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Beyond Budgeting in Jotun

A case study on substituting the budget with separate forecasting and targeting tools in a global, industrial corporation

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ABSTRACT

The following thesis is a qualitative study aimed at contributing to the Beyond Budgeting literature on unbundling the traditional budget by answering the question:

"Why may global, industrial corporations attempting to go Beyond Budgeting struggle to effectively substitute the budget with separate forecasting and targeting functions?"

We find this research problem interesting, as there are no case studies today documenting potential struggles of separating the forecasting and targeting functions. The aim is to fill this gap in this literature by providing insight into the process and struggles inherent in this separation process.

As the basis to answer this question, we have performed a case study on Jotun, a global chemicals company originally from Norway. Jotun introduced a targeting tool called *Strategic Target Planning (STP)* in 2007, and have in parallel attempted to make what they call cost budget into a forecasting tool.

Beyond Budgeting literature proposes several reasons for separating the traditional budget into individual processes, such as decreased resource use due to less negotiation, more flexibility because of more autonomy, and less gaming as there are fewer conflicting purposes.

In this case study we found that Jotun has only partially managed to remedy these issues by substituting the budget with separate forecasting and targeting tools. One interesting finding that has not been addressed in previous literature is the paradox of autonomy. If an organization already has a culture based on the decentralization and trust that is necessary for Beyond Budgeting to function well, this culture can be counter-productive to the implementation of Beyond Budgeting in the first place. We also found evidence that separating the forecasting and targeting function from the traditional budget could still lead to skewed incentives and gaming, as these new tools can still be misinterpreted or involve conflicting purposes, such as resource allocation, benchmarking and bonus schemes. A third finding was that the substitution of the budget with separate forecasting and targeting tools may lead to more flexibility in terms of upwards spending, but not as much downwards. This implies that spending in excess of the forecast is possible as long as the business case is good, but that there is less flexibility in reducing costs when actual needs turn out to be less than forecasted as employees perceive the funds to be allocated already.

PREFACE

The following master thesis is written as part of the double degree program between NHH – Norwegian School of Economics in Bergen, Norway, and EGADE Business School in Monterrey, Mexico. Because of this, it has been supervised by professors from both institutions, namely Dr. Sabina du Rietz and Dr. Roberto J. Santillán-Salgado respectively. First and foremost we would like to thank them for all their valuable expertise and feedback during the entire process. The results would undoubtedly not be the same without their support.

The research is carried out as part of the FOCUS research program for SNF – Institute for Research and Economics and Business Administration. SNF has provided us with both financial resources and methodological advice, and it is our hope that they are satisfied with the results we have provided them. We would also strongly encourage SNF to continue their Beyond Budgeting research as we truly believe it is the future of management accounting for many organizations out there.

As this was a case study, we have been interviewing more than 10 employees, all of which have taken time out of their schedule to talk to us without any personal gain, and for that we are deeply grateful. The study would have been in no way as comprehensive and thorough without access to their experiences and data. We would like to mention Morten Grevle at the Norwegian headquarters especially as he has been both our connection with Jotun the entire process, as well as getting us in contact with interview subjects and answering our clarifying questions at short notice.

This study is also the final piece of our five year long education, and we would like to thank all the amazing people that we have met during those years, both students and professors. We started out with a keen interest in business, but will graduate with a deep appreciation and love for it.

We would like to finish with a quote from J.R.R.Tolkien in the voice of Gandalf, which we believe highlights the need for the Beyond Budgeting flexibility in the first place, as well as the struggle with implementing it:

> *"For even the very wise cannot see all ends."*

TABLE OF CONTENTS

CHAPTER 1: INTRODUCTION

1. INTRODUCTION

1.1 BACKGROUND

Since the *Relevance Lost* debate in the 1980s, there has been a surge in criticism against the traditional budget, both by academics such as Hope and Fraser, and industry professionals such as Bogsnes and Wallander (Hope & Fraser, 2003) (Wallander, 1995) (Bogsnes, 2009). The criticism is mainly based on the view that the traditional budget has significant weaknesses as a management accounting tool. This criticism has led to a surge of companies abolishing and replacing the budget.

The budget is criticized for trying to serve too many roles at once. In the traditional budget, target setting, forecasting and resource allocation all gets bundled into one process. By forecasting and targeting at once, a role conflict occurs. While targets are supposed to be ambitious, forecasts should be realistic. This often leads to forecasts being too conservative in order to not set targets that are too hard to reach.

Another problem with the budget is that while it is meant to serve as a roof for spending, it essentially also becomes a floor (Hope & Fraser, 2003). It is not necessarily desirable that employees reach the exact budget number, but employees may still try to reach the number in order to avoid budget cuts in upcoming periods even if this is not in the company's best interest. The traditional budget may in other words provide employees with wrong incentives. The budget has also been criticized for being a too resource- and time consuming process that is too detail oriented and centrally managed, making it irresponsive to changes in the environment.

Beyond Budgeting aims to solve many of these problems by moving away from the traditional budget, and unbundling the purposes that the budget is supposed to serve. Beyond Budgeting literature claims that likely users of Beyond Budgeting operate in dynamic environments with unpredictable competitors and customers, and are often highly dependent on knowledge workers (Rickards, 2006) (Helle, 2014). Furthermore, Otley claims that implementing Beyond Budgeting in large, complex organization may prove difficult, especially at the lower levels (Otley, 1987). Beyond Budgeting is therefore viewed to have the most potential at the top levels of the organization, while it loses its edge at the lower levels.

Based on these characteristics, our case company, Jotun, being a large Norwegian chemicals company with many diverse and geographically dispersed subsidiaries, may seem like an unlikely adopter of Beyond Budgeting. Still, the company has abolished traditional budgets at a group level, managing largely on key performance indicators (KPIs) both over the short term and the long term. This is an attempt to improve the management accounting function by separating the forecasting function and the targeting function in order to better achieve strategic targets.

For the target-setting purpose, Jotun utilizes a tool they call "*Strategic Target Planning*" (STP), which is used to set targets for the coming three years. They are derived at the local level, and then consolidated to the regional and group levels. One of the most important numbers in the STP are the cost growth and sales growth numbers. For forecasting they have adapted their so-called *cost budgets* to serve this purpose. Although the term may appear ambiguous or confusing, this tool is not intended to be a budget. In addition to these tools, Jotun performs a biannual "*business review*" for each company, focusing heavily on key performance indicators (KPIs) and other strategic measures.

1.2 RESEARCH QUESTION

In cooperation with the FOCUS program at NHH and Jotun, this thesis will attempt to answer the following research question:

"*Why may global, industrial corporations attempting to go Beyond Budgeting struggle to effectively substitute the budget with separate forecasting and targeting functions?"*

In order to explain in more detail what this thesis will discuss, and why this formulation was chosen, we will briefly outline the specific elements:

"…may…" simply underlines that these are not absolute challenges that all corporations will necessarily face, but rather what they should be prepared to possibly have to deal with.

"…global…" is used as the case company we study operates in a wide range of countries, with very different cultures and competitive landscape (Cambridge Dictionary, u.d.). As global organizations may differ greatly from organizations operating in only one or a few countries, our findings will mostly be relevant to other global organizations.

…industrial…" emphasizes the fact that the case company is a secondary sector company. (Businessdictionary.com, u.d.). Once again, it also indicates which other organizations would be likely to perceive the findings as relevant. This is because industrial companies usually have different employee compositions, production schedules, market conditions and more.

"…corporation…" is intentionally chosen instead of more neutral terms such as "organization" to tie its relevance closer to for-profit organizations and the private sector rather than NGOs or the public sector (Businessdictionary.com, u.d.).

"…*effectively*…" emphasizes that not only are we looking at the struggles related to the implementation of Beyond Budgeting, we are also investigating how well the new solution solves the common issues of the traditional budget. This is done by looking at how well the gaming, flexibility and resource aspects of Hope and Fraser have been solved by the separation.

"…forecasting…tools" is used as a broader term instead of "cost budgets" to stress the generalizability of the results, and clear up the confusion between the term Jotun uses and what the actual tool is (Businessdictionary.com, u.d.). Many corporations might want to test similar tools without using the same term as our case company did.

"…targeting tools" is similarly used as a more generalized term for the STP tool that our case company uses as target numbers (Investorwords.com, u.d.).

To date, there is no publicly available research documenting potential struggles of separating the forecasting and targeting functions. Our thesis aims to fill this gap in the literature by providing insight into the process and struggles inherent in this separation process. Hopefully, other companies that are interested in separating the two tools may learn from our thesis, and as a result may be better suited to tackle the Beyond Budgeting implementation process and the challenges that they may face.

The actual analysis will consist of two main parts: evaluating the implementation, management and technical separation of the two tools and their technical separation, and evaluating the effectiveness of the new solution. The framework for the first part will be a nine point guideline on implementation by academics Hope and Fraser, supplemented by a seven point guideline by industry professional Bjarte Bogsnes (Hope & Fraser, 2003) (Bogsnes, 2009). As a theoretical framework to evaluate how effective the new solution has been, we will look at three major aspects of criticism towards the traditional budget presented by Hope and Fraser (Hope & Fraser, 2003). The first aspect, *the resource aspect* is based on their claims that the process of creating and following up budgets requires a lot of time, money and human resources. The second aspect, *the flexibility aspect* is concerned with traditional budgets being inflexible and not providing managers with sufficient and timely information. The last aspect, *the gaming aspect* is based on Hope and Fraser's observation that "*the extent of "gaming the numbers" has risen to unacceptable levels*". We will evaluate the effectiveness of the new solution based on to how well these problems have been solved by the separation.

1.3 OUTLINE

The thesis is separated into six chapters including the introductory chapter. In *chapter 1* we present the background for the chosen subject, as well as the purpose of the thesis and the research question. In *chapter 2* we go on to outline relevant literature and theory on the subject. In *chapter 3* we will introduce Jotun as a case company, describing their management accounting processes. *Chapter 4* describes our chosen research method and design. In *chapter 5* we present, analyze, connect and discuss the findings in light of the theory. The final part, *chapter 6*, outlines the thesis takeaways, such as answering the research question and recommendations to Jotun, similar companies, and future research.

CHAPTER 2: THEORETICAL FOUNDATION

2. THEORETICAL FOUNDATION

In this chapter we will present the theoretical foundation of the thesis. As we are seeking to investigate the struggles that a global industrial firm attempting Beyond Budgeting may face when separating forecasts and budgets, we will begin by introducing the traditional budget and criticism against the traditional budget in order to give the reader the necessary background to understand the motivation behind attempting Beyond Budgeting. We will then approach the effectiveness part of the research question by investigating to which extent the three challenging aspects of the traditional budget according to Hope and Fraser can be solved by substituting the budget with separate forecasting and targeting tools (Hope & Fraser, 2003).

In order to understand how and when implementation of Beyond Budgeting may be appropriate, we have included a part about Beyond Budgeting in general, covering both the perceived benefits as well as potential challenges with Beyond Budgeting. We supplement this by looking at literature about implementation by Bogsnes and Hope and Fraser to get pointers as to how well the Beyond Budgeting implementation in Jotun has worked (Bogsnes, 2009) (Hope & Fraser, 2003). *For the sake of balance and nuance, we have also added a section on common criticism and challenges related to Beyond Budgeting.*

2.1 TRADITIONAL BUDGETING

A traditional definition of management accounting is

"the process by which managers assure that resources are obtained and used effectively and efficiently in the accomplishment of the organization's objective" (Anthony, 1965).

In the literature, budgeting has traditionally been described as the cornerstone of management accounting (Pietrzak, 2013). Most businesses today rely heavily on budgets, and it is commonly accepted that a well understood and implemented budget is a strong advantage for the company (Raghunandan, et al., 2012).

According to Bergstrand, Boye and Bjørnenak the traditional budget can be defined as

"*... an action plan for the company with goals for its profit centers that describes the expected consequences expressed in economic terms and based on defined assumptions for a limited period*" (Bergstrand, et al., 1999).

The budgets are usually developed for the next financial year in accordance with the strategic and operational activities of the business (Anthony & Govindarajan, 2007). The strategic activities are usually performed at an executive level, focusing on long term targets, while the operational activities are usually focused on making sure that short term targets are being reached efficiently. The management accounting, and therefore, budgeting process, is usually performed somewhere between these two levels (Anthony, et al., 1992).

From a traditional budgeting perspective, the budgeting process can be simplified into an annual process consisting of three parts (Royal Melbourne Institute of Technology, u.d.). The first part consists of reviewing financial data from previous years. These financials create the foundation for the next year's budget. This budget affects how employees will act in the coming year, which in turn will be reflected in next year's financials. This becomes a continuous process where each activity is influenced by the other activities.

Figure 1: Traditional budgeting process

Leaders have justified spending time and resources on developing budgets for the better part of a century, particularly because managers have a need to reduce the uncertainty of the future (Mellemvik, et al., 1988). Having easily accessible, good budgets has traditionally been a strong competitive advantage, especially so if those budgets are better than those of the competitors. However, the information used to develop the budgets needs to be reliable and correct. This is a prerequisite for the company to remain dynamic and to be able to seize opportunities that should arise (Sull, 2009).

Traditional budgets are frequently used to control how organizations utilize their allocated resources over a given time period. Many business leaders spend a lot of time focusing on finding deviations from the budget, and understanding why they happened in the first place. This brings us to one more of the roles that the budget fills, which is determining which departments and functions seem to be overspending or underspending (Mellemvik, et al., 1988). The motives for running a budget may differ from organization to organization, however, the recurring theme is that large organizations would like to have a concrete plan for the organization; they wish to follow up on the results regularly, and need a tool to coordinate activities among the different departments.

Horvath and Sauter has concluded that the budget mainly serves three purposes (Horvath & Sauter, 2004). Firstly, it is supposed to coordinate the organization’s financial activities, secondly to communicate the financial expectations, and lastly to motivate managers to work for the organization’s best interest.

2.2 THE CASE FOR BEYOND BUDGETING

2.2.1 CRITICISM AGAINST TRADITIONAL BUDGETING

The traditional budget, which became popular at the beginning of the 20th century has in the last decades been put in the spotlight because of its need for modernization (Hamel, 2007) (Hansen, et al., 2003). The criticism initially began decades ago in the 1980’s, starting with the “*relevance lost*” debate where Robert. S. Kaplan and H. Thomas Johnson criticized management control systems for having lost their relevance, and not giving managers sufficient information anymore (Kaplan & Johnson, 1987). According to Kaplan and Johnson the traditional management control systems such as budgeting were outdated, too aggregated, and too twisted to be used as a base for making decisions in the changing business environment. They especially emphasized the traditional budget's tendency to use the fiscal year as a basis period for the budget, as this was an arbitrary way of dividing the periods, and irrelevant to the organization's actual business cycle.

Jan Wallander, the former CEO of Svenska Handelsbanken has been outspoken when it comes to the practice of running businesses without traditional budget practices. He voiced his concerns about the traditional budget in 1999 in his article *Budgeting - An unnecessary evil*, where he claims that since the budget takes into account large amounts of very detailed data, oftentimes a year in advance, the data may be irrelevant or misleading once the budget is put to use. The forecasting techniques used are often simple, and there is a tendency to assume that trends will continue in the same direction that they have been going previous years without justifying why (Wallander, 1995). This leads to a lack of foresight, and generally leads to budgets with bad forecasts and deviations from the forecasts that are hard to explain (Bergstrand, et al., 1999).

In 2001, following the *Relevance Lost* debate and Wallander's article, Neely et al. made a list consisting of 12 significant weaknesses that exist in the traditional budgeting and planning approaches based on previous research in the field (Neely, et al., 2001).

First of all, it usually takes significant amounts of time and resources to develop budgets. Given the time and effort required to put them together, the budget is often perceived to offer little value. They also often lead to more static and less responsive organizations, contributing to a more command and control focused organizational structure. On this point, the budget has been criticized to not be adapted to the network structures that the new business world so often requires organizations to adopt. Sometimes the budgets can be contradictory, undermining the overall strategy. They have also been known to be too infrequently developed and updated, usually based on the fiscal year. Also, many budgets are based on guesses and questionable information, rather than actual facts and figures.

Furthermore, budgets have the potential to make employees feel underappreciated and undervalued, focusing too little on value creation and too much on cost reduction. It can lead to gaming and unwanted employee behavior, restricting incentives to share knowledge and information, leading to barriers between departments.

2.2.2 THE THREE BUDGET ASPECTS

In 2003, Hope & Fraser built on the works of Wallander, Neely et al. and Kaplan and Johnson, claiming that there are three main reasons as to why there may be better ways to run an organization rather than relying on traditional budgets. We have chosen to categorize these reasons as *the resource aspect*, *the flexibility aspect* and *the gaming aspect*.

THE RESOURCE ASPECT

According to Hope and Fraser, "*budgeting is cumbersome and too expensive*" (Hope & Fraser, 2003). They argue that the process of creating and following up budgets require a lot of time, money and human resources. Employees have to spend a lot of time on details and running numbers, which gets in the way of value-creating activities. Usually, this process consists of a lot of back and forth between different departments, while trying to agree upon the final outcome of the budget, since every department usually wants as much resources as possible. Once this is done, the budget is usually approved by the board.

The budget is then continuously revised throughout the year in the form of reports from different departments in order to be able to evaluate their performances. Hope and Fraser claims that the average budgeting process takes between four and five months, while a survey by Libby and Lindsay from 2007 showed that U.S businesses on average spend 10.3 weeks to complete the budgeting process (Hope & Fraser, 2003) (Libby & Lindsay, 2007). All these resources are according to Hope and Fraser spent trying to tell what will happen in the future, usually at a time when there is very much uncertainty about what the future holds (Hope & Fraser, 2003). Ekholm and Wallin noted that in many organizations, the budgeting process has become a strict, yearly ritual (Ekholm & Wallin, 2000).

THE FLEXIBILITY ASPECT

The second reason according to Hope and Fraser, is that "*budgeting is out of kilter with the competitive environment and no longer meets the needs of either executives or operating managers*" (Hope & Fraser, 2003). Traditional budgets are rather inflexible, which in a rapidly changing environment with heavier competition will not provide sufficient and timely information for the managers of these organizations. Managers today are dependent on dynamic, real time information about their environment and competitors in order to be able to make profitable decisions. Furthermore, these managers are dependent on having the freedom and flexibility to make quick decisions.

Bergstrand, Boye and Bjørnenak emphasized that budgets oftentimes do not allow for real time information flow and responsiveness, which can result in decisions not being made in due time, and departments or entire organizations being stuck in limbo while waiting for the approval to proceed (Bergstrand, et al., 1999). Since more and more organizations exist in environments that are turbulent and frequently changing, the formal and rational approach that has been common in the business world in the past are becoming less and less relevant (Anthony & Govindarajan, 2007).

