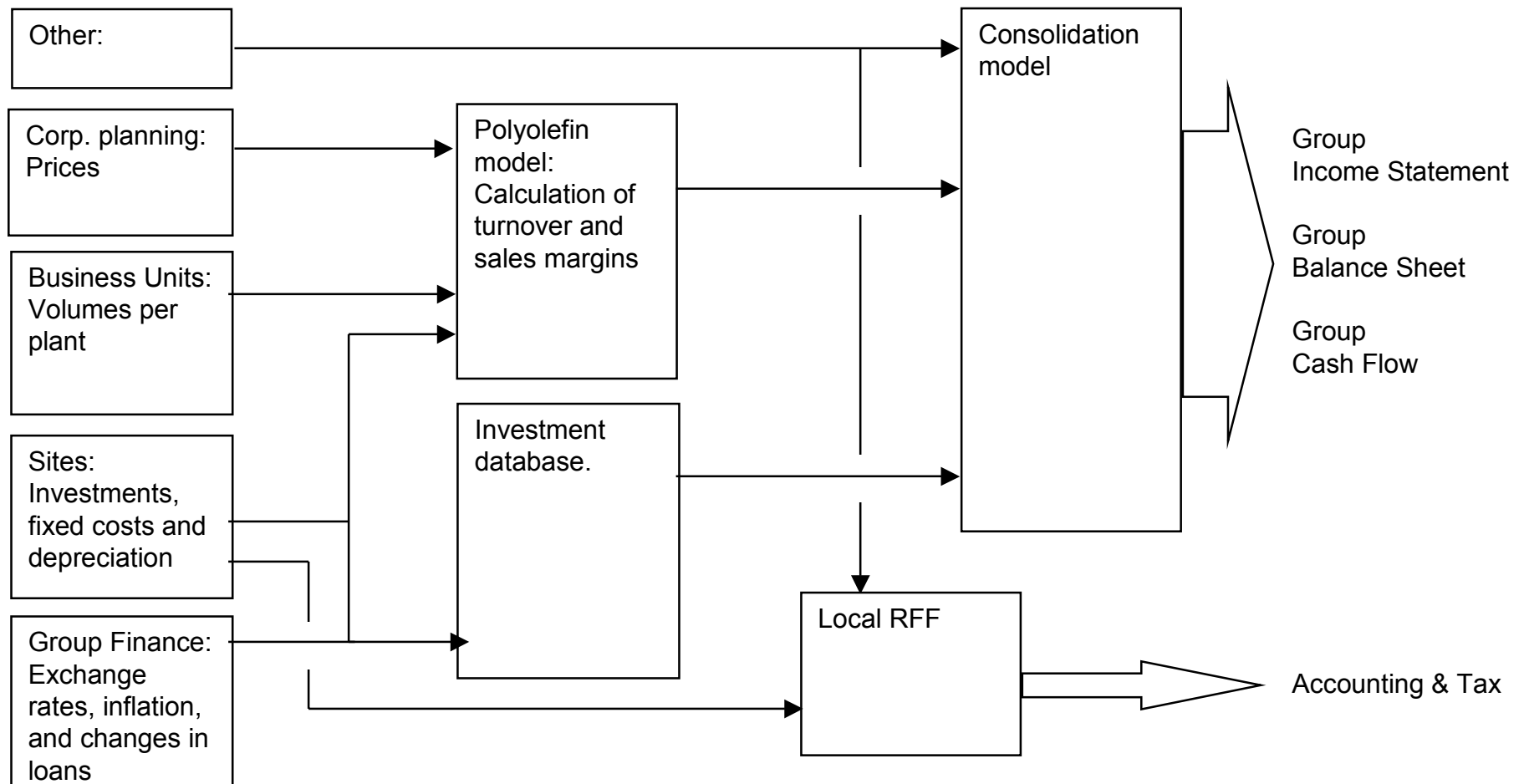


Rolling Financial Forecast

- For financial and tax planning at Group level and main legal entities
- No element of target-setting - only most likely outcome
- Updated quarterly , covering next 5 quarters
- Minimal resource use focusing on less details
- Higher accuracy than budgets
- Benefits
 - ✓ Continuously looking one year ahead
 - ✓ Always incorporates latest external and internal assumptions
 - ✓ No conflict between forecasting and target-setting



The Rolling Financial Forecast Process





In Practice, This Is How We Do It! (1)

Market price developments

- Price Drivers:
 - Industry stock building
 - General market consumption
 - Capacity developments
 - Trade between Asia, Europe and the US
 - Data built up from product groups

- Source:
 - Corporate Strategic Planning
 - Market Analysts in Business Units PE & PP

Market volume developments

- Volume Drivers:
 - Sales activities
 - Industry stock building
 - General market consumption
 - Capacity developments
 - Planned maintenance jobs
 - Alternative market channels
 - Data built up from assets

- Source:
 - BU Operations Planners



In Practice, This Is How We Do It! (2)

Fixed costs, depreciation and investments

- Fixed costs drivers:
 - Site Development Program (more for less)
 - On-going projects
 - General activity level
 - Head count

Investments are handled separately

- Source:
 - Site controllers

Exchange rates, inflation and loans

- Source:
 - Group Finance forecasts the developments in exchange rates and inflation based on the economic climate.
 - Changes in loans are based on the current loan agreements.
 - Financial needs are calculated based on the difference between cash flow from operations and financial obligations.