THE GAMING ASPECT

Hope and Fraser's last argument was that "*the extent of "gaming the numbers" has risen to unacceptable levels*" (Hope & Fraser, 2003). By gaming, we mean intentional profit seeking at the expense of the greater good, either during the development of the budget, or in the process of reaching the budget numbers (Eriksrud & McKeown, 2010). The employees work under a fixed performance contract which the managers evaluate their performance against. Since the employees are being measured against the budget, they will oftentimes have incentives to game the numbers while negotiating the budget initially, for example through negotiating for their performance targets to be easier to reach. Examples of such behavior would be to convince the person evaluating their performance to evaluate them on a target that is seemingly hard to achieve from the outside, but which in reality is easy to achieve by the people negotiating.

Another example of gaming is that employees have a tendency to spend their entire budget for a given time period, because they expect that the budget will get cut the next time period should they not spend it all (Hope & Fraser, 2003). This works against the intended purpose of the budget, which is to give the employees a roof to their spending, as the budget now also becomes a floor to their spending. Freixas, Guesnerie and Tirole gives a similar example of gaming the numbers, called "the ratchet effect" (Freixas, et al., 1985). This is when employees avoid giving their full effort during a period in order to not be given harder targets for the next period.

To add to these potential gaming effects, there are several other academic accounts on how budgeting can lead to dysfunctional behavior in organizations. Budgets may for example have the unintended effect that managers spend their time trying to find excuses for deviations from the budget, as well as giving faulty forecasts in fear of receiving punishment should the forecasts reveal bad news (Bergstrand, et al., 1999). In addition to this, the budget can have a tendency to create plans that are too rigid, reduce cooperation and creativity between different departments and demotivate employees, which eventually leads to lower competitiveness for the organization as a whole (Ekholm & Wallin, 2000) (Covaleski, et al., 2007).

2.2.3 BEYOND BUDGETING AS A SOLUTION

Instead of being just another tool in the management toolbox, Beyond Budgeting aims to be a new, coherent management model that creates room for more flexible ways of managing the company by moving away from traditional budget as we know it (Hope & Fraser, 2003). It is different from models and frameworks such as the balanced scorecard, and is not meant as an alternative to such tools, nor are they mutually exclusive. This is done through increasing the flexibility and responsibility of operational managers, as well as creating more transparent and open information flows. The model outlines a range of alternatives to traditional management by focusing on dynamic coordination throughout the organization, such as continuously updated forecasts and resource allocations, as well as relative targets and evaluations, outlining a range of alternatives to managing based off of the traditional budget. Perhaps most importantly, Beyond Budgeting aims to unbundle the traditional budgeting process, and therefore making the previous financial performance, employee action and the budgeting function less dependent on each other in order to create more reliable and relevant forecasts and targets.

By relieving managers of the duty of developing and following up budgets frequently, they can spend more of their time trying to solve day-to-day challenges and problems (Wallander, 1995). This will make them more responsive to dramatic changes in the competitive environment, whereas trying to navigate through the changes on a budget runs the risk of disrupting the adaptation, rather than helping the organization adapt. What matters is not what the employees were doing half a year ago or in the last quarter, rather, what matters is what the employees and the organization are doing right now.

Wallander builds on this by arguing the importance of making sure that the organization does not get flooded by irrelevant information (Wallander, 1995). The organization should make sure that the information flow includes employees only when the information at hand somehow affects the work of the employee. The employees in an organization should be able to decide for themselves which information they consider instrumental to their performance and work. Instead of management holding back information and distributing it on a case by case basis, information should be made available to employees based on principles that contribute to a more transparent information system (Hope & Fraser, 2003).

Implementing Beyond Budgeting in a company involves letting go of fixed, predetermined targets, and rather evaluating the organization and updating forecasts continuously so that the company can adapt to its surroundings (Hope & Fraser, 2003). The increased responsibility and flexibility given to the lower level managers is supposed to not only make the company more dynamic and responsive, but also hopefully make the employees feel more ownership to the organization. The desired result is that this leads to a higher internal commitment among employees, which in turn will lead to the individuals being more willing to define and perform the necessary actions for the company as a whole to reach their targets without external commitment (Argyris, 1998).

Beyond Budgeting aims to move away from the budget as a “fixed performance contract”, and rather to a “relative improvement contract”. By setting goals along several dimensions instead of just focusing on the absolute numbers of the budget and short term profitability, the hope is that a more long term perspective will emerge among the employees, rather than the short term perspective of traditional budgets (Merchant & Stede, 2007). This new relative performance contract aims to place trust and confidence in the ability of lower level managers to make better decisions, within certain limits, compared to what a centralized management is able to do (Hope & Fraser, 2003). On top of this, Hope and Fraser noted in their research that companies that apply Beyond Budgeting no longer inhibit the “spend it or lose it” mentality.

The Beyond Budgeting Roundtable has released and frequently updates their twelve Beyond Budgeting principles based on their observations of what works in practice (Beyond Budgeting Institute, 2016). The principles are divided into leadership principles and management processes, as they recognize that alignment between these two sets of principles is critical to the successful implementation of Beyond Budgeting.

Leadership principles	Management processes
• 1. Purpose - Engange and inspire people around bold and noble causes; ***not*** *around short-term financial targets* • 2. Values - Govern through shared values and sound judgement; ***not*** *through detailed rules and regulations* • 3. Transparency - Make information open for self-regulation, innovation, learning and control; ***don't*** *restrict it* • 4. Organisation - Cultivate a strong sense of belonging and organise around accountable teams; ***avoid*** *hierarchical control and bureaucracy* • 5. Autonomy - Trust people with freedom to act; ***don't*** *punish everyone if someone should abuse it* • 6. Customers - Connect everyone's work with customer needs; ***avoid*** *conflicts of interest*	• 7. Rhythm - Organise management processes dynamically around business rhythms and events; ***not*** *around the calendar year only* • 8. Targets - Set directional, ambitious and relative goals; ***avoid*** *fixed and cascaded targets* • 9. Plans and forecasts - Make planning and forecasting lean and unbiased processes; ***not*** *rigid and political exercises* • 10. Resource allocation - Foster a cost conscious mind-set and make resources available as needed; ***not*** *through detailed annual budget allocations* • 11. Performance evaluation - Evaluate performance holistically and with peer feedback for learning and development; ***not*** *based on measurement and* ***not*** *for rewards only* • 12. Rewards - Reward shared success against competition; ***not*** *against fixed performance contracts*

Table 1: The 12 Beyond Budgeting Principles

The true goal of Beyond Budgeting is not only to remove the budget, rather it is to instigate a change in both processes and management in a way that surpasses just letting go of the budget (Bogsnes, 2009). One of the ways to do this is by implementing rolling forecasts, rather than using traditional budgets as forecasting tools. Hope and Fraser suggest that by implementing rolling forecasts unbundled from the traditional budget, it is possible to create more reliable forecasts that are independent of targets and available resources (Hope & Fraser, 2003). The rolling forecasts are supposed to simply carry information, and not be used to evaluate employees in order to make sure that they are objective. A study from 2007 revealed that introducing rolling forecasts increased the predictability of planning and reduced sandbagging (Tanlu, 2007). Sandbagging refers to the act of padding the budget with slack in order to appear more favorable in the future.

The Beyond Budgeting methodology advocates moving away from absolute targets, in favor of using relative targets that are based on either external or internal references (Hope & Fraser, 2003). This can remove many of the problems present in traditional budgeting, and perhaps most of all the gaming aspect, since employees are now measured against best practice instead of absolute numbers that can be influenced by the employees. It can also increase the motivation and willingness to perform of the employees, as they are now being measured against reachable goals that are based on things that they can influence (Locke & Latham, 1990). Benchmarking also makes coordination, communication, resource allocation, evaluation and control easier, since the numbers are likely to be unbiased and not influenced by unwanted factors.

Key Performance Indicators (KPIs) are key financial figures and other performance measurement figures that are assumed to be critical to the organizations performance. By using KPIs instead of budgeting numbers, one can develop relative KPIs, whereas budgets usually utilize absolute numbers. This allows for benchmarking towards competitors, other departments within the organization or joint ventures, which makes it possible to determine whether the performance is above, on par or below the industry standards (Wallander, 1995). Good KPIs are suited to measure the organizations performance through key figures and benchmarking, but they should also be performance enhancing.

Good KPIs are important to measure performance, but it is also of importance to develop appropriate targets in order to map out the direction of the organization (Kaplan & Norton, 1996). While the budgets generally set targets based on absolute numbers, a good target strategy is to set relative targets based on the KPIs in order to increase the flexibility of the management system, as well as reducing the complexity of the decision making process. Bogsnes argues that setting relative targets leads to more dynamic processes that are not limited by predefined budgets, but rather a process in which each project is evaluated on whether or not it contributes to reaching the targets (Bogsnes, 2009).

2.2.4 FORECASTS

Bogsnes claims that a good forecast is one that is our best guess for the future expected outcome, no matter if it is a desirable outcome or not (Bogsnes, 2009). A forecast is supposed to be an estimate for the most probable outcome of an expected development (Hoff &

Bjørnenak, 2010). By forecasting correctly, the business will be able to see issues quickly when they arise, and allow the company to take corrective actions.

While the traditional budgeting perspective often uses the budget as a forecasting tool, Beyond Budgeting aims to unbundle the forecasting aspect from the targeting aspect of the budget. By having a forecasting process that is outside of the budget, only the most important variables need to be included, making the forecasts more accurate and reliable (Bergstrand, 2009). This leads to less work being needed to develop the forecasts, as well as being more flexible than traditional budgets, since they are not tied to the annual budget anymore. Managers will also reduce their incentive to game the system in the process of developing forecasts (Boesen, 2000).

One tool which Beyond Budgeting advocates may consider using to create more objective and independent forecasts is the zero-based budgeting approach as developed by Peter Pyhrr (Pyhrr, 1970). This approach advocates building each year's budget from the ground up, in order to create a case for the next year's spending as if there is no baseline. In a Beyond Budgeting perspective, this would entail building forecasts from the ground up, rather than just adding a fixed percentage to the previous year, hopefully leading to more correct forecasts that take into account changing market conditions.

Beyond Budgeting theory recommends not only unbundling the forecasts and targets, but also implementing rolling forecasts, which implies that they are continuously updated throughout the year. Choosing how often to update the forecasts depends on the uncertainty in the environment, but a common way to utilize rolling forecasts is to make a twelve month forecast while revising and updating the forecast every three months. By using this kind of forecasting, not only will it be possible to extract the unbundling benefits, but it will also make it easier for managers to predict future events and discover deviations from the trends. This allows the company to respond to changes more quickly. However, it is important to include only the most critical factors, otherwise the rolling forecast process may end up taking just as much time as the budgeting process.

2.2.5 TARGETS

Targets serve as a motivational technique, and are supposed to aid managers in choosing the right course of action while serving as encouragement for employees to succeed and to achieve stellar performance (Chartered Global Management Accountant, 2012).

There are several advocates of ambitious targets, or stretch targets in the Beyond Budgeting literature (Bogsnes, 2009) (Hope & Fraser, 2003). Stretch targets are set with the purpose of motivating the organization to maximize their performance. However, if the target is too ambitious, the result may be the opposite, and the employees may find the target demotivating (Otley, 1987). In 1981, Doran made the claim that good goals should be specific, measureable, assignable, realistic and time-related (Doran, 1981). Bogsnes advocates the use of these goals, but emphasizes the importance of making sure that the criteria of the goals are balanced (Bogsnes, 2009).

2.3 IMPLEMENTING BEYOND BUDGETING

While it is generally accepted that change is necessary for organizations to keep growing, Higgs and Rowland found that 70% of change-oriented attempts have been unsuccessful (Higgs & Rowland, 2005). It is believed that the most common cause for failing change strategies is poor implementation (Thomas, et al., 1988).

Because Beyond Budgeting is a relatively new innovation, there has not yet been developed a framework specifically for the implementation of Beyond Budgeting. However, management accounting is a popular field for academic research, and there exists a lot of literature on the subject of implementation of management accounting in general, and other specific management accounting tools. For example, Argyris and Kaplan, Shields and Krumwiede all wrote papers on implementing the management accounting tool Activity-Based Costing, but these frameworks would prove too specific for this study, and may even be too outdated for today's business environment (Argyris & Kaplan, 1994) (Shields, 1995) (Krumwiede, 1998). On the other side of the spectre are academic works such as Burns and Scapens' "*Conceptualising Management Accounting Change: An institutional Framework"* that end up on the too generalized end of the scale, which would leave the analysis too abstract to actually yield tangible conclusions (Burns & Scapens, 2000).

In order to counter this problem, we would rather like to base our analysis on the implementation advice of academics Hope and Fraser, while at the same time pairing it with industry expert Bjarte Bogsnes' and his 2009 book, *"Implementing Beyond Budgeting: Unlocking the Performance Potential"* (Hope & Fraser, 2003) (Bogsnes, 2009). By supplementing the academic advice of Hope and Fraser with the professional experiences of Bogsnes, we aim to to uncover new and interesting connections and findings that will lay the groundwork for future research, which may one day lead to a specific implementation framework on Beyond Budgeting.

2.3.1 HOPE AND FRASER'S GUIDELINES

Hope and Fraser found that there is little uniformity in the implementation processes of Beyond Budgeting to this day, however, after interviewing over a hundred managers working at different levels of different organizations, they developed a set of guidelines to help aid potential Beyond Budgeting adopters in the implementation of the tool (Hope & Fraser, 2003).

They note that the first issue of the implementation is to *define the case for change* (Hope & Fraser, 2003). This case should be based on the problems that management is currently experiencing with operating on the annual budget, with a vision of the benefits that unbundling the budget will give. Important aspects to consider is the scope of the Beyond Budgeting project, as well as whether the implementation should be done through the entire organization, or if it should begin with a pilot project. This clear case for change will both serve as a plan and a foundation for support from essential contributors in the process.

Once the case for change has been made, the next step involves *convincing the board* (Hope & Fraser, 2003). It is important to use the case for change to convince the key decision makers in corporate that their potential concerns will not act as severe obstacles.

After the approval has been made, the next step is to *get started by removing the budget by convincing the operational employees of the resource savings benefits* (Hope & Fraser, 2003). By explaining to the employees that unbundling the traditional budget is likely to reduce the time spent on the management accounting, they may feel less overburdened and willing to go along with the proposed changes.

The removal of the budget must be accompanied by a *coherently designed model,* since a move away from the budget can be confusing if the alternative is not easily understandable (Hope & Fraser, 2003). The traditional budget is a coherent model that is easy to understand for the employees, so unbundling the budgets into forecasts and targets must be clearly explained, as well as rewards and recognition being realigned to the new process in a way that employees understand and can accept changing to.

Once this model is designed, the company must continuously *train and educate the employees on the use of the new model* (Hope & Fraser, 2003). Combining a well-designed model and the implementation process with good training and education material that can support the implementation is crucial to the success of the unbundling process.

The finance team of the company may feel that they are being left in the dark, so explicitly and clearly *realigning the roles of the finance team* in advance of the process will help reduce their uncertainty of the future, allowing the team to know where they stand once the implementation begins (Hope & Fraser, 2003). This can be done effectively through involving the finance people in all the changes that are being made, ensuring that they have sufficient training before the actual process implementation.

Hope and Fraser advises to *let behavioral change come from process change*, and not explicitly tell managers what to do (Hope & Fraser, 2003). They believe that with no budget to dictate the managers, the only option is to accept the greater responsibility and accountability for their actions. This means that they should not impose actual rules to how to handle the new processes, but rather to let the employees adopt around the presented guidelines.

Secure short-term wins to keep resistance at bay in order to show hard evidence of the success of the new management accounting tools (Hope & Fraser, 2003). Hard numbers are often easy to use as an argument, and finding that profit has increased and costs have been reduced will serve as a strong argument with people believing that the project is a failure before the company experiences all of the other less tangible benefits.

Lastly, the short term wins should be *consolidated to the corporate center* to secure long term support of the initiative from corporate management (Hope & Fraser, 2003). Corporate is in a sensitive position when changing the management accounting system so drastically, so making sure that they can prove the benefits and achievements on an aggregate level will be crucial in the continued support for the unbundling of the budget.

2.3.2 BOGSNES' GUIDELINES

We will supplement these guidelines with advice from a book written by industry professional Bjarte Bogsnes, which outlines a seven step guideline to implementing Beyond Budgeting based on his own experience of the implementation process of Beyond Budgeting in several companies, among them the Norwegian energy giant Statoil (Bogsnes, 2009). It is important to note that these points are not made based on academic research, but on industry experience.

As Beyond Budgeting is still in its infancy, not all the literature has been subject to academic criticism, and this part is no exception.

To *create a clear case for change*, it is important to explain the fundamental flaws of traditional budgeting to the employees in order to create a sense of urgency (Bogsnes, 2009). All the flaws should not be addressed at once, as employees are busy with different schedules and different focus areas. Address the issues using examples from your own organization, while making sure that the communication is structured and clear. If using the 12 principles in the communication process, it is advised to make sure that the close link between the leadership principles and the process principles is understood by the employees, so that they understand that the change will be for the entire organization, processes and leadership alike.

Bogsnes explains that from his experience, the best way to *handle the resistance* is to explain to the sceptics that Beyond Budgeting may indeed fail, and costs may increase, but the downside is limited (Bogsnes, 2009). The upside on the other hand is a lot greater, and cases from similar businesses have shown promising results that may be replicable. The sceptics need to understand that you are willing to accept the risk, and that you understand their concerns, while at the same time emphasizing that should Beyond Budgeting not work, turning back to traditional budgeting is not going to be a long and tedious process.

Not everything can be planned to perfect detail, and the implementation of Beyond Budgeting is no exception (Bogsnes, 2009). There will be surprises along the way, but these will have to be dealt with as they arise. This means that before taking the leap, it is of course necessary to plan and design new processes and map out what and where the big risks are, but once this is finished, it is better to start the implementation and deal with issues that arise along the way as they happen. *Design to 80% and jump*, because it is impossible to plan the implementation perfectly.

Human resources should be involved as early as possible in the process for several reasons (Bogsnes, 2009). Both the company and the process needs HR involvement, as the Beyond Budgeting process is far more than just a financial journey. HR needs to be in on the process in order to help make sure that the new performance management process is both consistent and integrated, through strategies and business targets to individual targets and rewards. Beyond Budgeting goes much further than merely changing management, and as such incorporating the entire business, not only the finance function in the implementation process can be very helpful.