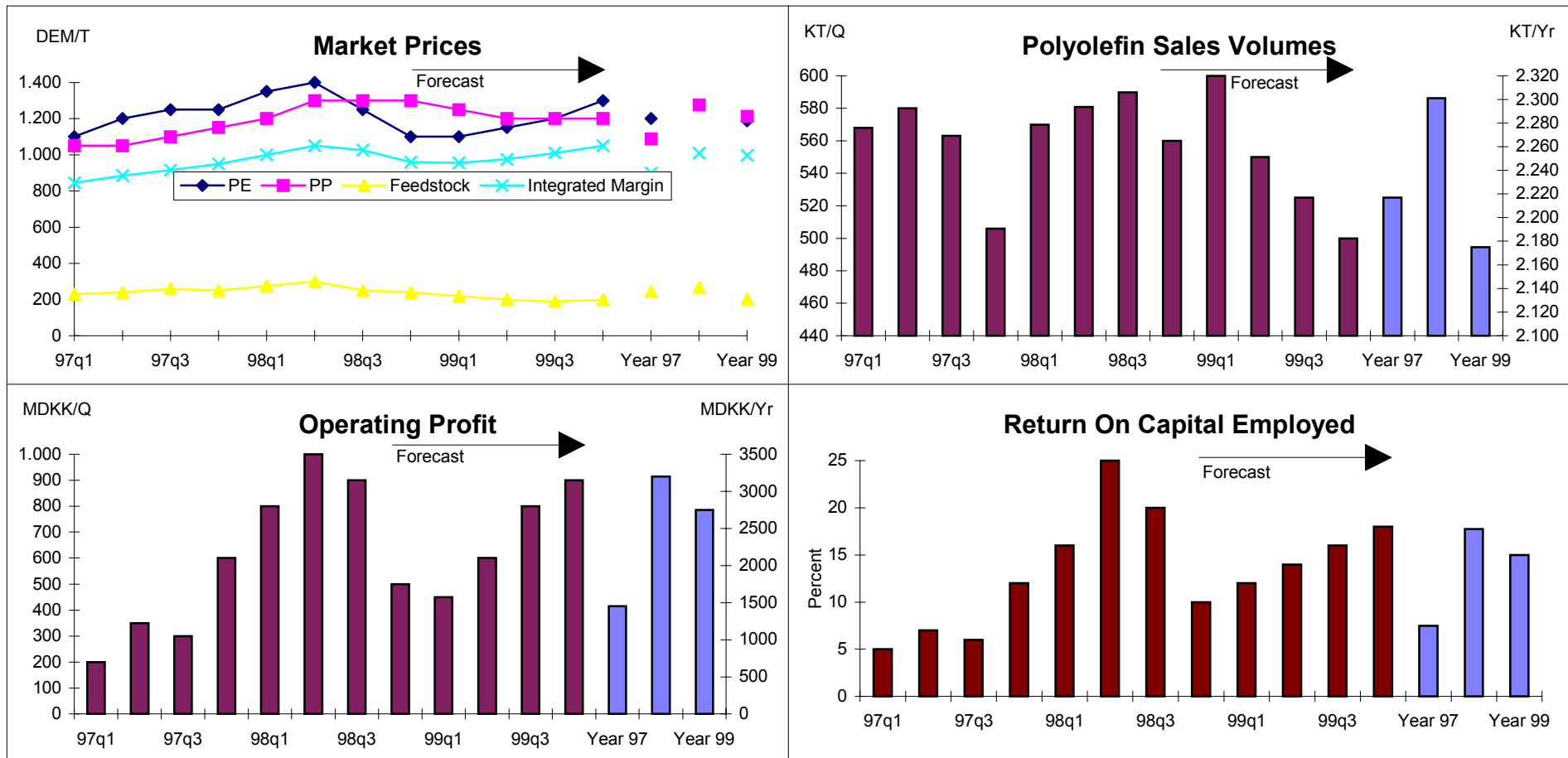
The Forecasts Include Full P&L and Balance Sheet

CONSOLIDATED P&L
Turnover
Sales margin
Fixed costs
Operating margin
Depreciation
Operating profit
Profit of ass. comp / sale of ass.
Financial income
Financial expenses
Net finance
Net extraordinary items
Profit before taxation
Income tax provision
Profit after taxes

CONSOLIDATED BALANCE SHEET	
ASSETS	LIABILITIES
Cash / deposits	Trade payables
Trade receivables	Short term int. bearing debt
Other receivables	Dividends to be paid
Inventories	Other liabilities
Current assets	Short term liabilities
Tangible fixed assets	Long term liabilities i)
Financial fixed assets	Badwill
Fixed assets	Other provisions
Total assets	Provisions
	Subordinated loan
	Minority interest
	Share capital
	Premium on issue
	Profit for the year
	Retained earnings
	Shareholders' equity
	Total liabilities



Updated View on Group Level, Quarterly





Balanced Scorecard





The Balanced Scorecard Approach Provides More Than Traditional Budget Measures

What is new ?