Make sure to drive the change through a *pull-based and company-owned implementation* (Bogsnes, 2009). By choosing to drive the implementation process from within the company, it is both easier to remain in control of the project and to make sure that consultants are not just pushing a predefined framework. It will also serve as a refreshing change, especially for large companies that often hire consultants. By starting the implementation process in departments that are willing to volunteer initially, the most motivated managers can serve as pilot projects that can motivate less enthusiastic departments in the long run.

Implementing Beyond Budgeting is a long process, and there are many obstacles to overcome (Bogsnes, 2009). It is not a rapid implementation process, and each department and team that enters the process will face unique challenges. It is crucial that management understands that the implementation process consists of *many small battles* on the way win the war.

It is important to not become a fundamentalist (Bogsnes, 2009). Just because an organization is implementing Beyond Budgeting, it does not mean that budgets are prohibited, but it is encouraged to avoid using them if possible, since it can lead to confusion. Budgets can serve as forecasts, targets or resource allocation, and as such, referring to the budget can lead to misunderstandings. However, some departments may find that running spreadsheets and calculations that are similar to budgets useful. The hope is that over time, the departments that can benefit from moving away from the budget will do so, but you cannot instruct everyone to simply stop running a budget.

2.4 BEYOND BUDGETING CHALLENGES

Regardless of the coverage in academia on the flaws and weaknesses of traditional budgets, Beyond Budgeting as a solution to the problem has not yet been heavily covered in the literature. One of the voices of concern is David Otley. He considers Beyond Budgeting to have significantly more potential at the top levels of the organization, but argues that it loses its edge once you move to the lower levels of the organization (Otley, 2007). This comes from the fact that at the higher levels of the organization it is easier to get access to the financial information of the organization’s competitors. At the lower levels, creating forecasts, plans and benchmarks based on competitor information becomes increasingly difficult.

Furthermore, he emphasizes that replacing the traditional command and control function of the budget with more flexible responsibility to the employees and lower level managers has strong potential, but he considers it to be a difficult task to implement the Beyond Budgeting in large, complex organizations that demand significant amounts of planning and coordination.

Rickards claims that a major issue with Beyond Budgeting is that it has a relatively small circle of potential users (Rickards, 2006). Rickards estimated that somewhere around 10-20% percent of organizations can actually benefit from implementing Beyond Budgeting, since the concept depends on a series of premises to be fulfilled in order to properly extract the positive effects of unbundling the budgeting functions. Organizations that operate in markets with dynamic demand and unpredictable competitors and customers will generally have the most benefit of implementing Beyond Budgeting, as these companies are more likely to significantly benefit from the increased flexibility and more precise goal orientation that comes from unbundling the traditional budget. Companies operating in static, predictable environments may find that the time and resources spent introducing and implementing Beyond Budgeting exceeds the potential benefit.

One of the criticisms towards Beyond Budgeting is that it is most suited for companies that are dependent on knowledge workers in dynamic business environments (Rickards, 2006) (Helle, 2014). According to Sandvik, knowledge work can be defined as "*complex problem-solving work tasks that demand processing of information and a diversity of skills in an autonomous context*" (Sandvik, 2011). There will be significant differences in management styles depending on the kind of workers working in an organization. This means that Beyond Budgeting is not necessarily applicable in every company (Rickards, 2006).

Successful implementation of Beyond Budgeting relies on a high compliance between the management and leadership culture and the twelve principles of Beyond Budgeting. Having a strategically supportive and relevant culture can contribute to creating and stimulating a good implementation process of Beyond Budgeting (Chatman & Cha, 2003). A high cultural fit between the organizational culture and the Beyond Budgeting principles is therefore seen as an important criterion for successful implementation of Beyond Budgeting (Hillestad & Espedal, 2011).

Differing cultures from department to department in multinational corporations (MNCs) may also lead to and create differences and ambiguity between the employees in the organization on their paths to their common target (Meyerson & Martin, 1987). This may materialize as differences in values, efforts and identities. In an MNC, departments in different countries will differ on job related dimensions such as individualism, long term orientation, power distance, masculinity and how they cope with uncertainty (Hofstede, 1991). All these dimensions may lead to and influence different behaviors, and therefore also how they relate to the concept of Beyond Budgeting. As such, the implementation of Beyond Budgeting may require the organization to be adaptive across national boundaries in order to be successful (Hillestad & Espedal, 2011).

In a study conducted by Dugdale and Lyne, both financial and non-financial managers were surveyed about their budgeting habits (Dugdale & Lyne, 2006). The majority of the managers said that not only do they consider the budgets important for planning, controlling, measuring performance, coordinating and communicating, but they also disagreed that budgets lead to dysfunctional behavior. More than half of the surveyed managers said that the budgeting methods had changed somewhat in the past years, however, these changes consisted of more sophisticated methods of traditional budgeting and even tighter financial controls. The managers generally seemed to disagree that budgets provide little to no value.

Another study performed by Libby and Lindsay gave similar results to the study by Dugdale and Lyne (Libby & Lindsay, 2010). They surveyed managers in medium to large sized member organizations of the Canadian and U.S. institutes of management. The majority of the respondents were manufacturing organizations, followed by the service sector. Around 80% of the surveyed managers responded that they were not planning to abandon traditional budgets in the near future, while 5% said that they were considering it, and only 1% confirmed that they would definitely move away from traditional budgets. Shastri and Stout also conducted a survey, where they found that managers perceived the budget as useful, where more than fifty percent of the respondents claimed that they found the traditional budget useful or very useful related to business objectives (Shastri & Strout, 2008).

However, the majority of the respondents in the survey by Libby and Lindsay made clear that they were planning to either change or adapt their current budgeting system (Libby & Lindsay, 2010). These results suggest that traditional budgets indeed carry a significant value to managers, but that there is some improvement potential within the processes.

2.5 SUMMARY AND APPLICATION

In this chapter we have outlined relevant literature that we will use when approaching the research question. It will also serve as the foundation which we aim to contribute to academically. We began by introducing the traditional budget in order for the reader better to understand the Background for Beyond Budgeting, and the motivation to attempt implementing it. This is important in order to understand the next part, where we look at problems and challenges that academics and industry professionals have found with the traditional budget. We also look at how Beyond Budgeting aims to mitigate these problems. These two parts lay the foundation for the theoretical framework we will use to approach the research question.

One of the clearest solutions to the problems associated with the traditional budget is to unbundle the budget into separate tools that serve individual purposes. We found that the literature as of today contains very little academic research on companies actually going through with this separation process. We are therefore interested in investigating what challenges an organization may experience in this process, as well as to which degree it has worked for our case company.

To explain the challenges our case company may have experienced, we added a section on implementation of Beyond Budgeting by academics Hope and Fraser which have a nine point guideline for implementing Beyond Budgeting, which we will supplement by a seven point guideline by industry professional Bjarte Bogsnes. This is where our main contribution to the literature will likely be, since at this point in time, most of the literature on Beyond Budgeting implementation is written by industry professionals. We aim to investigate and explain these struggles in such a way that other organizations attempting to unbundle the budget may find aid in our thesis, as well as providing a foundation for future research on the separation of forecasts and targets.

As a theoretical framework for the effectiveness of the solution, we will use the three most accentuated problems coined by Hope and Fraser as the resource-, flexibility- and gaming aspect to evaluate to which degree the separation of forecasts has worked effectively in our case company. We do this by investigating to what extent the problems outlined by Hope and Fraser have been mitigated.

CHAPTER 3:
CASE PRESENTATION

3. CASE PRESENTATION

In this chapter, we aim to give a concise, but broad overview of the chemicals company, Jotun, and the specific case we are studying. We will briefly outline their expansion, organization, markets, performance and management accounting systems. We believe it is important for the readers to have a clear picture of what Jotun does to get the most out of the analysis.

3.1 JOTUN AS A CASE STUDY

As a global, industrial corporation, Jotun can be viewed as an unlikely adopter of Beyond Budgeting. Still, they have gone out of their way to abolish the budgets and try to unbundle the budgeting functions into separate forecasting and targeting tools. This gives a unique opportunity to investigate potential struggles of separating the forecasting and targeting functions, which as of this date is poorly documented in the literature. Our case company is also interesting because it has the potential to prove that an organization that operates under different conditions compared to the usual Beyond Budgeting company may still be successful in its implementation.

3.2 FOUNDING AND HISTORY

Jotun was established in 1926 by Odd Gleditsch sr. as *Jotun Kemiske A/S*, but has since grown into a large global corporation (Jotun A/S, 2016a). To most people known only as a brand of paint for residential purposes, they are also a large industrial player, selling a wide range of paints, coatings, stainings, antifoulings and other chemical products. By 2015, the Jotun Group had representations in more than a 100 countries, with production in 21 of these. They currently have almost 10,000 employees on a worldwide basis. Still, the Gleditsch family holds 54 % of the company stock directly or through holding companies (E24 DinePenger A/S, u.d.). In addition, the Norwegian conglomerate Orkla holds another 42.53 %. Ownership in Jotun has been stable for a long time, with only small changes among minority shareholders.

3.3 CURRENT ORGANIZATION AND INTERNATIONALIZATION

Today, Jotun maintains a matrix organization based on geography and segment[1] (Jotun A/S, 2016b) (Jotun A/S, 2016c). The geographical organization is necessary due to the different geographical markets, as well as increased outsourcing, especially in later decades. At the same time, the product markets are so different that also a segment-based organization is needed. In addition to this over-arching matrix, the different locations have functional departments and teams, such as marketing, HR and manufacturing.

In total, Jotun has 63 companies within the group, located in 45 different countries[2] (Jotun A/S, 2016d). Most of these are fully owned by Jotun, while in others they own only a stake of the company shares. Only a few companies do not have the word "Jotun" in their name, even in companies where the group has a minority participation as small as 0.01 %, signaling a strong focus on branding and community.

Even with the global expansion, Jotun has still chosen to keep its corporate headquarter at their office in Sandefjord, Norway (Brønnøysundregisteret, u.d.) (Grevle, 2015). Jotun has also defined what they refer to as *core processes,* which are implemented across the group as a whole, involving HR, operational development, R&D, competence development, HSE, technical expertise, CSR and others (Jotun A/S, 2016e).

However, subsidiaries are given a large share of autonomy and decentralization, with only about 10% of total employees working in all of Scandinavia (Jotun A/S, 2016f). The different geographical divisions are largely self-provided in the sense that products are often made regionally, or even nationally, with little export between the different regions. Even though chemicals are fairly easy to move, the value-to-volume-ratio of chemicals is often too unfavorable to justify centralizing production too much.

Internationalization in Jotun started early, with manufacturing opening in Libya in 1962 and Thailand in 1968 as notable examples. They currently have 85 different nationalities

[1] See Appendix 1 for organizational chart

[2] See Appendix 2 for list of subsidiaries and 3 for geographic dispersion

represented, and even the regional divisions have great diversity. As examples, the Scandinavian division has employees from 31 countries and the Middle East, India and Africa division has employees from 50 countries. On the other hand, both the board of directors and management team consist only of Norwegians (Jotun A/S, 2016g) (Jotun A/S, 2016h).

3.4 FINANCIAL PERFORMANCE AND GROWTH

Even as an old company, Jotun has seen tremendous growth lately. The last ten years, they have had a compounded average growth rate of more than 9% in revenues and 16% in operating profit[3] (Jotun A/S, 2016c) (Jotun A/S, 2011). In addition, they have been able to keep strong profits every year, even through changing market conditions at both the micro and macro level, as well as internal growth and expansion[4].

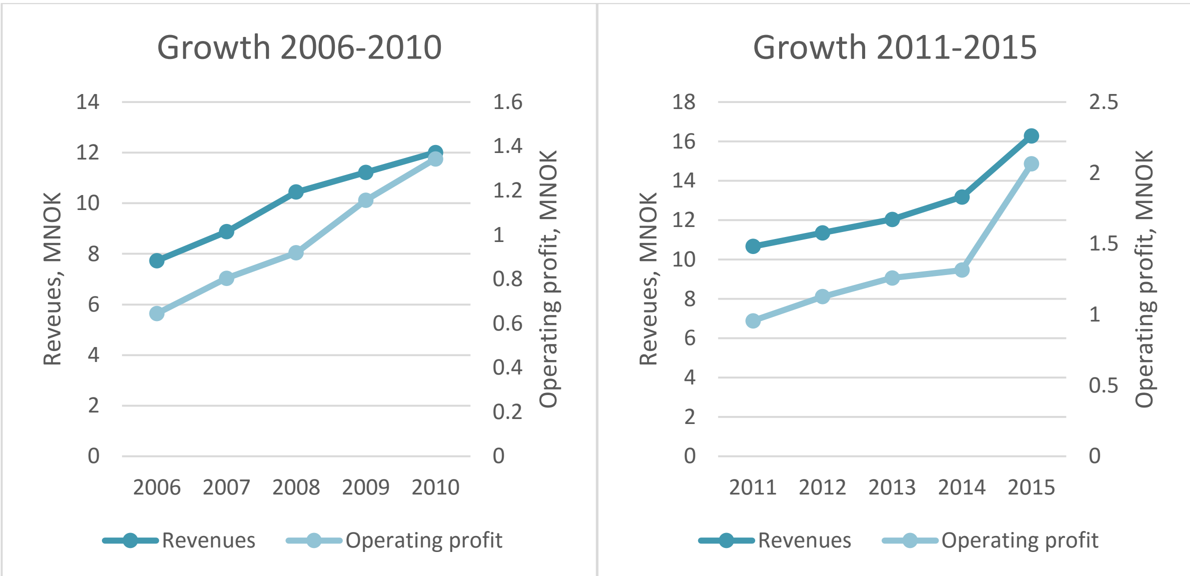

Figure 2: Financial growth 2006-2015

[3] Note that the graphs are split as Jotun changed accounting standards from NGRS to IFRS in 2011, lowering the reported revenues by about 20%. As an example, 2010 numbers changed from more than 12 MNOK to less than 10 MNOK when changing accounting standards.

[4] See Appendix 4 for market breakdown

3.5 MANAGEMENT ACCOUNTING

To increase the range and quality of their reporting, Jotun introduced balanced scorecards in 2005 and removed their group level budgets in 2007 (Hjelvik, 2009). In a February 2014 interview with Norwegian newspaper Dagens Næringsliv, CEO Morten Fon claimed that

> *"It is six years since anyone on the board saw a budget. My main task is to develop Jotun organically. We know that we wish to grow and have good strategic plans. On a daily basis, we manage by key performance indicators. That works excellently for our sake." (Segrov, 2014).*

Instead, they manage largely by key performance indicators, or KPIs, both in the long and short term (Segrov, 2014). These KPIs are largely financial, and have some overlap with what a traditional budget would track (Grevle, 2016). Jotun conducts a bi-annual "*Business Review*" for every company, which is heavily focused on their KPIs and other strategic measures (Grevle, 2015). They also use benchmarking, especially internally between segments and companies.

Jotun evaluates all their companies on a biannual level, during what they call the *Business Review* (Grevle, 2015). The evaluation is performed by group executives, regional executives, and segment executives. These reviews last for one to two days, depending on the size and complexity of the companies. As part of the evaluation, different key performance indicators are discussed, such as the aforementioned ratio of cost growth to revenue growth and performance compared to targets.

As a standard, companies are expected to deliver a positive cash flow by themselves, and not need funding from the Jotun group to finance growth (Grevle, 2015). In addition, they are expected to deliver cash dividends to contribute to group profits. Larger investments such as a new warehouse or an important upgrade of the facility will normally warrant an approval from the group management. When it comes to incentives such as bonus schemes, the regional and local levels are left a lot of autonomy.

Furthermore, what used to be a traditional budget has over time been changed into what they now call *"cost budgets"* (Grevle, 2016). This tool, despite its ambiguous name, is not a budget, as it is not an allocation of resources, or a complete overview of all the different areas of the organization. Rather, it is intended to serve as a detailed forecast of the most important variables related to expected costs in the coming year. The goal is to spend less resources developing complete budgets, and rather make more reliable and accurate forecasts by only focusing on the most important elements on the local company levels.

Their last main tool is the *"Strategic Target Planning",* or just *STP*. The STP is a tool for setting targets for the coming year. These are derived at a local level, before they are consolidated to the regional and group levels. Where the cost budgets are intended as an objective forecast, the STP numbers are more of a subjective target.

This way of doing Beyond Budgeting is an example of not having to implement all the twelve principles religiously, but rather tailor the approach to the organization's needs. Since Jotun is a large manufacturer, many managers still see the benefit of using budgets in the manufacturing process. That some managers still use traditional budgets does not mean that Jotun does not do Beyond Budgeting. They have tried to unbundle the targeting and forecasting function of the budget by introducing the STP and Cost Budgets, respectively making the targeting and forecasting processes lean, unbiased and unrelated to each other, rather than focused around strict rules and organizational politics. At the same time they have empowered employees to make more autonomous and flexible decisions through a more transparent organization. The ambition is to mitigate the downsides of traditional budgeting to a great extent, while creating a more autonomous and responsive organization.

CHAPTER 4: RESEARCH METHODOLOGY

4. RESEARCH METHODOLOGY

In this chapter, we will outline, explain and discuss the methodology used in the research for this thesis. The chosen methodology will frame the research, and provide support and limitations for the findings and conclusions.

4.1 RESEARCH DESIGN

The research design is the researcher's description of the complete research methodology (Johannessen, et al., 2006). In this part we will structure the entire process from the top-level, "What do we want to answer?", to the bottom-level, "How are we going to answer this?" (Easterby-Smith, et al., 2008).

4.1.1 PURPOSE

A research purpose can be classified as either exploratory, descriptive or explanatory (Saunders, et al., 2012). Exploratory research is the most open-minded and usually seeks to probe into an entirely new field of study, or simply a new angle or perspective. To a large extent, exploratory research works as a stepping stone to further research. Descriptive research is more about filling the gaps about what is happening, and how, as exploratory often leaves a lot unanswered. As such, it is less tentative and more accurate. Lastly, the explanatory research addresses the why, and aims at establishing a causal relationship or connecting different ideas into a more holistic picture.

We have chosen to approach our thesis as explanatory, as we are investigating *why* there may be struggles in effectively separating the forecasting and targeting function of the budget. We wish to uncover and explain the reasons behind the potential mismatch between the intended purpose and the actual implementation. While there is a reasonable amount of academic research outlining the benefits of Beyond Budgeting in general, there is a lack of studies on potential struggles in the implementation of Beyond Budgeting. This makes it interesting to investigate why and how reality may differ from the textbook ideal.

4.1.2 RESEARCH PROBLEM

To create a more focused thesis with a clear objective, it is useful to formulate a specific research problem (Zikmund, 1997). The research problem should indicate where current knowledge is lacking or has a gap (Brewer & Hunter, 2006). It should aim to capture both the particular content of the thesis, as well as the applicability to other organizations, processes or strategies of similar nature. It should suggest both the breadth and limits of the relevance of the findings. We have thus defined the following research problem:

"Why may global, industrial corporations attempting to go Beyond Budgeting struggle to effectively substitute the budget with separate forecasting and targeting functions?"

4.1.3 RESEARCH APPROACH

We have to choose a research approach based on how explicit or implicit the theory is used in the research. An inductive research approach is more flexible and pragmatic, where researchers gather data to build their theory (Saunders, et al., 2012). The deductive approach on the other hand, is more based on existing theory and seeks to test this. A third approach, the abductive research approach uses both inductive and deductive research at the same time, in a process that Dubois and Gadde named "systematic combining" (Yin, 2013).

This thesis applies existing, more general theory on a specific case: substituting the budget with separate cost budget and STP numbers. We also aim at making the findings generalizable to other companies attempting to introduce such tools. However, there will also be elements of an inductive research approach, as we are gathering data and interpreting it through inductive means in order to better understand how Beyond Budgeting may present struggles and opportunities that have not yet been researched. As such, we would argue that the thesis is abductive.

4.1.4 RESEARCH STRATEGY

In this part we present our plan to obtain the necessary information (Denzin & Lincoln, 2005). It outlines the strategy of getting from point A, the research question, to point B, the answer to that question (Yin, 2013).

Three main research strategies are the empirical based research, ethnography, and case study (Mehmetoglu, 2004). The first concerns collecting data as a foundation for developing new theories, the second is used to describe and understand groups, and the third to study and explain some sort of phenomenon in a wider context.

Case studies are in general recommended for answering research questions about “how” or “why” (Yin, 2013). For this reason, case study appears to be the most suitable strategy for this thesis. The phenomenon to be researched is the separation of the cost budgets and STP numbers in Jotun, with the underlying Beyond Budgeting philosophy as the wider context.

Given that we are conducting a case study, there are several options to choose from. Firstly, we can distinguish between studies based on a single case versus several cases (Yin, 2013). Secondly, there’s a distinction between holistic and embedded case studies.

Studying a single case is common in situations where only one unique case exists, or sometimes as a typical example of a greater trend or phenomenon. It will usually require less resources as well, or at least offer more in-depth study. The multiple case approach is more suitable to achieve a higher level of generalization or to pick up on different variations or nuances.

Furthermore, the choice between holistic versus embedded case study can be viewed as a choice between top-down and bottoms-up. A holistic study will look at an organization as a whole, and then aim to make conclusions viable for all the sub-units as well. An embedded study, on the other hand, will look at some or all of the sub-units individually, and use this information to paint a broader picture of the organization as a whole.

This study will focus solely on Jotun and the budget separation in order to have the ability to perform more in-depth research. The reasons behind the potential struggles of implementing Beyond Budgeting are likely to have subtle nuances and therefore require a careful investigation in order to be fully understood. Furthermore, as Jotun is such a diverse and globalized organization, looking only at the organization as one entity will ignore important nuances. Besides, as this is a study on implementation, it makes much more sense to look at how this affects the actual sub-units. Thus, this research will be a single, embedded case study.

4.1.5 DATA METHOD

For this thesis, the research data will be highly qualitative, as the interviews will all be non-numerical in both question and answer, and not supplemented by surveys as this would require a much greater amount of interview subjects and giving less in-depth answers, whereas we want to uncover feelings, opinions or motivations (Nyeng & Wennes, 2006) (Robson & Foster, 1989). Numerical data will only occasionally be used as supportive examples or argument, while not being given the center of attention. Because Beyond Budgeting is very conceptual, what matters more is the perception and understanding of the concept, rather than financial figures.

4.1.6 DATA SOURCES

As there exists no previous related studies for Jotun, we will have to rely largely on primary data, data which is generated and gathered specifically to answer our research question (Gripsrud, et al., 2004). All the interviews which the actual analysis is based one will be primary data. We will mainly use secondary data, data that originates from an unrelated purpose, in the theory and company presentation to understand the case and build the hypotheses.

4.1.7 INTERVIEW METHOD

Interviews can be classified as either structured, semi-structured or unstructured (Saunders, et al., 2012). The first category involves very rigid and inflexible interviews, usually following a strict questionnaire. This method allows for more quantitative analysis of the data, or at least comparisons between different groups or interviewees as they are subjected to the same questions, asked in the same way.

The unstructured interviews, are by far the most flexible and pragmatic, and would act more like a conversation than an interview. It is usually applied when the researchers want to probe into a new field of study or to uncover data they have little previous knowledge about.

As we will be two people doing the interviews, only interview each person once, we have a sufficient grasp on the subject to prepare questions, and we wish to maintain the flexibility of follow-up and in-depth questions, the interviews conducted in this thesis will be mostly semi-structured. We have a pre-defined list of questions, but which questions are asked and in what order varies between the interviews[5] (Maylor & Blackmon, 2005). According to Bernard, this is usually the best approach if the researchers are only able to interview the subject once and need the pre-defined questions to make sure that they are able to cover everything, or there are several interviewers in order to ensure consistency (Bernard, 2006).

[5] See Appendix 6 and 7 for interview guides.

4.2 SCOPE

Given the aforementioned research question, as well as the method choices discussed and made in the previous sections, it would be useful to take a closer look at the actual scope and content of this thesis.

With Jotun being a huge global corporation, it would be virtually impossible to interview all employees, or even representatives for all the different offices. On the other hand, relying on too few subjects or only one office would decrease the validity and generalizability of the findings. Hence, there is an obvious trade-off. In order to get a broader view of the organization, as well as making our results more generalizable, we chose to focus on business units from four different countries: China, Malaysia, United Kingdom and United Arabic Emirates. By doing this, we could pick up cultural nuances, but at the same time find common ground between the different offices. We believe that choosing four different geographical offices offers both the opportunity to make our research solid, but at the same time manageable.

From all of these countries, we asked for three interview subjects from different areas of the business unit, such as finance, marketing and manufacturing. However, the total number of interviews was somewhat lower due to inability or insufficient capacity from some of the scheduled interview subjects. The purpose of these interviews was to understand how cost budgets and STP are actually practiced at the local offices, and uncover potential challenges and negative effects that other companies might face in a similar situation substituting the budget with separate forecasting and targeting tools. The interviews gave valuable insight on how the different tools were being used, as well as uncovering inconsistencies between the intentions of the management and the actual functions. It also helped uncover inconsistencies in the use of the tools between departments.

In addition, we interviewed some regional financial executives. As these are higher up in the system, we expected them to have a better understanding about the purpose of the cost budgets and STP. The interviews were thus more focused on the separation process when it first happened, usefulness, and actual practice.

4.3 METHODOLOGY EVALUATION

The methodology evaluation looks at different aspects of the chosen research design to evaluate the technical and academic quality. This will be done in two parts: reliability and validity.

4.3.1 METHOD RELIABILITY

Reliability refers to how well the chosen method consistently will return the same results (Moskal & Leydens, 2000). There is a number of different kinds of reliability. *Inter-rater reliability* measures the consistency in interpretation of the data. *Test-retest reliability* refers to whether or not the same test conducted at different points in time will return the same results. *Parallel forms reliability* refers to which extent different measurement tools would produce the same results for the same individuals, while *internal consistency* refers to whether or not different items on the same test produces the same result. (Gay, 1987).

As this thesis deals almost exclusively with qualitative data, inter-rater reliability may be the greatest reliability issue, since quantitative data is usually more reliable than qualitative data. As the data collected will mainly be the transcribed answers from the interview subjects, the data will be consistent. However, interpretation may not be. As the analysis relies heavily on tying data together, drawing parallels, discovering patterns and understanding opinions, different people may arrive at somewhat different conclusions. As researchers, we will most likely agree on the main points as we discuss them back and forth for a long time. However, we cannot guarantee that others reading the data will interpret them the same.

We see two main sources as to why our results would vary over time. The first would be if Jotun changed their use of the two tools after the interviews were conducted, a drastic measure that would render much of the research void for their part. However, the findings would still be relevant to other corporations wanting to try something similar. The other source would be the issue of the local offices lagging far behind corporate plans in terms of the separation, so that even though the process is officially over by now, the actual effects may take longer to stabilize in practice.

By using semi-structured interviews we believe that the results would largely be the same if the interviews were conducted using differently phrased questions or conducted by different interviewers. An unstructured interview might be too random in what it captures, while a structured interview is too fixed to allow for adequate nuances. The semi-structured interview still has main topics it touches upon, thus covering all the important elements, while still allowing for follow-up questions and clarifications.

As we largely probe for different things in the different questions, we expect our interview questions to return consistent answers on the same sub-topics. However, there is some overlap between the different subjects, which may pick up different nuances. The goal while completing the interview guide was however to make sure that the questions were mutually exclusive and collectively exhaustive.

4.3.2 METHOD VALIDITY

While reliability tests consistency, validity looks at whether or not a test produces the correct result (Moskal & Leydens, 2000). It does not help to have consistent results if they are consistently wrong. In total, we have five types of validity: *Face validity* refers to whether or not stakeholders perceive the test as relevant to the topic. *Construct validity* regards to which extent a test measures what it is intended to measure. *Criterion-related validity* refers to correlation with another test for the same measure. *Formative validity* expresses the quality and quantity of normative data returned by the test. *Sampling validity* regards whether the broad range of sub-topics or parts are adequately covered.

We do not expect *face validity* to be a significant issue for this research, unless the interview subjects feel the questions are so far off from the topic that they give lazy or even sloppy answers. We expect to uphold the *construct validity* by not taking responses out of context, or using them to answer other questions than what the interview subjects actually were asked. We will also abstain from ignoring other factors not included in the research, and thus making the conclusions more general than we actually have the basis for. As for *criterion-related validity* this is not much of an issue for our thesis as there are no similar tests being conducted. We also do not expect *formative validity* to be an issue, as the interviews we are conducting are not assessments of the interview subjects, but rather of the corporation and their tools. Perhaps the most pressing validity issue is the *Sampling validity*, since the overarching research question is broad and complex. Hence, a lot of effort has to be put into ensuring that all main aspects are covered in a satisfying way during the interviews.

4.4 ETHICS IN ACADEMIC RESEARCH

Writing this thesis, *Academic Integrity* is our main responsibility. Key elements according to the European University Institute are here *honesty, trust, fairness, respect, legality,* and *communication*: *Honesty* is about personal and intellectual honesty in both research and results. *Trust* is about creating a climate of mutual trust for free speech. *Fairness* is about equality in interactions between research members. *Respect* is about respect for oneself, the research, other research members, and the process. *Legality* is about adhering to legal norms, especially in terms of copyright and intellectual property. *Communication* is about aiming to communicate the research and its results as widely and freely as possible

As a research team of only two persons, many of the inter-personal elements should be easily accomplishable. The main challenges on our part will be to develop an appropriate research design, accurate and complete referencing, and wide communication of the results.

4.4.1 BASIC PRINCIPLES

The Belmont Report is one of the most established guides to ethics research, and establishes three main principle[6]s: Respect for persons, beneficence and justice (National Commission of the Protection of Human Subjects of Biomedical and Behavioral Research, 1979). The writers of the report claim that these basic principles:

> *"…refers to those general judgments that serve as a basic justification for the many particular ethical prescriptions and evaluations of human actions"*

In the context of this thesis, it follows that we will give the interview subjects sufficient time and space to give voice to their opinions. We also hope that the process of contributing to our thesis will provide an arena for self-reflection, as well as someone to bounce ideas off.

4.4.2 APPLICATIONS

The second part of the Belmont Report deals with application of ethical standards, split into *informed consent, risk/benefit assessment,* and the *selection of subjects.*

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[6] See Appendix 5 for ethics framework.

We will make sure to provide the involved individuals with sufficient information about different aspects of the research, such as procedure, purpose, anonymity and content. This information must be provided in an orderly fashion and context, and in a way the individuals will easily be able to understand. In our case, this is probably more of challenge, especially taking the language barrier and short time frames during interviews into account.

All the interviewed individuals must willingly be able to participate in the research. Again, this is especially crucial for tests and experiments. However, there are voluntariness issues also for our research. Even though consent might easily be reached, it is important that it is a willing consent, and they do not feel that they have no choice in the matter. This is an important factor when first establishing contact with the different interview subjects, so that they do not believe this is a direct order from Jotun, but rather a request and a desire.

We will do our best to assure the anonymity for the research subject, and reduce the risk of sensitive corporate information being leaked. To the first account, the aforementioned censoring of names and contextual information that could reveal the source will be utilized. More specifically, we will state the country for all the local employees. For the regional CFOs, we will only write exactly that, as anything more would be a clear identifier. To the second account, we try to base the research largely on public or other non-sensitive information where possible.

CHAPTER 5: ANALYSIS

5. ANALYSIS

In this part we will answer the research question by going more in-depth in the cost budget and STP tools, and how they have been separated in a technical manner. We will begin by comparing the intention of the tools as it is outlined by the headquarters with how it is practiced at regional and local levels. Differences between intention and actual practice give an indication of where the organization has met challenges and struggles in the implementation process. For the sake of relevance, we will focus mostly on those practices that actually differ from intention. To determine potential reasons for the struggles, we compare the implementation and management approach of Jotun to the guidelines provided by Hope and Fraser and Bogsnes (Hope & Fraser, 2003) (Bogsnes, 2009).

We then use the three aspects by Hope and Fraser as a theoretical framework to decide how effective the new solution is compared to a traditional budget (Hope & Fraser, 2003). *We will do this by investigating how well the problems and issues presented by Hope and Fraser have been solved by separating the cost budgets and STP tool.*

5.1 COST BUDGETS

When CEO Morten Fon removed their group level budgets in 2007, Jotun decided to put more emphasis on tools that could help support and fill the roles that the budget previously filled. The tools have been implemented and adopted with varying degrees of success.

As part of their Beyond Budgeting approach, Jotun have changed their traditional budgets into what they call cost budgets (Grevle, 2015). Although the name may be confusing, it is not a budget in the traditional sense, which is mostly focused on resource allocation. These cost budgets are instead intended to be more of a detailed forecast to give Jotun managers an idea of what is expected to happen in a given period. They are not intended as a line in the sand, but rather an objective estimate. Jotun has had cost budgets for a long time, and while they were previously closer to a traditional budget, Jotun has in the last few decades attempted to make it more focused on forecasting (Grevle, 2016).

The cost budgets are made for the following accounting year, and Jotun as a group has chosen not to use rolling forecasts, or in this case rolling cost budgets (Grevle, 2015). The process is usually a cooperative task between the local finance departments and the other departments for the different parts. The cost budgets are then consolidated from lower levels up to department and company heads. There is however no consolidation of the cost budgets at group level, and the cost budgets are in most aspects only given local attention (Grevle, 2016).

Jotun also attempts to focus more on the gap between cost budgets for two years, rather than cost budgets and actual numbers (Grevle, 2015). Managers would have to be able to explain why they expect a cost to increase from previous years. However, large gaps between cost budgets and actual performance would still warrant an explanation. Noteworthy, performance compared to the cost budgets is not a part of the business reviews.

When interviewing Jotun's employees, there appeared to be a large degree of disagreement and confusion regarding the purpose and role of the cost budgets. Many could not see any difference between Jotun's cost budgets and traditional budgets, referred to them simply as "budgets", or did not even recognize the term "cost budget" if it was used by the interviewers.

> *"I do not know really, I consider the cost budgets to plainly be a normal budget, not just a forecast."*
> – Interview, China

> *"I think the cost budgets are more of a traditional budget for us. But the way it appears to be used by the rest of the group, I would suggest that they are using them more as forecasts."*
> – Interview, Malaysia

> *"I do not make a distinction between budgets and traditional budgets, whether it is a cost budget or something else. To make a budget is to make a budget. It is the same terminology. I could not tell you the difference between them, because there are not any, as far as I am concerned."*
> – Interview, UK

The reason for this lack of agreement on how to use the tool likely stems from the lack of a "coherent plan" as advised by Hope and Fraser for changing the cost budget to a forecasting tool (Hope & Fraser, 2003). Jotun instead adjusted the use and purpose of the tool over time as they were moving away from traditional budgets. This is also in discord with Bogsnes' recommendation to create a clear case for change (Bogsnes, 2009). If employees are not aware of why they have to change the old process, they are also unlikely to adopt the new process.

> *"I think it would have been easier if Jotun has introduced some kind of forecast tool as well when they introduced the STP. They just said that* "The cost budgets are now forecasts", *which lead to a lot of confusion. If they instead had said* "We are now abolishing the budgets; from now on we will have the STP for target-setting and a "tool X" for forecasts"*, things would have been a lot easier."*
> – Interview, CFO

> *"At this level, we kind of know what the cost budget is about, and we are trying to keep up with the changes from corporate. But the companies, you know the national level, that information does not reach them. They just keep at it."*
> – Interview, CFO

At the same time, handling the resistance against using the cost budgets as a forecast will be hard unless there is a concrete plan that corporate and management can use to clearly indicate what the intentions of the cost budgets are (Bogsnes, 2009).

Instead of identifying the forecasting purpose, many employees considered the cost budget to be mainly a resource allocation tool. This implies that employees feel that the resources forecasted in the cost budgets are already approved expenditure. Jotun has not assigned this purpose to a specific tool, which has led to confusion and differing opinions regarding which tools would be best fit as an allocation mechanism.

> *"I think in our company, the budget and the forecast are not that clearly differentiated. I think that it can be a combination because we make this budget according to our forecast for sure. We think that this will happen, and we make it into a budget. And then it becomes a budget and you can spend it next year."*
> – Interview, CFO

> *"For the factories, they are resource allocation. If we look at the cost budgets related to marketing spend or things like that, they are a target."*
> – Interview, CFO

> *"Cost budgets are mostly forecasts and resource allocation. Probably mostly resource allocation, to be honest. At least to me."*
> – Interview, CFO

Perceiving the cost budgets as a resource allocation mechanism might lead to employees knowingly forecasting pessimistically so that they will have sufficient resources in the coming period, as well as seemingly performing better than the forecast (Hope & Fraser, 2003). This will in turn make the forecasts less reliable, as they are not based on the employees' best guess for the future expected outcome, defeating the purpose of such forecasts in the first place.