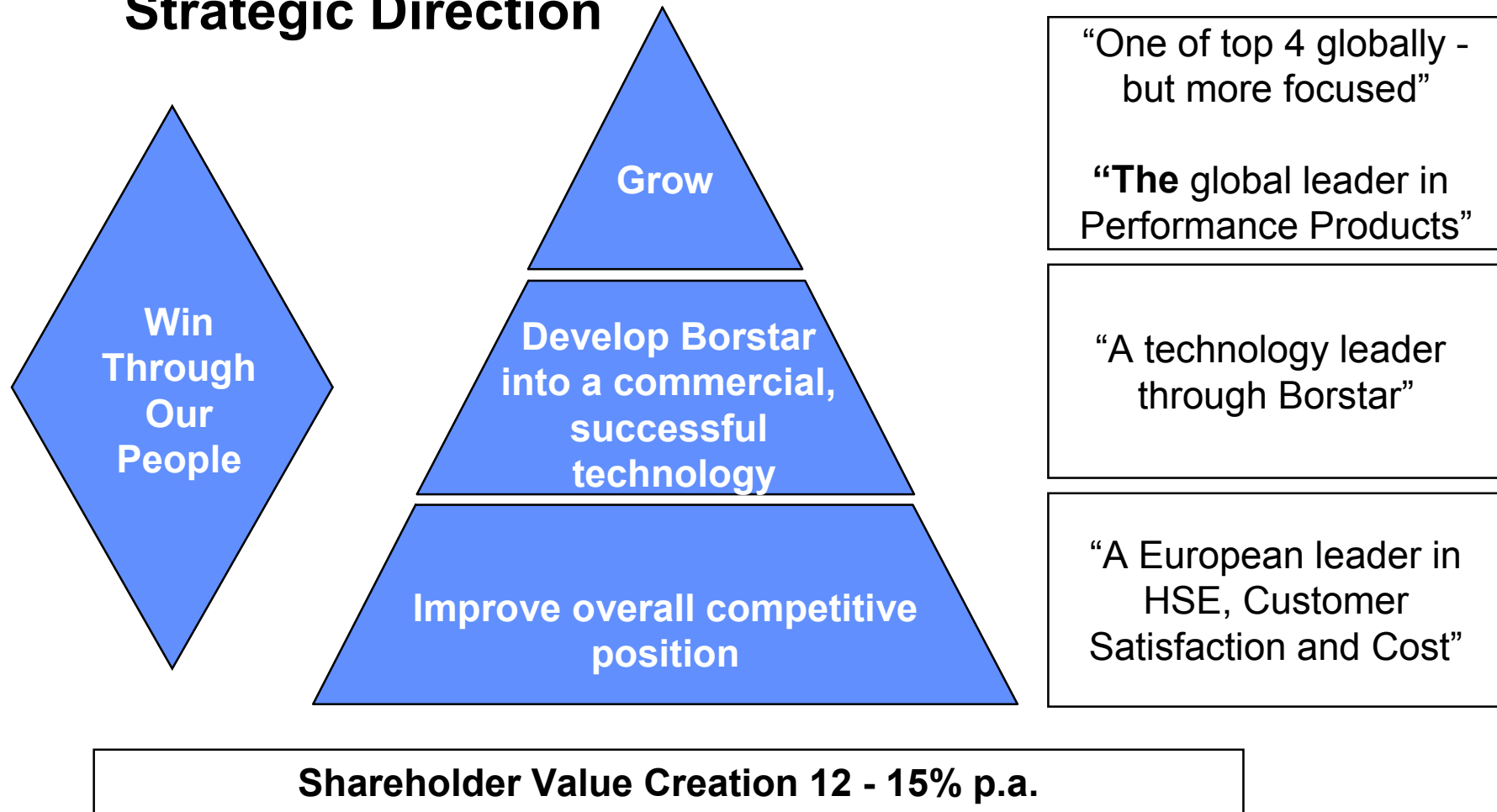
- More focus on non-financial performance ('balance' between financial/non-financial)
- Use strategy more systematically as guidance for selecting KPI's

How can we use it ?

- Use scorecard for target-setting and reporting progress
- Addresses the drivers behind the financial figures
- Use the scorecard to communicate the strategy