Furthermore, many employees expressed a wish for the forecasting to be less dependent of previous periods. As of today, most departments and companies start with the cost budgets for the previous and current periods, and evaluate whether they should increase or decrease any kind of spending. Instead, some employees called for so-called zero-based budgeting where previous cost budgets are irrelevant (Pyhrr, 1970). Cost budgets less dependent on previous periods would likely make the them more reliable as forecasts, again aligned with the Beyond Budgeting philosophy.

> *"I would like to say that we went back to basics and did a full sort of cost-up approach or zero-based budgeting when we make the cost budget, but we do not do that. For example, on many costs they will be adjusted upwards by the rate of inflation, two or three percent, typically labor cost. We will inflate that, and then we will look at the other costs and determine if there are any significant changes around labor cost. So we take last year, we add a percentage for inflation, but of course we look at* "Are we going to recruit one or two sales people, are we going to recruit a new head of a division, are we going to recruit another ten people in the factory?" *There is a lot of those things, so the cost will be determined very much by looking at the past, like* "yes, we had a big exhibition last year that we are not going to have this year, okay, we will adjust for that"*, but it is nevertheless really to a significant extent based on the previous year."*
> – Interview, CFO

> *"I think we need more of the Beyond Budgeting to be quite frank, and trying to not look at the previous year, but actually to look at what you want to do for this year and try and do a zero-based approach, but it never seems to be time to take a particular company and start from scratch, because it is such a big effort to do that, so inevitably you get* "What is marketing spend? Let us look at last year. What traveling are we going to do? Well, let us look at last year". *So it becomes the norm to look at the prior year. It would be good if we could do more zero-based budgeting."*
> – Interview, CFO

Despite Jotun's decision to not implement rolling forecasts, several employees expressed a want to make the cost budgets rolling throughout the year. Suggestions regarding how often they should be renewed differed from every six months to a monthly basis, with a twelve month horizon.

> *"Cost budgets are forecasts, but it is not a rolling forecast. So it is more or less fixed for the year, and that is a challenge. The challenge here is for big companies when it comes to the cost budget, what happens if they do not get the growth? So the companies are very smart in sticking with the budget, they attain the cost budget properly. But they will not be able to achieve the sales budget. If the cost budget is somewhat linked to the sales, and it is more like a* "If you are not selling more then you cannot increase the costs" *kind of approach. We should implement rolling forecasts, like we need to keep the review of the cost budget every three months or six months."*
> – Interview, CFO

Using rolling forecasts is very prevalent in the Beyond Budgeting literature because of its tendency to be less backwards-looking and more forward-looking, increasing the forecasting ability compared to a static forecast (Bogsnes, 2009) (Hope & Fraser, 2003). It also lets deviation discussions revolve around why the forecasts have been changed, instead of why reality deviated from the forecasts, making skewed forecasts less viable. To add to this, some companies had actually started making their own rolling forecasts for internal use, without this being group policy.

> *"We use rolling forecasts to measure performance, because first of all in the monthly results that come out every month which I have to comment on, they will require a comment as to where I am against the rolling twelve months, so to that extent we are using it to push the way we are in the region. In business reviews and other business meetings we will also go back to those numbers and say* "Yes, but where are you against the rolling twelve months, how are you going to achieve the strategy, and given that your rolling twelve months is x less than it should be, or x more than it should be?". *It goes both ways, recently we were looking at the fact that the rolling twelve months were significantly better than STP for 2016 for certain divisions. We are continually looking at a trend line of how actual compared to strategy compared to STP, and we will then challenge companies on* "Well, hold on a second, you are always under-forecasting or you are always over-forecasting. Let us get some real estimates, so that will be a challenge to the companies."."
> – Interview, CFO

If we disregard that practice differs quite a lot between regions and companies, even the perception of Jotun's original intention was quite different. This implies that the local units and employees not only chose to adapt the tool from its intended use to what they thought was best, they were misinformed or confused about what the tool was even intended to do in the first place. A lack of understanding of the original intention is likely to lead to misunderstandings across regions, and the tool losing a lot of its generalizability (Bogsnes, 2009). There is also a risk of receiving numbers from different regions and segments that are not comparable because they were developed and understood in different ways.

> *"The purpose of the cost budgets is to simplify the process and make the spending linked with the business requirements."*
> – Interview, China

> *"I think Jotun changed the cost budget to enable us to respond to changing market conditions more easily, but I am not sure if it worked."*
> – Interview, Malaysia

> *"The main reason why we have cost budgets is to have a more realistic view of the present situation which could be viewed from the futuristic perspective and arrive at a realistic target."*
> – Interview, United Arabic Emirates

> *"I think the main purpose is supposed to be resource allocation, even though that is not necessarily what we do here."*
> – Interview, UK

Another possible reason is the fact that cost budgets are given little weight on the global level. Even though this is a fair decision in itself, focusing instead on other performance measures like the KPIs, it could easily be a cause of confusion. With little vertical communication regarding the cost budget numbers or purposes, different companies, segment or regions will not necessarily even know that the way they utilize the tool is in discord with intention or other practices.

5.2 STRATEGIC TARGET PLANNING

The Strategic Target Planning tool, or STP, was introduced in 2007 as an initiative by both the board and the CEO, Morten Fon to act as a targeting tool, at both company and group levels (Grevle, 2016). This implies that the numbers are supposed to be more optimistic and ambitious than the cost budgets, which is very well in line with the literature (Bogsnes, 2009) (Hope & Fraser, 2003). The same goes for maintaining a broad range of different figures, enabling the companies to set targets for more than just pure financial numbers. The fact that the initiative of implementing STP came from the board and the CEO means that the initiative has been backed by corporate from the very beginning.. This indicates that the struggles to unbundle the forecasting and targeting tool is not a product of the board not supporting the process, which is one of the hurdles that Hope and Fraser advise to overcome (Hope & Fraser, 2003).

There is a strong overlap between what is included in the STP and KPI measures (Grevle, 2016). While the cost budgets are not consolidated to group level, the STP numbers are. This makes it easier for the executives to manage by KPIs, as they also know what the target is.

Typical financial STP figures are total sales, COGS[7] and profit (Jotun A/S, 2016i). Although all the STP figures are numerical, not all are financial. Quantity is for example a big part of the targets as well, to somewhat account for price and currency fluctuation.

During the interviews, there appeared to be more of a consensus regarding the STP tool than the cost budgets, but even that one had some differing opinions. While none of the employees disagreed that it was a targeting tool, many perceived it to have other purposes as well, such as forecasting or resource allocation. While some correctly identified the intentional targeting purpose, others at least partially considered it to be for example a forecast or control mechanism. This is in strong discord with the Beyond Budgeting literature, which strongly advocates keeping the target just a target (Hope & Fraser, 2003).

> *"They are a bit forecast, a bit target and a bit resource allocation. For resource allocation, for example, in my region, there are two paint factories and one powder factory. So the paint factories manufacture for the region, and therefore to allocate resources, we have to know what generally will be the demand. So we will put together demand for the region. Let us say it was 24 million liters last year, and it is going to be 23 million liters this year. So to that extent, it is a resource allocation for the factories. Otherwise, it is an aspiration to ensure that it follows the key objectives of the group, one of which is to grow organically. And so, it is always looking at growth. And I think we are also getting a reality check of* "Yes, okay, is it an aspiration? Can we? Is it realistic? And if it is, have we correctly looked at all the other financial numbers?" *So it is a bit of a mixture of those things."*
>
> – Interview, CFO

> *"The purpose of the STP is to establish more ownership amongst budget holders and thus more control over performance in meeting budgets. To move to STP I think is desire to drive harder in a particular direction."*
>
> – Interview, UK

[7] Cost Of Goods Sold

> *“The STP we make is kind of ambitious, but at the same time we want it to be realistic, so it ends up as a mix of a forecast and a target.”*
> – Interview, CFO

We would argue that there are two main reasons that there is more consistency in the STP usage than cost budgets usage based on our interviews. First of all, the STP tool was introduced fairly recently, giving corporate management an easier job in defining a coherent purpose and function as suggested by Hope and Fraser, instead of trying to change an already established tool (Hope & Fraser, 2003). Secondly, the STP numbers are given much more attention at higher levels as well, where the cost budgets are not. This makes alignment with intention and across practices much easier as management will be more inclined to follow up the use of the tool.

A traditional budget is often used for many secondary purposes as well, such as a foundation for incentives or a benchmark for performance (Bergstrand, et al., 1999). Even though it can be argued that the STP would be a better basis than cost budgets for such purposes, the literature suggests avoiding secondary purposes. After all, preventing conflicting purposes is maybe the greatest reason for separating the budget into individual processes in the first place (Hope & Fraser, 2003). Many of the interviewees expressed that the STP would be a better basis for these purposes compared to the cost budget, even though this was not necessarily part of the intended use of the targets. Especially incentive schemes that were at least somewhat tied to the STP tool appeared to be common already.

> *“The whole reason we got the STP tool was to take away all of those functions from the budget, like bonuses and benchmarking. I mean, how could you else say that* “We are doing X much better than the competition?” *or* “You did Y better than we expected?”. *You need that target, otherwise you are just making up bullshit.”*
> – Interview, UK

> *“Bonuses should be based on STP, not cost budgets. If you want to say* ”You did a good job this year”, *you have to measure that against a target, not a forecast. I mean, measuring it against the forecast is not wrong in itself, but it breaks the forecast, and then you can never trust those numbers again. The targets are supposed to be negotiated anyway, so it is less of a problem.”*
> – Interview, CFO

> *“The targets numbers are our best indicator of how well we are doing anyway, because they are our targets. That is the thing, really. If you beat your forecast, you forecasted badly. If you beat your target, you performed well.”*
> – Interview, UK

5.3 TECHNICAL SEPARATION OF BUDGET FUNCTIONS

Beyond Budgeting proponents advise to separate the forecasting and targeting purposes into two different numbers with two different processes, or what Jotun has chosen to call the cost budget and the STP (Hope & Fraser, 2003). At the most basic level, the difference between the cost budgets and the STP tool can be described as objectivity versus subjectivity (Grevle, 2016). The cost budgets should be an objective forecast of what is expected to happen, while the STP is a subjective tool used for more ambitious targeting in line with overall strategy.

Hope and Fraser suggests letting behavioural change come naturally from the process change (Hope & Fraser, 2003). This would entail that the responsibility to interpret and utilize the tools should be left to the employees after the initial guidelines have been released.

However, as the cost budget is a somewhat seamless continuation of the traditional budget and the STP a newer tool, official purposes for the two tools were never thoroughly defined and separated (Grevle, 2016). Nor has Jotun established any comprehensive guidelines for the two tools for distribution to the regional and local units, and they have been given extensive autonomy in terms of interpretation. This is in part due to Jotun’s non-authoritarian company culture and organization, and in part to accommodate to local customs and regulation.

Corporate intention is that the cost budget should work as an objective forecast, while the STP is more of a subjective targeting tool (Grevle, 2016). Some employees did indeed identify this differentiation.

> *"In general, our cost budget is supposed to be an estimate of what we expect to happen in the coming year, while the STP is more what we* want *to happen, I believe."*
>
> – Interview, UK

> *"I would say that the cost budgets are mainly forecasts, while the STPs are Jotun's, or rather our, targets."*
>
> – Interview, United Arabic Emirates

With the two tools meant to have different roles, one being a conservative forecast and the other an ambitious target, one would expect the actual numbers to be quite different as well (Bogsnes, 2009). However, it turns out the aggregate cost budget and STP numbers differ little, if anything. If the target is essentially the same number as the forecast, that leaves little room for different functions, even if one perceives the two tools to be different in terms of purpose.

Many employees reported that they often aimed at making sure the total costs forecasted in the cost budget and targeted in the STP tool were the same. This alignment appeared to be going both ways as they were often made at least in part over the same stretch of time; The targeted costs would limit what could be put into the cost budgets, while the cost budgets would serve as a roof for the STP targeting.

> *"There is no major variance in cost between the cost budget and the STP, but there could be difference in revenue. It depends on the market condition and changes."*
>
> – Interview, China

> *"Mostly cost budget is very close to the cost level in STP numbers, at least where I work."*
>
> – Interview, China

> *"I believe cost budgets and STP number can vary some, but not much. 10% may be an accurate estimate."*
> – Interview, UK

Some even went as far as to claim that they saw little difference between the function and purpose of the cost budget and the STP. This would imply that not only the numbers were very similar, but also the actual tools. This appeared to be an almost circular effect where similar numbers left little understanding of different purposes, while the conception that the tools were similar led employees to feel that the numbers had to be at least close in terms of magnitude.

> *"I do not think there is a lot of difference between the cost budgets and the STP. If you are asking me about my region, then the cost budget is part of the STP. If we do a strategy, we start with the volume, we then go fully into the sales, we look at what the cost of sales is, we come out with the gross profit, we got the management cost near the cost, and we got EBIT below. And the manageable cost, another cost in the strategy need to really tie up with what the budget is."*
> – Interview, CFO

in the way it was described by interview subjects, it seemed more that the practice of the cost budget was too close to the intention of the STP, than the other way around. Even though there was discord related to the STP as well, few perceived the STP tool to have any forecasting function or purpose. As such, it can be argued that in terms of separating the two tools, the cost budget is the main issue.

For those who did see a difference between the two tools, even that appeared inconsistent. When asked directly what they perceived to be the difference between the cost budgets and the STP, employees had quite differing answers. Employees would often refer more to how they perceived the tools or how it was used in their local company, instead of what the group intention was, even if asked specifically about the latter.

"STP is company direction or driving tool primarily based on market force. Whereas cost budgets is a projection into the future, partly based on past performance, that is routinely updated to incorporate input and information reflecting changing market, industry and/or business conditions. We choose both methods because both tools have merit and demerit points."
– Interview, Malaysia

"Cost budgets rely more on historical data and maintaining performance, whereas STP factor in the direction the company wants to take."
– Interview, UK

"STP is more macro oriented that considers the overall profitability and financial position of the company. Cost budget is more micro based concept."
– Interview, United Arabic Emirates

"STP is a company's business plan for next three years in general figures, including sales, cost, profit plan. Cost budget is the next year cost plan in details."
– Interview, China

A general perception was that the STP numbers are given more weight at corporate level, while the cost budgets are more of a regional and local matter. This is in accordance with Jotun policy which at a corporate level is focused more on targeting and KPI management rather than cost budgets, for example in the business reviews.

"I have been part of a lot of business reviews, and we have never really discussed the cost budgets there. It is all about KPIs and targets. And also about strategy and performance in general. We never talk about the cost budgets."
– Interview, CFO

"I do not have the impression that corporate really cares about our cost budgets at all, just how we perform. I am not sure if we even send them to them, at least not from what my bosses have told me."
– Interview, Malaysia

“I mostly manage the company just by the cost budgets. The targets are just something we make to send upwards in the organization.”
– Interview, Malaysia

Several interview subjects blamed lack of information or guidelines regarding how to use the cost budget and STP tools as the reason for discord between intention and practice, and between different practices. Jotun has to little extent provided training or even guidelines on how to use the cost budgets and STP, which is in strong discord with Hope and Fraser’s suggestion to have continuous training and education of the employees (Hope & Fraser, 2003). This has led to the local companies themselves deciding how to use the two tools, though with traces of some regional consistency. They reported that the current practice at their office instead was a result of how it had always been done, or what they deemed to be the most suitable use of the tools. Even though some companies use the tools as intended, this appeared to be almost more by chance, as few could really identify why they used them this way other than that it seemed to work for them. By including HR in the process of realigning the finance department’s role, as well as communicating the guidelines passed down by corporate, there is a higher probability that the process change will go more seamlessly and the tools being used more in accordance with the intended purpose (Hope & Fraser, 2003).

“I definitely think there is a confusion regarding the two tools and how they differ, particularly on lower levels within the businesses. They do not really understand what the tools are meant to do.”
– Interview, CFO

“The cost budget just kind of changed on its own, really. The STP tool was introduced maybe ten years ago, but we were never really told how to use it, and for what.”
– Interview, UK

“I have no idea how the other offices use the cost budgets, I could very well be quite different from what we do. The STP use I think is kind of similar, or at least closer.”
– Interview, Malaysia

> *"I think the STP were just rolled out without any guidelines whatsoever, or I did not see any. We just made it into what we felt we needed. There is probably less confusion regarding the cost budgets because they were always there, so people sort of know what it is about."*
> – Interview, Malaysia

Another common reason the interviewees gave was the large distances and global complexity of the Jotun group, which allegedly made it more difficult to communicate purposes. This appeared to be especially true for newer markets, while employees in regions where Jotun had had a presence for a longer period of time believed this to be less of a factor. However, these distances are just an inconvenience which could be at least partially solved by having clearer communication between corporate and the individual companies. In order for Beyond Budgeting to work it is crucial to be willing to try to overcome all the small challenges that arise during the implementation process, one at a time, rather than just thinking that they will pass by on their own (Bogsnes, 2009).

> *"Even though we of course have e-mail and phones, the geographical distances kind of feel like a distance in communication as well. When you feel like you do not know the people at corporate well enough, or their culture, it is more difficult to pick up the phone and call them. There are so many employees in Jotun, you cannot know even half of them."*
> – Interview, UK

> *"I think that Jotun has been in many countries for more than thirty, forty years, for example in my region we have been for forty years. I think we have come a long way, and are only seeing the communication challenges especially in the new markets."*
> – Interview, CFO

A related issue was the importance of different cultures, in terms of both accounting and management. While Norwegian business culture is typically fairly autonomy- and trust-based, other countries often have a more hierarchical business culture (Hofstede, 2016) (Schwartz, 2006). This also appeared to be less of an issue with the STP tool because it, as mentioned previously, is given more weight at a group level, thus leaving less room for local adaption or interpretation.

> *"To me it seems like the employees in India and other Asian countries are treating the cost budgets more like a traditional budget, or a limit if you will, while the European companies are kind of treating it like some sort of forecast. I am not sure if this is because the Indians like stricter budgets more, could be just that, or if it is just more difficult to communicate the cost budget purpose to units so far away. Probably a bit of both, would be my guess."*
> – Interview, UK

> *"Some cultures are very concerned about targets, others about hard control. I think the different countries have just adapted the cost budgets to what they believe it should be, or wish it was. Like I said, we do not report on cost budgets, so it really is kind of up to us what we make of them. The STPs are another story, with the business reviews and all."*
> – Interview, Malaysia

Especially with Jotun being such an autonomous group where local companies are given a lot of freedom, it has proved difficult to align practices. Even though corporate headquarters at least to some extent are aware of the discord in how the tools are used, they are reluctant to force certain practices on their local companies, since this could take away from the perceived autonomy. Academics generally agree that Beyond Budgeting is dependent on autonomy and decentralization in order to work effectively (Hope & Fraser, 2003). However, this may create a difficult implementation paradox, since that same autonomy and decentralization complicates implementing Beyond Budgeting effectively in the first place.