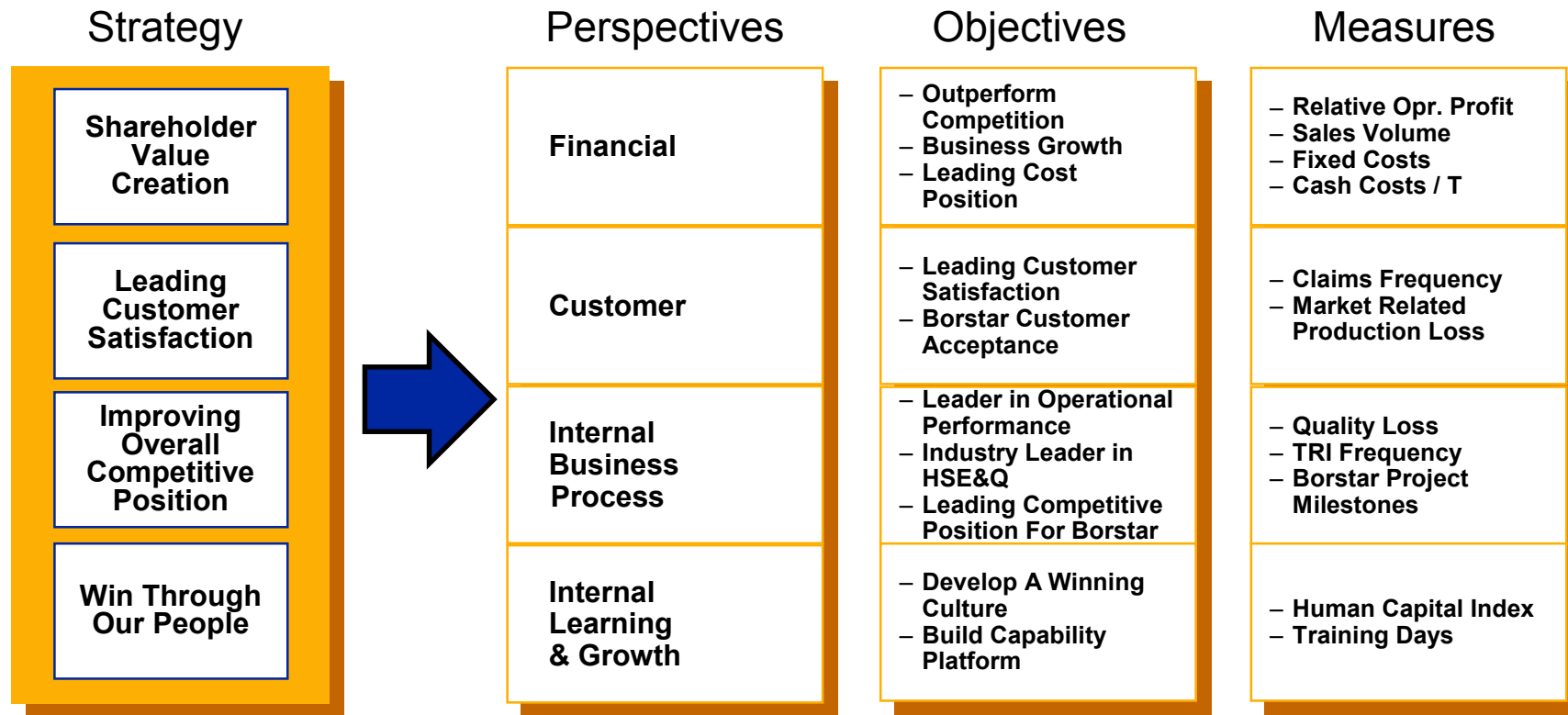


The Starting Point for the Balanced Scorecard Is Our Strategic Direction



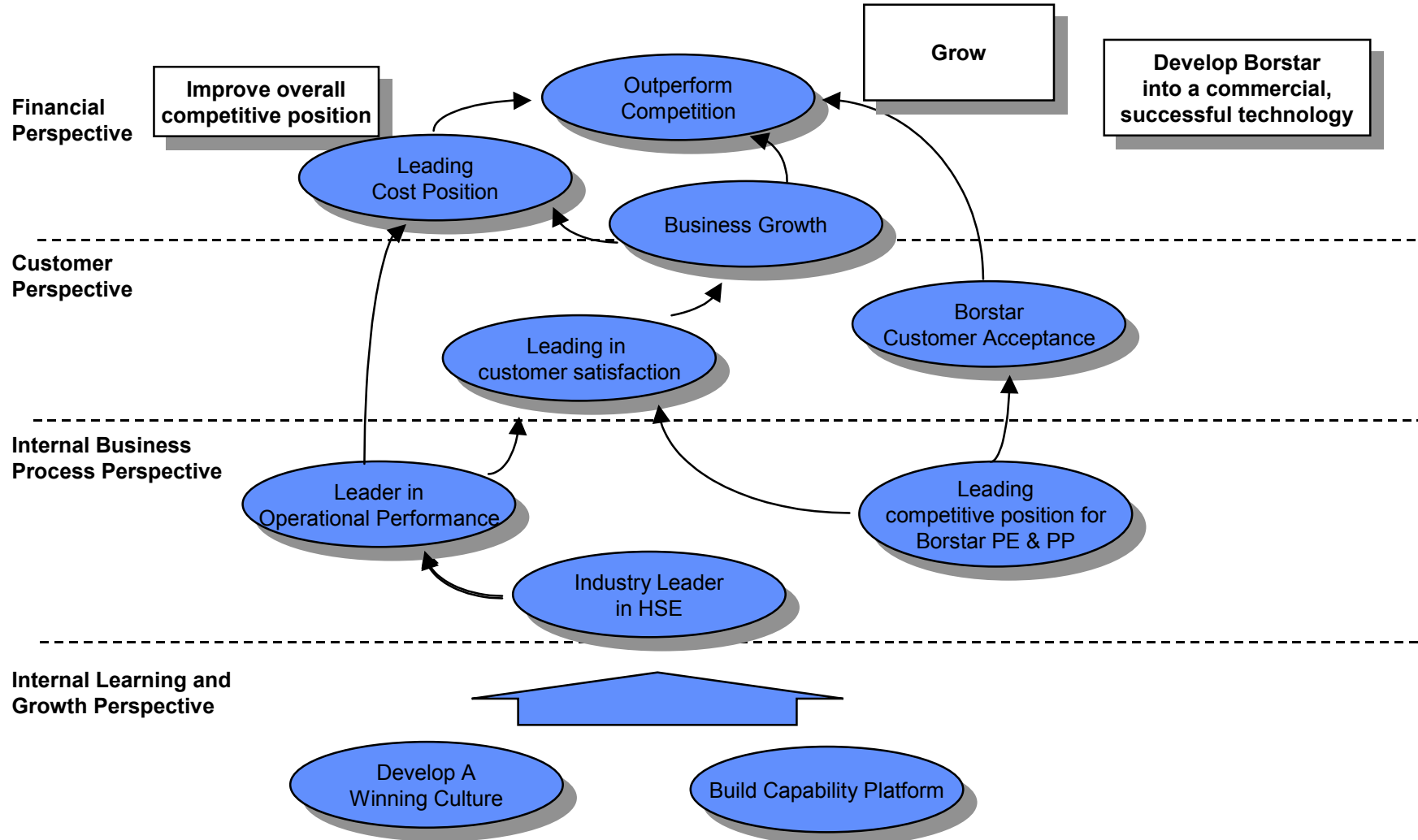


Key Performance Indicators Are Being Derived From Our Strategic Direction





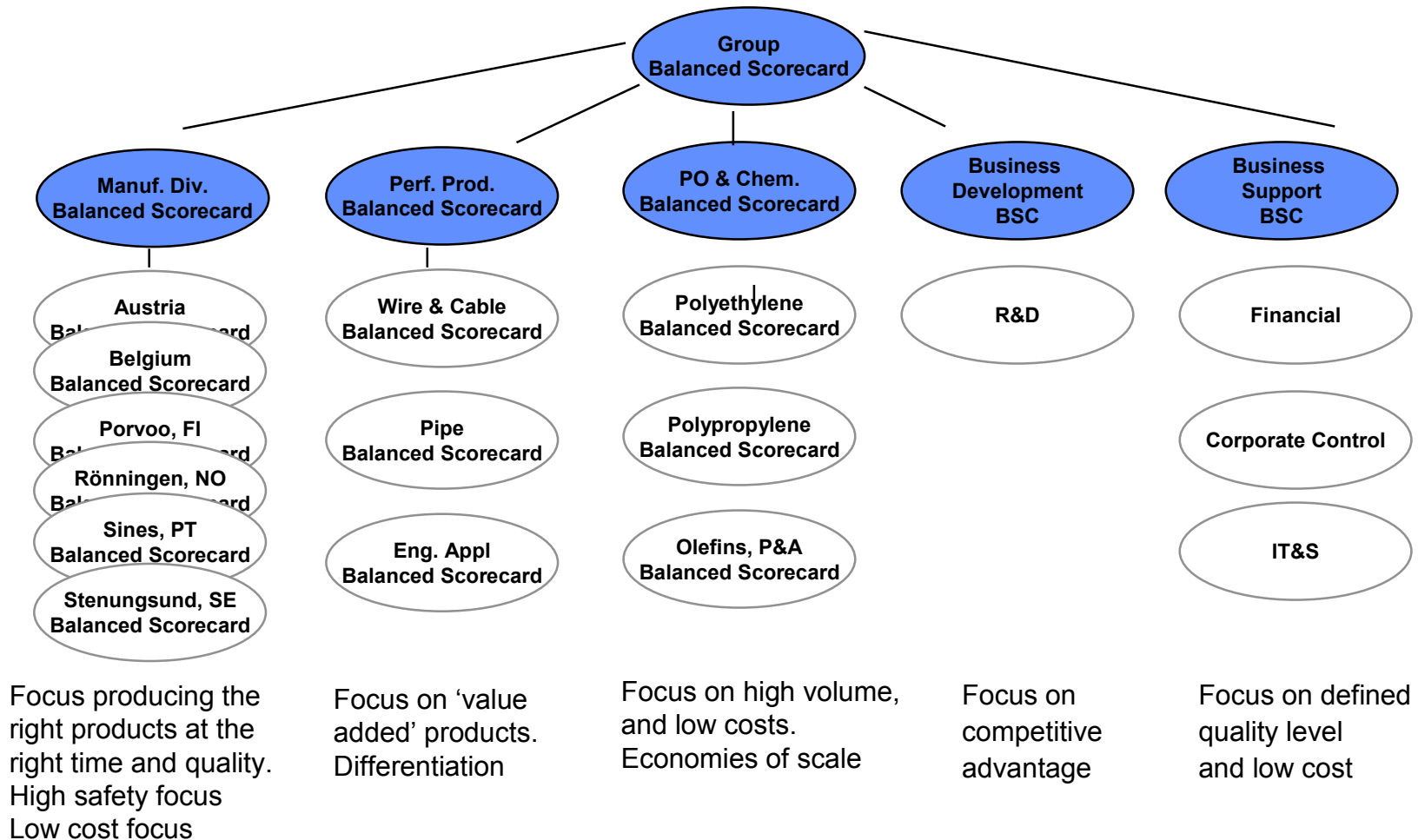
Corporate Strategic Objectives





Direction Set on Group Level, but Each Unit Owns Their Balanced Scorecard

Focus on value for owners