> *"People just read into the tools what they want them to be. If you believe that budgets are about keeping costs down and you see the name* "cost budget" *then of course you are going to make it into a cost control issue. I mean, that is what it says, what it is called. But if you believe budgets are about forecasting, that is what you are going to make it, because it makes more sense, at least to you."*
> – Interview, Malaysia

> *"Jotun is too afraid of hurting anyone's feelings; it is a very Scandinavian company. That autonomy is sometimes great, but it makes enforcing anything a nightmare."*
> – Interview, CFO

Another potential reason for why the cost budgets especially has failed to pick up on its forecasting role could be that they are given far less weight on the higher levels of the organization. Even though it is a group-wide tool, its use is mostly meant for the local levels. According to our interview subjects, there were several related issues with this, such as letting cultural and geographical factors play a much larger role in affecting the practices, complicating communication and guidance.

While the ratio of the more traditional manual labor workers to knowledge workers according to theory should have been an issue, we did not really find much support for this during the interviews (Rickards, 2006). When asked about the relevance of worker composition, this turned out to be less of an issue than many other factors in terms of how it affected the usage and separation of the two tools. Even though there are a lot of manual labor workers in Jotun, they appear to be so removed from the management accounting processes that it leaves little impact. Another possible explanation is that the autonomy and trust mentality of Jotun is so established in the organization that also manual labor workers accept and work by it. Typical knowledge workers we talked to also emphasized that they had never heard of cost budgets outside of Jotun, during neither education nor other companies, and therefore believed that previous experience would hold little relevance.

> *"I do not think workforce composition, people's education and everything, makes much difference. The people dealing with cost budget and STP are mostly knowledge workers anyway."*
> – Interview, CFO

> *"Most of our blue collar workers who have worked for other firms before have only worked with budgets, so I am not sure if they would know the difference between a traditional budget and our forecasts budgets, or even between a forecast and a target. But I do not think it makes much difference, they do not really influence the numbers. I do not think it matters if I tell them that* "This is your target for next year" *or* "This is your limit for next year*"*."
> – Interview, Malaysia

Some employees suggested more differentiation of the two tools to sort out the confusion. Interestingly enough, the differentiation models proposed were pretty much in line with how the tools were intended to be used by the corporate management, even though none of the interviewees actually mentioned that intention. Typical reasons for more differentiation were instead avoiding duplicated efforts and being able to achieve different things.

> *"What it has come down to is that there is not really much of a difference between the STP and the cost budgets, as I see it. What you target with the STP automatically just becomes the budget for the following year. They work together sort of. But I am not sure if they should, at least not that much. Jotun should clearly try to differentiate them more in my opinion."*
> – Interview, CFO

> *"There should definitely be more of a difference, otherwise there is no point having both tools."*
> – Interview, Malaysia

5.4 EFFECTIVENESS ASPECTS

In this sub-chapter, we will look at the three aspects outlined in the theory chapter regarding how traditional budgeting is suboptimal. To be able to say whether the management accounting tools they have chosen are effective, we must compare them to something. With Jotun not having used traditional budgeting in recent years, it makes little sense to compare to what Jotun did before under significantly different conditions in terms of market, personnel and strategy. Comparing Jotun to the industry would also be difficult, as we do not have similar data on competitors. Both methods would also involve a lot of noise concerning other factors influencing the effectiveness, which in turn would be challenging to account for. Therefore, we have chosen to compare Jotun to what we have called the *traditional budgeting regime*, which incorporates the foundations of what a traditional budget should be according to academic theory and general practice.

5.4.1 RESOURCE ASPECT

In terms of resources, one should expect two contrasting effects. On one hand, operating with two tools instead of one should in isolation lead to more strain on resources, especially if there is overlap between the two tools (Hope & Fraser, 2003). On the other hand, more clear-cut and one-dimensional tools should make the processes quicker and more streamlined, saving resources.

According to the theory, separating the different elements of the traditional budget should reduce the time spent on each part because there should be less negotiation due to clearer purposes (Hope & Fraser, 2003). We have in general found little evidence that Jotun spends less resources on their management accounting than what we could expect under a more traditional budgeting regime. It was a common view among the interviewees that dealing with both cost budgets and STP targets at the same time took a lot of time, and notably more than running with just one tool catering to both purposes would take.

> *"It feels like we do the same job twice, once for the cost budgets and later for the targets. A lot of times we just copy paste the same number, or take the forecast and improve them by 10-15 % or whatever."*
> – Interview, Malaysia

> *"It is difficult to set the targets right. If we have forecasted a certain number, then that is our best guess. How much better should a target be? I think we spend too much time on the STP."*
> – Interview, Malaysia

However, as the organization is managed mostly by KPIs, duplicating efforts is avoided with regards to the cost budgets at the top level. It appeared instead to be mostly an issue at the local levels, where both tools are used in parallel. Especially some of the regional CFOs reported having little interest in the cost budgets, and spent little time on them. They did however acknowledge that their subordinates would probably have to deal with both at the same time.

"I think the Norwegian headquarters only use the actual numbers and a bit of the target numbers. I do not think we have ever sent them our cost budgets. They pay much more attention to the business reviews and other things."
– Interview, UK

"At group level, Jotun is managed purely by KPIs and continuous improvement, not strategy numbers and cost budgets. We stopped consolidating cost budgets almost ten years ago, and never seen them since."
– Interview, CFO

Still, some resources are spent even at the top level, especially towards the STP numbers. To avoid largely unrealistic targets at group level, they are often made more conservative and obtainable before being made official. While most employees were happy with the STP tool, reporting the time they spent on it worthwhile, we were surprised to hear that the targets were often adjusted at the global level, even if they stayed untouched at lower levels. The reasoning behind this was apparently to make them more realistic: while all the targets in isolation can be ambitious, yet obtainable, it is highly unlikely that all the companies will meet their targets, making the aggregate targets unobtainable. However, this again increases the amount of resources spent towards STP, and makes the group targets arbitrary numbers rather than consolidated targets with strong ties to local ambitions.

"We consolidate all the numbers we receive before tweaking them. We want the board to receive more realistic numbers. Even though many of the individual companies might reach their targets, it is unlikely that they all will succeed."
– Interview, CFO

"One problem is that at the aggregate level, there should be some fit between the cost budgets and the strategy numbers. I am not really sure why it is like this, as targets on the individual level should be more ambitious than their respective cost budgets. But the consequence is that we have to reduce the targets at either regional or global level."
– Interview, CFO

However, separating the different parts of the traditional budget into individual tools did according to some interview subjects decrease the time spent on each of them because there was less negotiation and conflicting purposes. The views here differed largely between interview subjects. Some describe only short meetings to run over the numbers quickly, and only really spend time on large deviations from previous numbers.

> *"Last year I arranged one-hour meetings with each of my subordinates to discuss the cost budgets. I compared their suggestions with the latest data to challenge their assumptions."*
> – Interview, China

> *"It is simply a short discussion as to why we made an increase or why we made a decrease, depending on what you may have got in the previous years."*
> – Interview, UK

Others appear to go several rounds, with more back and forth, especially if they believe that the subordinates are purposely estimating too much. They often expect their subordinates to put a buffer in the cost budget, and will schedule negotiations to discuss where they could cut back on the estimates.

> *"We usually talk to all the individual sub-budget holders to determine their needs for the coming year, and we will bring some challenges to those needs. The subordinates are quite likely to put in as much as they like, but then the overall budget holder has to pull that back and ask* "Is that really necessary? What do we need as opposed to what is our aspiration? What if this happened?"."
> – Interview, UK

> *"You know, people will probably play games with that part of the process, to try to get as much as they can. People will always try to make their job easier."*
> – Interview, China

Others again confirmed that the negotiations went so far that the manager would even tell their subordinates to cut in their cost budgets. This in turn often led to subordinates on purpose adding a buffer in their cost budget because they expected that their manager would demand cuts. These two effects might very well be mutually reinforcing each other, corrupting the objective forecasting purpose of the cost budgets altogether (Hope & Fraser, 2003). Such negotiations are in general a strong violation of the objective and unbiased purpose of the forecast, while at the same time maybe the least of evils if the cost budgets are already skewed in the first place. In any case, it surely increases the amount of resources spent.

> *"They often say that the cost budgets are too high, that we are estimating too much resources, and that we need to cut it by so or so much."*
> – Interview, China

> *"It is common for the supervisor to tell his subordinate that* "this numbers is too high, we cannot spend that much, you need to cut it by 10 or 20 %"*."*
> – Interview, CFO

This does however appear to depend on region, as others give the opposite impression, instead reporting a practice that is closer to the corporate intention. Consequently, less resources is spent on negotiation in these cases, without any employees reporting that they felt the cost budgets or STP targets being worse off due to the lack of discussion.

> *"In the companies that I have worked for in the past, it has been a lot more restrictive on what you could do. It was very commonplace for people to be actually coming along and say "you need to cut ten percent of your budget" and to nag. And that has only happened once in the time that I have been at Jotun."*
> – Interview, UK

On the most basic level, the person(s) in charge of developing the individual forecasts should do just that, and they should simply be consolidated upwards without too much back and forth. If anything, targets could sometimes warrant discussion, while forecasts should not.

5.4.2 FLEXIBILITY ASPECT

From the literature, removing the line in the sand should make the organization more flexible and responsive (Hope & Fraser, 2003). Companies should be better able to respond to changes in market conditions, from both the supply and demand side.

Almost all interview subjects agreed that Jotun in most aspects is fairly flexible and responsive in terms of market changes and similar external factors. This was a common conception across companies, levels and functions as well, many comparing Jotun favorably with previous employers. Typical examples cited was capacity increases due to a larger new customer, competitor actions, or marketing to enter a new market.

> *"I think we are quite responsive to external changes. Because the budget is more a forecast than a budget in a way. At least I feel that if you have a solid reason, then you can do the change, even if it is beyond your budget."*
> – Interview, United Arabic Emirates

> *"If I were to put it on a scale of one to ten, maybe it is easier for me to illustrate that way, one would be very inflexible, ten would be very, very flexible, I would say Jotun is like maybe a seven to eight."*
> – Interview, Malaysia

This appeared to hold especially true when it came to substituting one expense for another, or to move money around, and as such not increase total costs levels.

> *"Well, I would say that we are quite flexible in terms of responsiveness. For example, if within a year, I have an X amount of marketing budget, let us say I have ten million as my marketing budget, and of course within these ten millions by working bottoms up we have kind of really planned what activities that we want to do. But if in the middle of the year there are opportunities that comes along, an unexpected competitor action that we need to react against, we still have a lot of flexibility for example to say that after a careful analysis we would channel the money away from the planned activity A, to another activity B."*
> – Interview, Malaysia

While a budget might act as a constraint in the sense that employees might not be allowed to spend more than the budgeted amount even if something unexpected arises, the Beyond Budgeting philosophy advocates a more adaptive approach. According to literature, employees should be allowed to spend more than forecasted or targeted if there is a business case for it, as the alternative might make the company miss an opportunity (Hope & Fraser, 2003). During our interviews, we found strong support that this is the case in Jotun. According to the employees, it was fairly easy to obtain the necessary funds, even in excess of the cost budgets, as long as they had a good reason why. Many even reported being able to overspend compared to the cost budgets by large amounts, though the greater the added expenditure, the better justification would be needed.

> *"I think we have very good, robust processes for any variations to the budget. My real job is to use the budget to control the cost. And then if we have something that we need to do new, for example if there is an investment because some new product comes along and I need to make an investment in production equipment, then we have a very robust process for reviewing investment, even if it is outside of the budget. Or for example, if we plan an investment for 2016, and we find that things move quicker than we expected and want to do it in 2015, we do have the necessary processes to enable that to happen. We have various scales, particularly on capital investment, where there is a certain amount I can authorize, there is a certain amount my boss can authorize in the region, and then above a certain amount it goes to Norway and has to be signed off by the CEO."*
> – Interview, CFO

> *"You can actually get the necessary signatures for a deviation by PDF'ing files, send them by e-mail, and asking the right person. These signatures can be obtained pretty quickly, so I have not seen the process slow down our responsiveness, it is quite easy actually to do things outside of the budget if there's a business case to do so."*
> – Interview, China

This notion is supported by the fact that Jotun in general does not punish over-expenditure, at least not smaller ones. Even in cases where managers deemed the over-spending to be unnecessary, or it proved so in hindsight, showing support and trust in employees was considered more important than reprimanding them. Employees, in turn, appreciated this autonomy, and claimed that it made them feel safer in making responsive decisions to market opportunities, making Jotun more flexible.

> *"Of course I could go through every single thing my people spend money on, and tell them* "That was not okay" *or* "You cannot spend this much"*, but at the end of the day I have to make a decision what I spend my time on. I mean, they are grown up professionals, they know what they are doing. Who is to say that I could make better calls anyway?."*
> – Interview, United Arabic Emirates

> *"This is Jotun. There are no consequences."*
> – Interview, CFO

There did however appear to be more responsiveness at the local level than the regional and global. Especially higher ranking employees expressed frustration regarding this. Where employees at local levels are able to take actions rapidly, there are often slower processes at higher levels due to attempts to reach consensus and keep everyone informed.

> *"You know, I have some experience in other companies. Jotun is large, but it is small in a way. The approach to the senior management is quite easy, it is much more linear. At the same time, as it is a more family oriented thing, sometimes it is not a very priority to change that much, it takes much more time. So you need to create a sense of urgency from the top to get the change, and then the change is very fast."*
> – Interview, CFO

> *"Jotun is slow to change. Management processes are slow, decision making is slow. It is slow for a reason, because it is a Norwegian company. It is still owned by private shareholders, and they do not have to report to a stock exchange, so they can take longer, and they have various principles like the grandfather principle, whereby they like consensus, and they like people to think things through, and not take fast, immediate reactions."*
> – Interview, CFO

Another restraint in responsiveness that we uncovered was the matrix organization. With less of a clear cut limit, Jotun employees are allowed to exceed their cost budget given that they have a good reason. However, they must often justify these reasons and seek approval from sometimes several levels up, which is more challenging within a matrix.

"There are a lot of interested parties within the group, so we try to make sure that all interested parties are on board before we make a decision, which is very time-consuming. This is part of the matrix structure that we have in place, where you have accountability to both the segment and the region. So we have two underlying structures in there, so you need agreement from both structures, and of all the parties that are going to be impacted by this. That actually takes time, to understand everyone's interest in the subject, before then getting a decision on what we should do."
– Interview, UK

However, flexibility is not just about being allowed to spend more if necessary, but also about spending less when warranted. Where the traditional budget regime in many ways pre-approve a certain amount, this is not always true for a Beyond Budgeting company, and even the forecasted amount might be "too much" sometimes (Hope & Fraser, 2003). Instead, employees should be encouraged to only spend funds if they feel it is justified, no matter what the forecasts or targets say. We find some support that Jotun has managed to establish such a mentality among its employees. The focus on cost growth versus revenue growth as an important KPI is an example of this, but it appears to go deeper as well as a more general conception.

"The review process and the preparation of cost budgets has gotten a lot more professional since I have been here. It improves year on year. The finance controller responsible for budgets is very proactive. He has actually given me an invite this week to review where we are. Production figures are a little bit down, and when production figures go down, if we plan on spending at the according budget levels, then the cost per liter goes up. So no doubt he will be asking me how we are doing on our cost budget, what are our forecasts, and if I can trim down spending a little bit. That is generally what happens if production levels are lower than expected."
– Interview, UK

Whereas Jotun appears to be very flexible in upwards spending, we found more mixed support for flexibility downwards. While some employees reported that they decrease their spending below the cost budget amount for example if demand is low, others considered the cost budgets to be a resource allocation tool. This implied that the funds were allocated once the cost budgets were approved, and that the employees had the pre-authorization to spend those funds.

> *"The thing is, no one is going to tell me no if I spend money from the cost budget, as long as they are not spent towards a party or something completely out of line. If I have a little extra at the end of the year, I am better off spending it on stuff I need then; it is easier than asking for more in the next year."*
> – Interview, UK

> *"I think once I have approved the cost budgets, my people will spend that money. I have tried to encourage them to spend less when they can, but I am not sure, in truth I consider those money spent as soon as I put my name on the cost budget."*
> – Interview, CFO

Many employees expressed approval of Jotun's focus on relative numbers, such as the sales growth vs cost growth ratio. This was allegedly especially important in terms of flexibility, and was considered a more fair form of performance measurement. This KPI is very much in line with what Beyond Budgeting proponents advocate in that it measures relative performance in a more flexible manner (Hope & Fraser, 2003). It is simple enough for everyone to clearly understand the input, and the output is comparable between companies.

> *"Once you have that money, you might as well spend them. As long as I have the revenues to show for, I will always get those costs approved."*
> – Interview, China

> *"We have some very particular things in Jotun, the current one is black over red, which means that sales growth must exceed cost growth, because we have had a problem in the last couple of years. It helps me understand where the costs have been growing quicker than the sales, and that was something new for Jotun I think, so we have certainly managed to reverse that trend in the region."*
> – Interview, China

We can also look at what happens if the cost budgets are exceeded. It appears that there are few consequences as long as the employees can justify spending more than what was forecasted. Employees felt that this made Jotun more flexible by allowing them to act in the company's best interest without fearing negative consequences towards themselves.

> *"We in this region are a little different from the rest, because we work on lean accounting principles where possible, and we work on a system of color visualization. For example, if we have a particular issue, for example where sales are growing a lot, and then the manufacturing cost is gone up a lot, just because it is over last year and over budget does not mean that it is a problem to us if the sales have gone up, and we therefore will not highlight that as a problem."*
> – Interview, CFO

> *"For the cost budget itself, there would not be consequences. It only matters in the context of profitability. You are allowed to effectively flex your spend with regards to how well you are doing in terms of your turnover, so a higher turnover would justify effectively a higher cost."*
> – Interview, UK

While overspending had few consequences as long as it was backed by increased revenues, or at least in some way justified, others preferred to offset increased costs in one area by decreased costs in another. This appeared to be especially true in the cases were the revenues could not be increased accordingly, and several employees references revenue growth versus cost growth as important here.

> *"You need to have a solid reason why you exceeded. If I spend more in the marketing side, then probably I have to reduce on the sales side in order to keep the whole department budget."*
> – Interview, China

Consistent communication also appeared to be important in terms of overspending. Getting approval for exceeding the cost budgets were usually easier if those discrepancies were communicated beforehand.