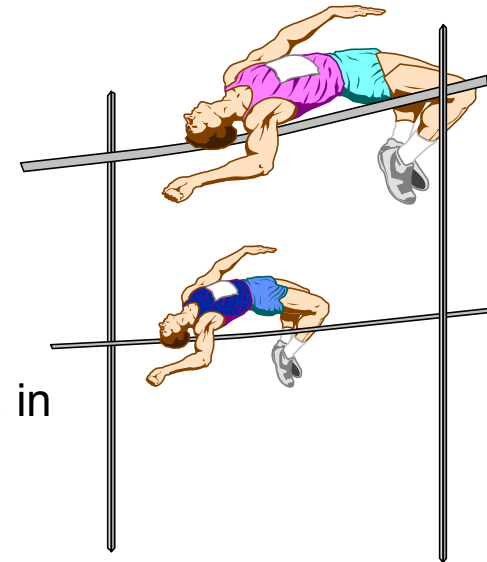


Controlling Fixed Costs



Means of Controlling Fixed Cost

- Competition sets the standard
- Performance is determined through benchmarking, e.g. in
 - Manufacturing
 - Sales
 - Support functions (e.g. Finance and HR)
- The relative performance concept includes fixed costs as an element
- As a lump sum, fixed cost most often is a target on the Balanced Scorecard