"I have been around long enough to know that there are times when things happen that you spend the money because it is the right thing to do, and as I have said before, the main thing I try to do is to not give surprises, try to let people know as well in advance as I possibly can what is happening, and why it is happening."
– Interview, UK

5.4.3 GAMING ASPECT

The gaming problem often relates to subordinates wanting to be allowed to spend as much as possible, while having to make as little revenue as possible, and thus tweaking the forecasts and targets to achieve favorable conditions (Hope & Fraser, 2003). This is not because employees have anything against helping the company achieve profits, but rather that they want any given result to appear as favorable as possible. This is especially true if bonuses or similar incentives are linked to performance against budget, making the budget numbers skewed and biased. Beyond Budgeting companies attempt to remedy this by separating the objective forecast and subjective target, such as in Jotun.

When explained the concept and some examples of gaming and asked if they thought it was common in Jotun, most answered dismissive. Many instead quoted examples from other companies they have worked for previously, and compared Jotun favorably.

"I have not really gotten any evidence of people using their budgets to maximize their own financial reward, if you like. I have not seen that."
– Interview, China

It did however appear that many employees felt that it was common for people to add a buffer to the cost budget. Typical reasons were to have something to give away during negotiations, or simply to make sure there were sufficient funds in the year to come. Both those controlling the cost budgets and those subjected to them appeared to be aware of this.

"I think people tend to overestimate their cost budgets to have a buffer, by maybe 10-20 %."
– Interview, China

> *"Like I said, people will always try to make their job easier. I do not think it is a case of maximizing their own bonus, but clearly for a production manager to come and ask for more people, that would make her job easier if she had more people."*
> – Interview, China

With the different conceptions regarding the purpose of the two tools, removing gaming also becomes more difficult. This is clearly shown based on how common negotiation on especially the cost budgets appears to be in Jotun. The moment there is an arena for negotiation, subordinates know that they may have to give something away during those negotiations, which incentivizes overestimating costs in the initial stages to have a buffer. Based on the interviews, this is not at all uncommon in Jotun, and a clear example of gaming.

In practice, Jotun rarely ties bonuses to their cost budgets, focusing instead on other measures of performance, such as performance compared to previous periods. This is good because it reduces the gaming incentive in preparing the cost budgets and STP targets as employees are not measured against them. Even though the potential and opportunity for gaming is still there, at least the motivation and potential payoffs are reduced. Incentive schemes are often quite comprehensive, involving both personal goals, company profits, and group profits. The composition did however appear to differ quite a bit between the individual companies, and of course between different types of positions. This again shows how the decentralized and horizontal management of Jotun both supports and threatens the Beyond Budgeting implementation at the same time.

> *"We have two parts. The first part is the sales part, the salesmen. This part of the bonus is linked with several criteria, like their sales growth, growth margin, and their DSO. This is the sales part. Then we have the non-sales part, like the finance department, HR department. Their bonus have two parts. One part is the company performance. For company performance we have several guidelines, like the company's EBIT, the company's working capital, the company's DSO, things like that. So if the company achieves the score, it will be the same to all the people. And then the second part is their personal individual KPIs. So each individual that manages, like me, have some KPIs. If I can achieve it, I will get a good score from my boss. Then these two parts combined together is my bonus."*
> – Interview, CFO

> *"I have to say the bonus structure in the region seems to be quite detailed, and quite well developed. So because of that, the manager's or the person's bonus is pretty well aligned with the best interest of the company, and it does get reviewed every year. We do play around with the bonus scheme if it is not giving the desired effect, as I understand it."*
> – Interview, China

A common gaming issue is that underspending in one year might decrease the budget in the next period, effectively encouraging the employees to waste any remaining resources at the end of the year to keep their budgets (Hope & Fraser, 2003). We have not found any signs of deliberate waste in Jotun to exhaust remaining resources, even though employees reported familiarity with the issue from other companies, and were thus aware of its existence.

> *"There are two reasons I do not think people would overspend on purpose to keep their resources. First of all because it affects the overall profitability of the company, and their bonuses are based on the profits. The second is that when we look at the marketing resources, we should not base it on the year before, but look at what sales we need to generate for that year."*
> – Interview, China

> *"I do not think that happens in Jotun. Do not get me wrong, I have seen it before many times in other companies, but not here."*
> – Interview, UK

It could be argued that this is due to the forecasting function of the cost budget. The less dependent one period's cost budget is on the previous periods, the less we would expect Jotun to be victim to such gaming (Bogsnes, 2009). However, several employees did report that previous cost budgets did indeed largely affect the new ones, and some called for more zero-based budgeting instead. This should effectively reduce the issue even further, even though it is already less of a challenge compared to many other companies.

One related issue we found instead was the action of moving operational costs between period. If they had currently underspent according to the cost budgets, employees would rather take some investments and larger purchases at the end of the year to make their job easier in the next one. This is not waste as such, but still gaming that might influence cost budgets and targets for the coming period.

> *"If you get into the final quarter of the year and you have underspent towards your cost budget, then there is an element of* "Well, what is it that we have not done and what is it we should be doing?" *and then to spend some of that money. I think that does happen. I am doing it myself. I have looked at things and thought* "Well, I have not replaced that comp yet, I normally replace that comp, perhaps I should be buying that spare now so it is there ready for me, so I will not have to spend it in January or February next year, I will buy it now"*."*
> – Interview, UK

> *"If you are trying to achieve a cost budget, there are a number of things you do not know whether will come along or not. We work on the cost budgets for a twelve month period, it is always better not to overspend in the early parts of the year, and that does mean that maybe you might want to try to spent a little more at the end of the yea. Because you spent less at the beginning of the year, and you do not want to have to spend a lot of money in the following year. So yes, there is an element of spending it towards the end of the year to try and make sure that in the following couple of months you do not get any big bills and that you get off to a good start of the next period."*
> – Interview, UK

It is also noteworthy that the trust superiors and finance managers have in the cost budgets and targets that the subordinates suggest for themselves and their department differs a lot. High amounts of trust were often reinforcing, where lack of trust would lead the manager often asking for cost cuts in cost budgets and targets. The subordinates would answer with more conservative forecasts and targets next period to ensure a buffer, which in turn would decrease the trust even further.

> *"From a finance point of view, most of them are being realistic. There is not much room to make the cost budget safer or make it easier to achieve it next year. My personal feeling is that we are using what is the most likely to happen in reality."*
> – Interview, CFO

> *"People are much more focused on maximizing their own pay bucket, than the best interest of the company."*
> – Interview, China

The aforementioned negotiations also have a role related to gaming. In one way, negotiations should to some extent reduce the impact of existing gaming because the numbers are challenged and possibly made more realistic. On the other hand, it also somewhat reinforces the gaming by indirectly encouraging the employees to give themselves a buffer so that they have something to give away during negotiations (Hope & Fraser, 2003).

CHAPTER 6: CONCLUSION

6. CONCLUSION

This chapter will focus on the larger takeaways from the thesis. We will briefly summarize the thesis and its relation to previous literature, before we present our main findings, both the new ones and those that support previous literature. In an attempt to increase the usefulness of our findings and give something back, we will also present some recommendations to both Jotun and similar companies based on our analysis. Finally, we will briefly discuss limitations for this thesis, and make some suggestions to future research.

6.1 SUMMARY

Up until this point, we have been through five main chapters. In *chapter one* we introduced the background and purpose of the case, arguing that because a case study on substituting the budget with separate forecasting and targeting functions has never been done before, it could provide valuable learning to other companies considering doing the same. In *chapter two* we outlined the theoretical foundation for our thesis, both why Beyond Budgeting might be of value and how scholars and business practitioners have recommended approaching the implementation. In *chapter three* we presented Jotun as a case company, with particular focus on their management accounting. In *chapter four* we went through the methodological choices for the thesis, and explain why we believe that a case study is the best approach to answering the research question. Finally, in *chapter five*, we presented the findings from all of the interviews, and discuss these in light of the theory with a special focus on where our findings differ from previous literature.

6.2 RELATION TO PREVIOUS LITERATURE

Previous literature has focused a lot on <u>why</u> substituting the budget with separate forecasting and targeting functions might be valuable, but not much on <u>how</u> to achieve that value. This concerns both what kind of research has been conducted, but also the answers proposed in the research. The former regards how literature has mostly focused on the differences between before and after Beyond Budgeting, instead of going into what happens between those two states. An example of this is the three aspects we used to measure effectiveness.

The latter refers to for example the guidelines proposed by Hope and Fraser and by Bogsnes. They focused on the overarching implementation of Beyond Budgeting, while there is not a lot of specifics on individual changes. In this thesis we have instead attempted to address one such change, namely substituting the budget with separate forecasting and targeting functions.

6.3 MAIN FINDINGS

Before we answer the original research question, it might do well to repeat it:

"*Why may global, industrial corporations attempting to go Beyond Budgeting struggle to effectively substitute the budget with separate forecasting and targeting functions?"*

During our analysis, we have uncovered a series of challenges and issues that Jotun has faced. While it is impossible to present a complete and comprehensive outline of all the possible challenges any company might face based on just one case study, we do believe that many of the challenges Jotun has experienced will be relevant also to other companies. These challenges have been split into two parts. The first part focuses on new findings, either because those challenges have not been discussed at any length before, or because our findings somewhat contradict previous literature. In the second part, we will outline the supportive findings that are in line with previous literature, not because they necessarily add that much new information, but because they still serve a purpose in strengthening and nuancing those notions.

6.3.1 NEW FINDINGS

During the research, we uncovered a paradox regarding autonomy and the implementation of Beyond Budgeting tools if actions are not taken in the right order. While the literature encourages independence, decentralization and trust for Beyond Budgeting to function well, that same autonomy seemed to make implementing Beyond Budgeting difficult in the first place. If management has already given up a lot of the formal command and control, they could end up with the sub-units deciding for themselves what to do with the tools. This leads to tools being used in a less standardized way between segments and regions, leading to less generalizable results from the tools and making it harder to them against each other.

While Beyond Budgeting aims to unbundle the traditional budget into separate tools for forecasting and targeting, we found that the new unbundled tools may still lead to skewed incentives and gaming. Even if the company successfully separates the forecasting and targeting purposes from each other, there is often a range of other purposes directly and indirectly connected to a budget, such as resource allocation, benchmarking and bonus schemes. If these are tied to the forecast or target, the gains from separating those two tools might be limited, whereas making separate tools for each of these purposes might demand significant resources. It seems that separating the budget purposes is not as simple as just splitting up the forecasting and targeting purposes, even though it is a good start.

While one of the arguments for unbundling the traditional budget is to save resources, we found evidence that in a large, complex organization such as our case company, significant amounts of resources were still spent on developing and updating the forecasting and targeting tools. Even though each of the new tools might be less resource consuming than a traditional budget, the sum is not necessarily smaller. With resource savings being one of the main reasons for Beyond Budgeting in the first place, it is challenging for a company to reduce the total resources spent when the number of tools is increased.

We found that it may be difficult to keep spending down if actual needs turn out to be less than what was forecasted. While our case company achieved good flexibility in terms of spending in excess of the cost budgets as long as it was warranted, it appeared to be more difficult to reduce spending in those cases. The implication is that funds will still be wasted if employees perceive the forecasts to be allocated resources.

Beyond Budgeting critics make the case that companies relying mostly on knowledge workers will benefit the most from Beyond Budgeting. However, we found little evidence that the large share of manual workers was a hindrance to the effective use of the new tools. The general workforce composition appeared to hold little importance, at least as long as the right people were in charge of the right processes.

6.3.2 SUPPORTIVE FINDINGS

In our interviews, we found that simply adapting an existing cost management tool to a different purpose rather than introducing an entirely new tool can prove to be problematic. Both Hope and Fraser and Bogsnes advocate creating a clear case for change. However, communicating this clear case for change is likely to be harder if the employees are told to adapt their new tool rather than starting from scratch. The employees may just end up assuming that the revised or adapted tool is the same as before, and management will have a hard time encouraging the change in practice.

We also found evidence supporting the notion that communicating and following up guidelines regarding Beyond Budgeting is more difficult in large, complex corporations. Large distances, different cultures and many vertical levels in the organization may all lead to employees interpreting and understanding the information released by corporate differently. It may also lead to employees being less likely to adhere and stick to the guidelines given, since no one is continuously training and educating them on the correct use of the tools, especially with new employees continuously entering the organizations.

We found that it might be difficult to develop a sufficient amount of trust to reduce negotiations between the different levels in the organization. To achieve savings in resource use, managers in particular have to accept less negotiation and instead put more trust in their subordinates and their numbers. Extensive back and forth likely leads to subordinates adding a buffer, and managers looking for somewhere to cut, creating a self-enforcing feedback loop. Establishing a sufficiently trust-based culture can be challenging, especially in countries where it is not the business culture norm.

Finally, we found that it may be difficult to cut the red tape when unexpected expenditures need to be approved in larger and more complex organizations. On one hand, Beyond Budgeting literature proposes removing the clear-cut limit of a traditional budget in favor of case-by-case decisions in order to increase flexibility in responding to threats and opportunities. However, companies may find it hard to achieve this benefit if those case-by-case decisions still need to go through many levels for consensus or approval, especially in matrix organizations like Jotun.

6.4 RECOMMENDATIONS TO JOTUN

It is always easy to give advice in hindsight. However, Jotun is not just an organization of the past, but also an organization of the present and future. For that reason, we want to briefly outline some recommendations based on our analysis, focusing more on what might be done moving forward, and less on what could have been done differently so far.

We would like to see Jotun completely substitute, or at least *re-launch the cost-budget*. It appears to us that a large part of the issue today is due to how Jotun just adapted an existing tool over time. Even though it seems that the tool they intended to design was appropriate, they have failed to make this a consistent practice as well. We would therefore suggest removing the cost budget, and introducing a new tool in its place, preferably under a new name to emphasize the difference, such as "costs estimates" or simply "forecasts". The new tool may be very close to the cost budgets in terms of intention, focusing on the forecasting purpose, but hopefully practice will follow suit as well. First of all, we believe that the re-launch itself should gather a lot of attention to the new tool, and indirectly also its purpose. Secondly, it would give the corporate level more power in terms of defining the new tool and creating a clear case for change; it is usually easier to define something you just created, than redefining something already established. Lastly, it is easy to reason why a new tool would require training and guidelines, whereas doing that with an established tool might go ignored or even offend employees as they feel that they know what the tool is about already.

Note that many of the remaining recommendations in this section will be based on the premise that Jotun chooses to re-launch a new forecasting tool. We do however believe them to at least partially maintain their relevance also if Jotun decides to keep the old cost budgets.

Today there is too much overlap and confusion regarding the purpose of the cost budget and STP tools in our opinion. Even though they are meant to function as forecasting and targeting tools respectively, practice is not true to intention. The STP tool is fairly close to its intention many places, but the cost budgets are used in a variety of manners, often also for targeting. Even though corporate employees have a fairly good and consistent understanding of the purposes of the two tools, there are no official definitions or guidelines. We would therefore advise on *formally differentiating the forecasting and targeting tool*. This would ensure alignment on corporate level, while also making it easier to communicate the purposes and procedures to the regional and local levels in a consistent way. The differentiation should be highlighted in all relevant communication between corporate and local levels in the near future.

As mentioned previously, many Jotun companies have already started making their cost budgets rolling, even though this is not the standard Jotun policy. We would however advise Jotun to *make rolling forecasts instead of fixed forecasts their policy*, or at the very least look further into it. Rolling forecasts are strongly in line with the general Beyond Budgeting literature, as it makes it easier to focus on changes in markets conditions and circumstances instead of deviations from the budget or forecast. By doing this, the forecasts will be less prone to gaming as the employees in charge of the forecasts will have to justify why they changed the forecasts, as well as more flexible because corrective action can be taken before those forecasts actually become reality.

Furthermore, the fact that so many Jotun companies already create rolling forecasts or cost budgets is a testament to its potential usefulness. Making it a standard will help align practices across the global organization, both in terms of using rolling forecasts in the first place, and how they do it. It is also likely that resources spent on such rolling forecasts would be reduced due to economies of scale from the standardization.

We would advise Jotun to *give forecasts more attention on a higher level*. This can be done by increasing the level of attention towards the forecast numbers outside of the local companies, such as business reviews and aggregation to group level. This should make standardization easier and bring attention to the new tool as the different regions and companies would be compelled to align their practices. Such alignment is especially important to remedy the issues related to large distances, communication and culture, which reportedly were important factors as to why the costs budgets were perceived and used so differently. As long as the new or changed forecasting tool is actually used mainly for forecasting, they should provide valuable information for the group as well. Unlike a targeting tool, the forecast would be unbiased and unskewed, and should not be tweaked like Jotun currently do with their STP numbers.

Even though Jotun to some extent has managed to separate the forecasts and target functions, and as mentioned should differentiate them even more, we believe they would also benefit from *delinking the targeting and forecasting tools from any secondary purposes*. This is in line with general Beyond Budgeting theory, which advocates separating different functions into different tools to avoid conflicting purposes. The most noteworthy secondary purposes here would probably be the basis for resource allocation and bonus schemes, as both of these can bring gaming biases into how the numbers are derived. We would for example advise basing any potential bonuses on performance compared to last year and competitors instead, or simply to consider reducing the amount of bonuses compared to fixed salaries. For resource allocation, we would advise a more pragmatic approach based on actual needs that arise during the year, or even introduce a new process separate from the forecasting and targeting tools.

It appeared that in many companies, there were sometimes quite cumbersome negotiations regarding both cost budgets and targets. This is problematic, especially for the cost budgets, as they are supposed to function as objective forecasts. As both Jotun and general Beyond Budgeting theory focuses on autonomy and trust, we would recommend applying these principles more to the management accounting processes as well. We believe that Jotun can *reduce negotiation by using a more zero-based budgeting approach*, where instead of arbitrarily starting with the previous forecast and adjusting it, forecasts should be made from the bottom up every time. Any discussions should not focus on changing the forecasts, but instead which conditions they are based on, how those conditions can be changed, and how Jotun can perform best under those conditions.

6.5 RECOMMENDATIONS TO SIMILAR CORPORATIONS

In this section, we will go through a few elements of how we would advise a company similar to Jotun to approach substituting the budget with separate forecasting and targeting tools. These recommendations will have some similarities to the ones we had for Jotun, simply because they are based on the same data and the same issues, but more aimed at companies who have not yet started the process. We have also tried to avoid repeating points made by other Beyond Budgeting researchers, instead proposing new suggestions to add to the literature.