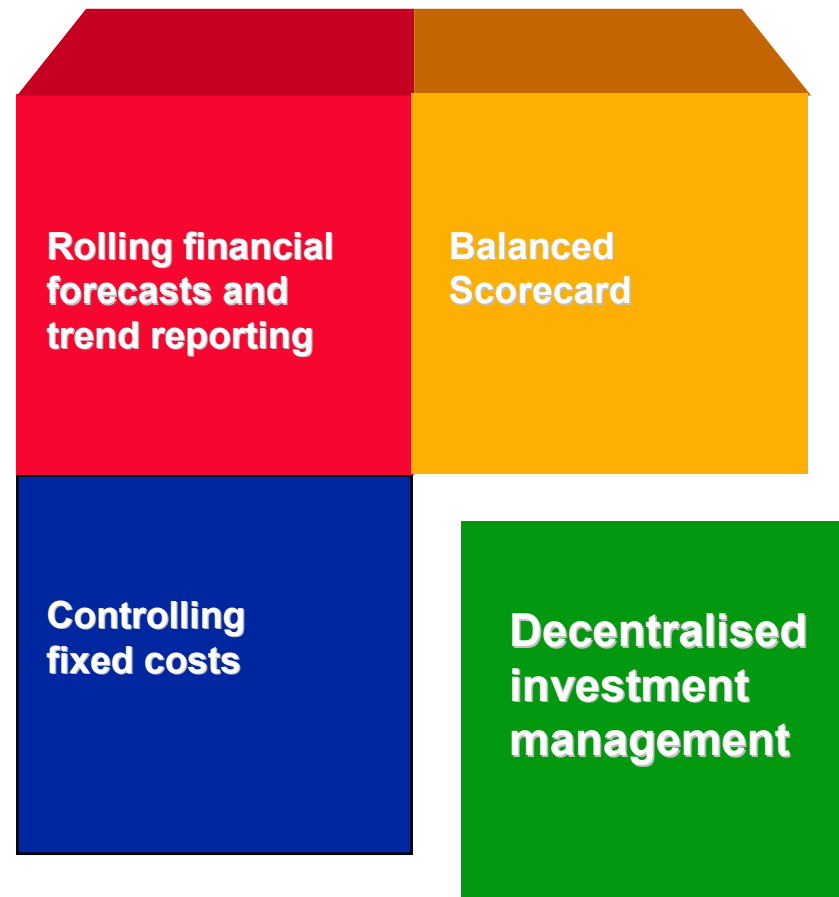
In Phase I, Activity Based Management Was Used to Understand and Manage Resources (Fixed Costs) Better

- Activities create a common language for describing costs and supporting benchmarking
- Activities help understand consequences of cost reductions
- ABM allows us to follow true project costs across the company
- ABC provides better information to manage customer and product profitability (true profitability)

- Experience Gained (Phase II):
 - After successful stand-alone solutions for ABM, the solutions were implemented in SAP only with limited success.
 - January 99: Decision taken to remove the ABM model from SAP to simplify the 'CO' environment.



Investment Management Based on Trend Reporting, Strategic Fit and Varying Hurdle Rates



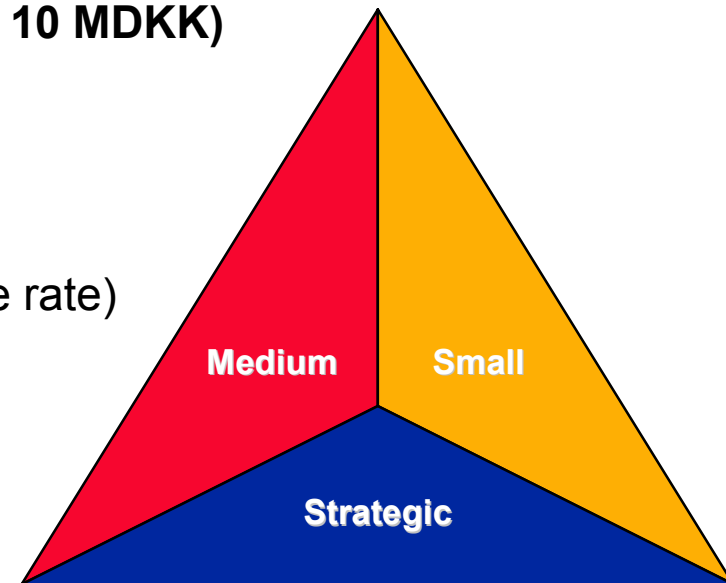


Investment Management Without Budgets

- **Small investments sites/functions (below 10 MDKK)**
 - ✓ Trend reporting, frames if required

- **Medium (between 10 and 50 MDKK)**
 - ✓ Varying profitability requirement (hurdle rate) depending on investment capacity in Rolling Financial Forecast
 - ✓ Strategic fit

- **Strategic (above 50 MDKK)**
 - ✓ Executive Board decides case by case

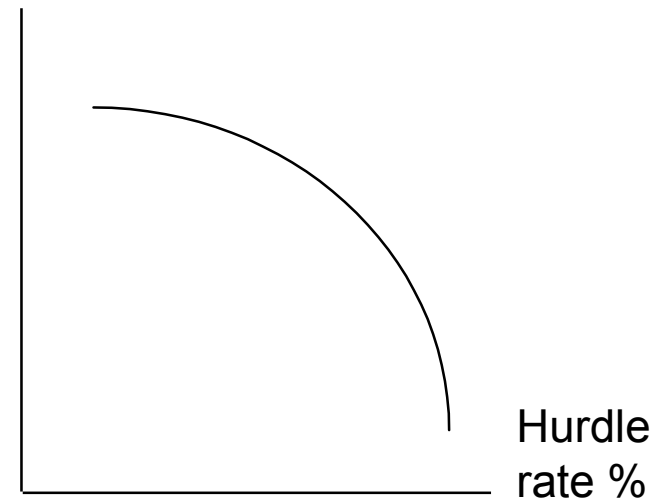




Controlling the Level of Medium Projects (10 - 50 MDKK); We Use the Hurdle Rate More Actively

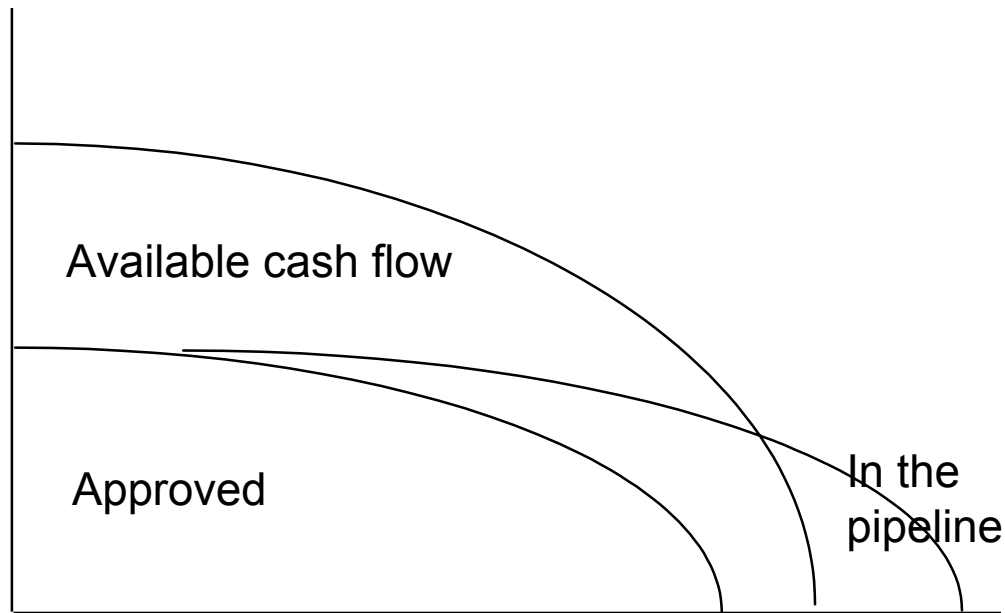
- The required hurdle rate will depend on desired investment levels and the group cash flow situation
- We have the option to distinguish between risk categories; lower hurdle rates for cost reduction projects than e.g. margin increase based projects

Investment level





Our Forecasting of Projects 'in the Pipeline' Has Improved



5 Years Later the Model Still Stands



BOREALIS IS A NON BUDGETING COMPANY!

We have changed some of our tools:

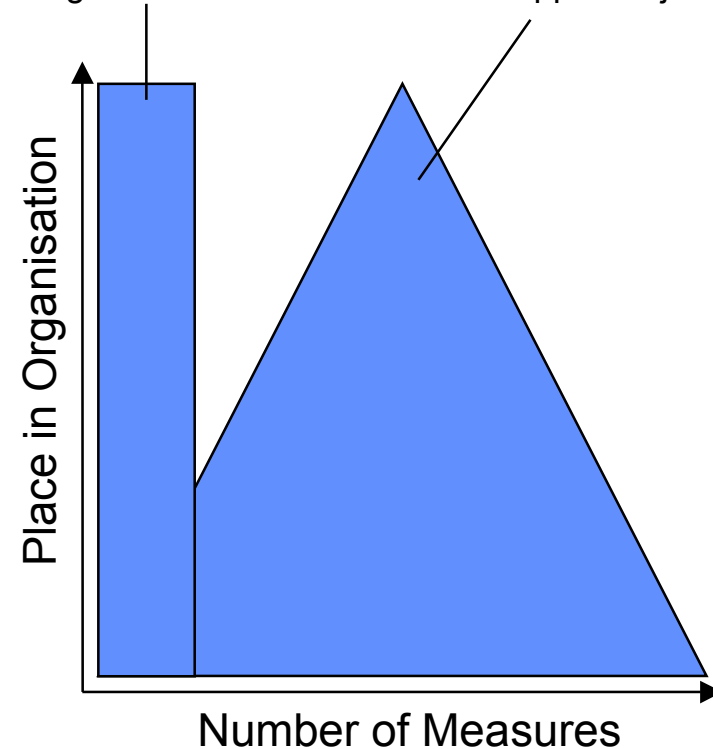
- External benchmarking in 1997 triggered tough cost targets across the company. The targets are long-term (1998-2000) and on total costs only.
- ABM partly taken out of SAP, system not flexible enough
- Rolling financial forecast process improved

Setting the Agenda - Focus on Objectives

- During implementation of the Balanced Scorecard the mistake was made to focus too much on measures.
- Measures were selected at group level, and these measures were cascaded to the organisation.
- Learning:
- Everyone in the organisation can relate to the corporate objectives, but relevant measures and targets have to be selected in each part of the organisation.

Focus on measures:
Same measures used throughout the organisation

Focus on objectives:
Specific measures selected for each unit to support objectives



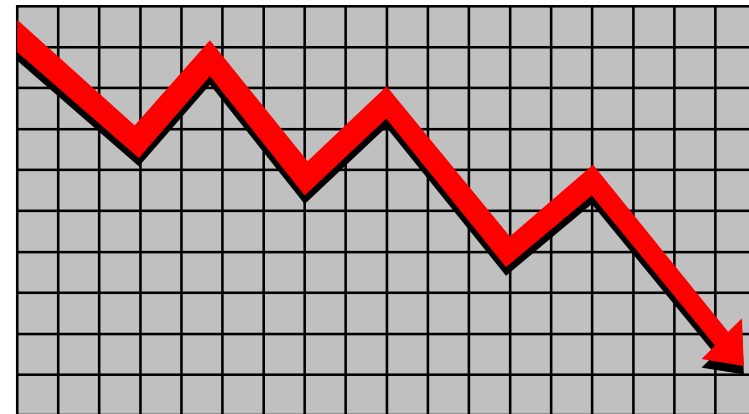
Target Setting Process

- When the Budget was replaced by the Balanced Scorecard for performance management, people welcomed it and set very ambitious and stretched targets.
- With the introduction of an incentive program based on the Balanced Scorecard, stretched targets were replaced by internal negotiation.
- Learning:
- Keep the Balanced Scorecard, but base the targets on relative performance, e.g. to the industry or to peer groups.

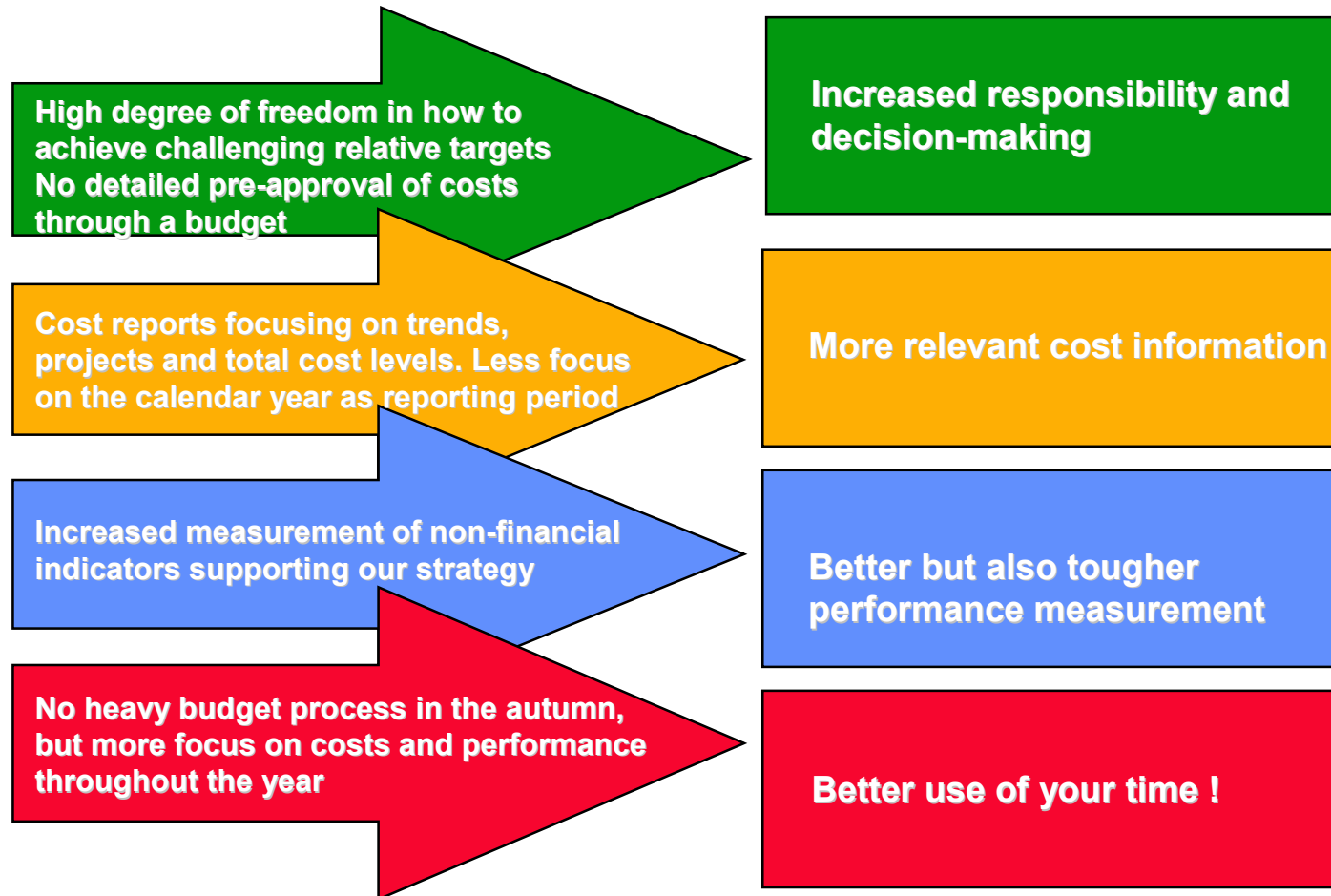


Heavy Investments Combined With an Industry Downturn Required a More Central Process for Remaining Funds

- The simplified 5 quarter rolling forecast gives the updated view on cash flow and capital spending.
- A co-ordination committee consisting of VP's from business, manufacturing and functions quarterly manages investment approvals.
- This ensures flexible and reactive decision making allowing to tighten or free up funds during the year.



How Does the Manager's Job Change ?



If you want to know more...

CAM-I Beyond Budgeting Round Table

www.cam-i.org/bb.html

Try the Beyond Budgeting wizard

www.project.bbrt.org

‘Creating Budget-less Organizations with the Balanced Scorecard’

The Balanced Scorecard Report

Harvard Business School Publishing, November-December 2000