We would advise *to introduce new tools instead of changing the old*. Many of Jotun's management accounting problems stem from the fact that instead of taking away the old budget and introducing new tools for the different purposes, they attempted to change their existing budget into something else. With a large and complex organization, it is difficult to communicate such changes to everyone. Introducing a new tool, however, is much more visible to the employees, and also gives corporate the authority to define the new tool.

We believe that companies would benefit from *doing a pilot implementation* in one or a few of their sub-units or companies before attempting to make the switch in the entire organization, to gain more knowledge about their own challenges. Jotun went straight to a complete change, and they will struggle more attempting to correct the issues they have uncovered. Every company is different, and to make sure the solution is uniquely tailored to the organization, a pilot rollout would be of great value.

While we have only looked at a company that separated the budget into two different tools, we would still advise considering more separation in order to *remove gaming sources and secondary purposes*. This would be especially true for companies that today have many other purposes tied to their budget, such as performance measurement or bonus schemes. Attempt therefore to separate all of these functions into different tools to avoid conflicting purposes, gaming and biased numbers.

While we do believe that Beyond Budgeting and separating the budget functions can be valuable in many cases, it is not necessarily the right step for every organization. The philosophy works much better in organizations focused on trust and autonomy, rather than command and control. Therefore, the company should *ensure an autonomous culture and approach to the management accounting*. However, some degree of management during the actual change is important to make sure that it is understood and implemented in the right way, even in an autonomous company. After that, involvement by exception should be the general rule.

When Jotun decided to abolish traditional budgets, the decision was made at board level, and only partially made it out to the regions and local companies. We would advise a more thorough process prior to the actual change to *establish ownership and familiarity at all levels*, especially in the finance departments. This could for example be done through workshops to create the guidelines, or training seminars for the relevant employees.

6.6 RESEARCH LIMITATIONS

It is important to underline that this research is only based on one corporation, and one must therefore be cautious regarding generalization of the results. One such limitation is the restricted base of companies and employees we have been in contact with. There might be other factors influencing the answers we received, which makes the interview subjects and their opinions less representative for Jotun at large.

There is also a time perspective at play here. The answers we would have gotten to similar questions when Jotun first attempted to go Beyond Budgeting might be very different from the ones we received now, or the ones we would have gotten five years from now. The results might therefore be less generalizable to other companies at different stages in the process, or where the Beyond Budgeting implementation has been subject to different choices and events during the process.

Another main limitation is the lack of previous research and theoretical frameworks. With Beyond Budgeting in general being very industry-driven, a lot of the available literature is based on the experiences of few companies and professionals. Without any general framework for analyzing the separation of budget functions, we had to tailor or own approach based mostly works by Hope & Fraser and Bognes instead.

6.7 SUGGESTIONS FOR FUTURE RESEARCH

In this section, we will try to outline some suggestions for future research on Beyond Budgeting. We will not go in to every aspect of Beyond Budgeting research, but rather those options that at least partially should be able to build on this thesis.

In this thesis, we have attempted to uncover both potential benefits and potential challenges in substituting the traditional budget with separate forecasting and targeting tools. However, many of the elements may very well be specific to Jotun, and other companies may face different challenges, or uncover different benefits. To establish a more complete picture of what companies can generally expect, we would suggest more case studies in the same fashion as this one, but on different companies, to complement what we have uncovered.

While we have attempted to uncover challenges and benefits, we have not evaluated Jotun's attempt to separate the budget functions from a quantitative viewpoint. It would be interesting to see a study focusing more on evaluating financial performance, resource usage and similar quantitative measures to view the usefulness of Beyond Budgeting from another perspective.

As Jotun is still struggling to implement their new management accounting change, it would be interesting to see a repeated case study focusing on the same elements as this thesis, in for example three to five years of time. This would be especially useful if Jotun indeed decides to follow through with some of the recommendations outlined previously in this chapter.

Even though Jotun has to at least some extent separated the forecasting and targeting functions into individual tools, the traditional budget is often the basis for more than just these two purposes. Others examples would be resource allocation, performance measurement, and compensation schemes. We believe it would be valuable to research how to separate these purposes from the budget as well, to remedy the issue of the secondary purposes of the traditional budget.

In this thesis we have found that Jotun does not aggregate cost budget numbers, while the STP numbers are tweaked after aggregation. There is in general a lack of research on if and how the forecasting and targeting numbers should be aggregated to maximize their relevance and value to the company.

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8. APPENDIX

8.1 JOTUN MATRIX ORGANIZATIONAL CHART

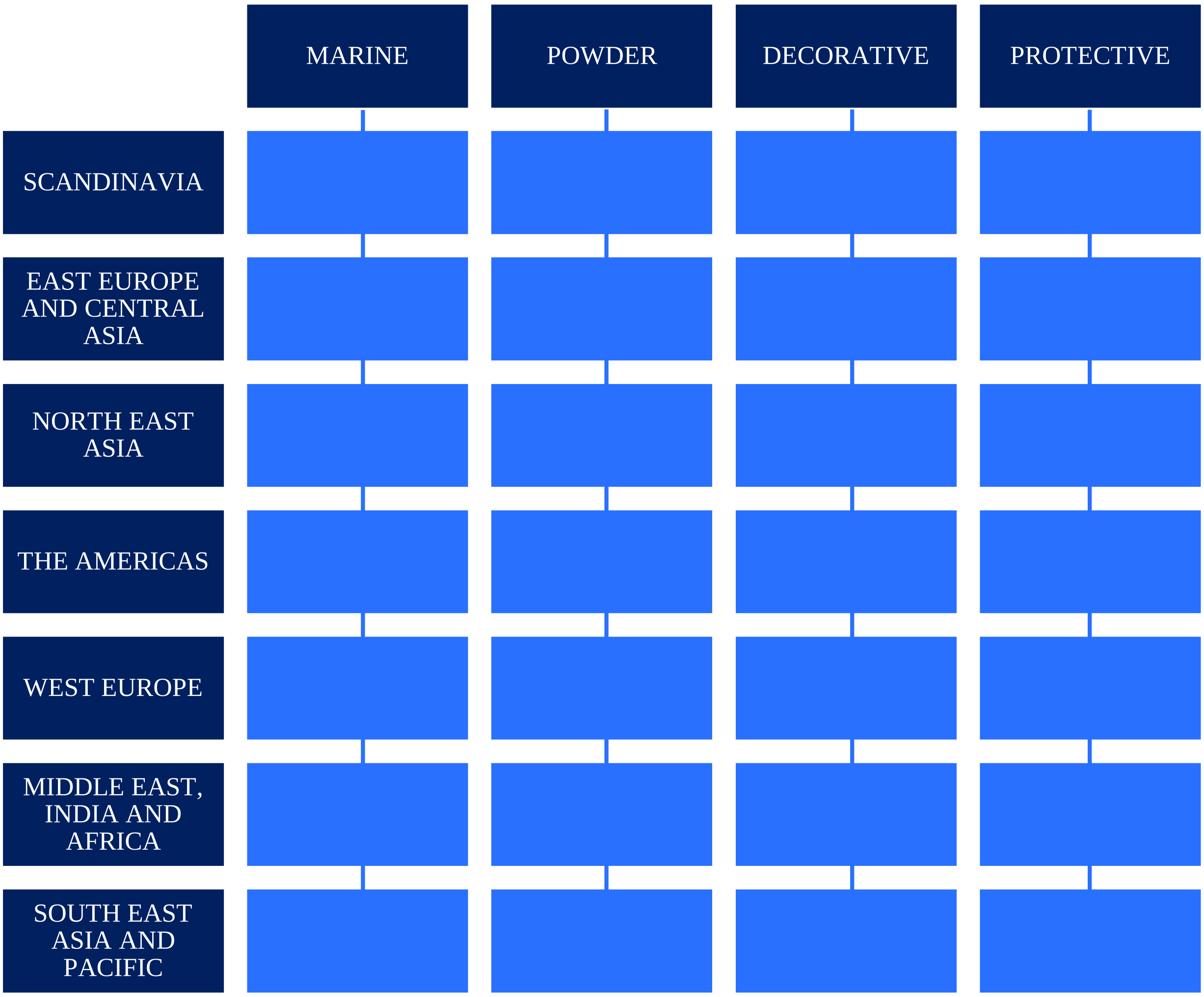


Table 2: Matrix organization in Jotun.

8.2 JOTUN SUBSIDIARIES

Company	***Country***	***Ownership***	***Region***
Jotun Algerie SARL	Algerie	70.00%	MEIA
Jotun Australia Pty. Ltd.	Australia	100.00%	SEAP
Jotun Bangladesh Limited	Bangladesh	100.00%	MEIA
Jotun Brasil Imp. Exp. &	Brazil	100.00%	AM
Jotun Bulgaria EOOD	Bulgaria	100.00%	EECA

Jotun (Cambodia) LTD	Cambodia	100.00%	SEAP
Jotun (Shanghai) Management Co. Ltd.	China	100.00%	NEA
Jotun Coatings (Zhangjiagang) Co. Ltd.	China	100.00%	NEA
Jotun Paints (H.K.) Ltd.	China	100.00%	NEA
Jotun Cyprus Ltd.	Cyprus	100.00%	MEIA
Jotun Powder Coatings (CZ) a.s.	Czech Republic	100.00%	WE
Jotun Danmark A/S	Denmark	100.00%	SCA
Jotun Powder Coatings L.L.L.	Egypt	100.00%	MEIA
El–Mohandes Jotun S.A.E.	Egypt	69.50%	MEIA
Jotun France S.A.	France	100.00%	WE
Jotun (Deutschland) GmbH	Germany	100.00%	WE
Jotun Hellas Ltd.	Greece	100.00%	WE
Jotun Insurance Cell	Guernsey	100.00%	WE
Jotun India Private Ltd.	India	100.00%	MEIA
P.T. Jotun Indonesia	Indonesia	100.00%	SEAP
P.T. Jotun Powder Coatings	Indonesia	100.00%	SEAP
Jotun Ireland Ltd.	Ireland	100.00%	WE
Jotun Italia S.p.A.	Italy	100.00%	WE
Jotun Kazakhstan L.L.P.	Kazakhstan	100.00%	EECA
Jotun Kenya Limited	Kenya	100.00%	MEIA
Jotun Libya J.S.Co.	Libya	80.00%	MEIA
Jotun (Malaysia) Sdn.Bhd.	Malaysia	100.00%	SEAP
Jotun Paints (Malaysia) Sdn. Bhd.	Malaysia	100.00%	SEAP
Jotun Powder Coatings (M) Sdn. Bhd.	Malaysia	100.00%	SEAP
Jotun Mexico S.A. de C.V.	Mexico	100.00%	AM
Jotun Maroc SARL/AU	Morocco	100.00%	MEIA
Jotun Myanmar Company Ltd.	Myanmar	100.00%	MEIA
Jotun Myanmar Services Company Ltd.	Myanmar	100.00%	MEIA
Jotun B.V.	Netherlands	100.00%	WE
Jotun Powder Coatings AS	Norway	100.00%	SCA
Scanox AS	Norway	100.00%	SCA
Jotun Paints Co. L.L.C.	Oman	62.00%	MEIA
Jotun Pakistan (Private) Limited	Pakistan	100.00%	MEIA
Jotun Powder Coatings Pakistan (Pvt) Ltd	Pakistan	98.86%	MEIA
Jotun (Philippines) Inc.	Philippines	100.00%	SEAP
Jotun Polska Sp.zo.o.	Poland	100.00%	WE
Jotun Romania S.R.L.	Romania	100.00%	EECA
Jotun Paints OOO	Russia	100.00%	EECA
Jotun (Singapore) Pte. Ltd.	Singapore	100.00%	SEAP
Jotun Paints South Africa (Pty) Ltd.	South Africa	100.00%	MEIA
Jotun Iberica S.A.	Spain	100.00%	WE
Jotun Sverige AB	Sweden	100.00%	SCA
Jotun Thailand Ltd.	Thailand	100.00%	SEAP

Jotun Boya San. Ve Ticaret A.S.	Turkey	100.00%	EECA
Jotun Paints (Europe) Ltd.	United Kingdom	100.00%	WE
Jotun Powder Coatings Ltd.	United Kingdom	100.00%	WE
Jotun Paints Inc.	United States	100.00%	AM
PRS Delaware L.L.C.	United States	100.00%	AM
Jotun Paints (Vietnam) Co. Ltd.	Vietnam	100.00%	SEAP

Table 3: List of companies in the Jotun group.

8.3 JOTUN SUBSIDIARIES

In terms of employees, the three Asian regions are by far the largest, all with more than 2000 employees (Jotun A/S, 2016f). However, the number of business units in the different regions is fairly unrelated to the amount of employees, with for example West Europe having four times as many business units as North East Asia, while having one third the amount of employees. In general, the Asian units are much larger in terms of the number of employees.

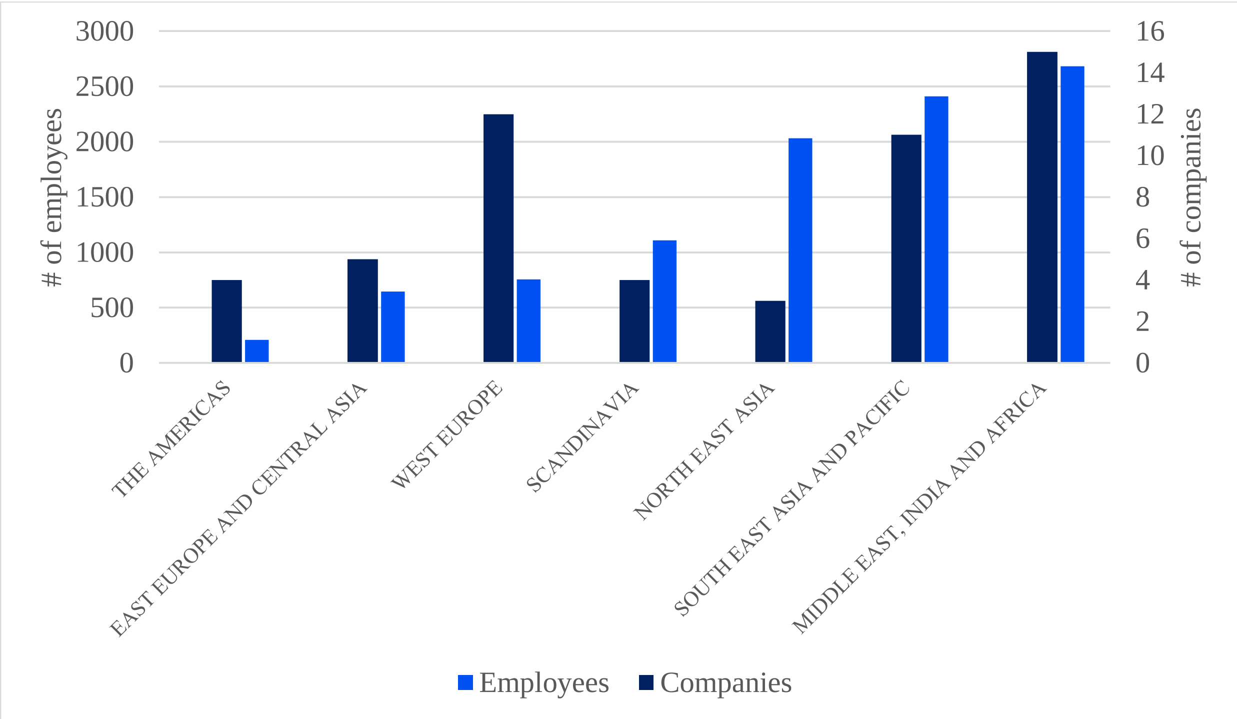


Table 4: Numbers of employees/companies by region.

8.4 JOTUN’S MARKET

Jotun is currently the ninth largest paint company worldwide in terms of sales volume (Jotun A/S, 2016j). A few years back, Orkla, one of the largest shareholders in Jotun, estimated the entire market to be USD 80bn, or about NOK 465bn. Jotun has a total market share of 3.0 %, ranging from 1.5 % in the decorative segment, to 20.0 % in the marine segment. However, Jotun’s segment size is fairly unrelated to the actual market size; the larger the market, the smaller is Jotun’s market share.

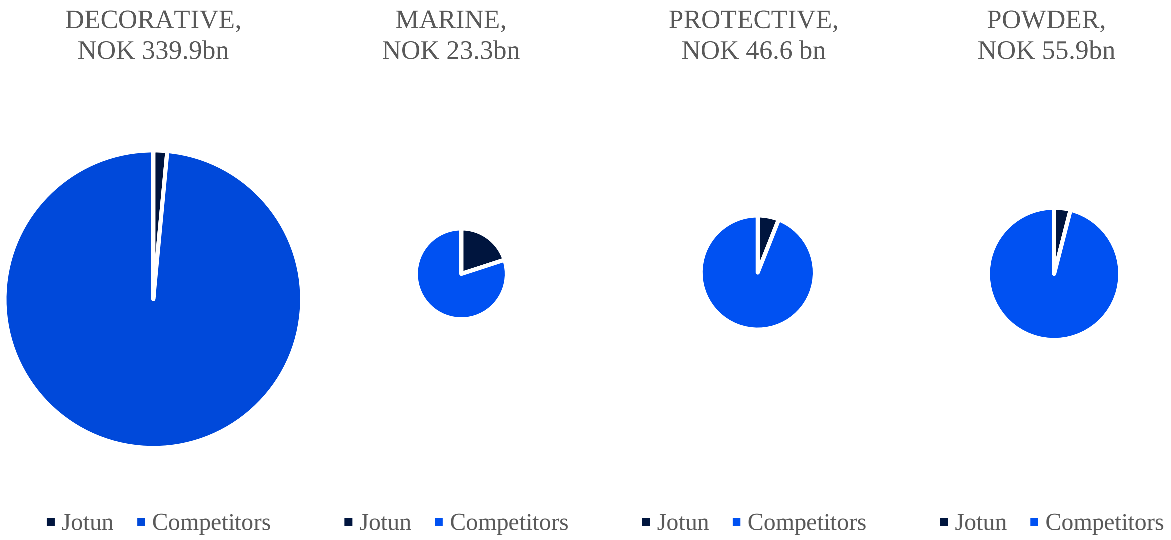


Figure 3: Market size and share, by segment.

Even though they are number nine worldwide, Jotun is still market leader in a broad range of countries, especially in the Middle East, where they are number one in at least one segment, or even the total market, in most countries. It has been a strategic aim for Jotun always to achieve a number one or two position in every market they enter (Nguyen, et al., 2009).

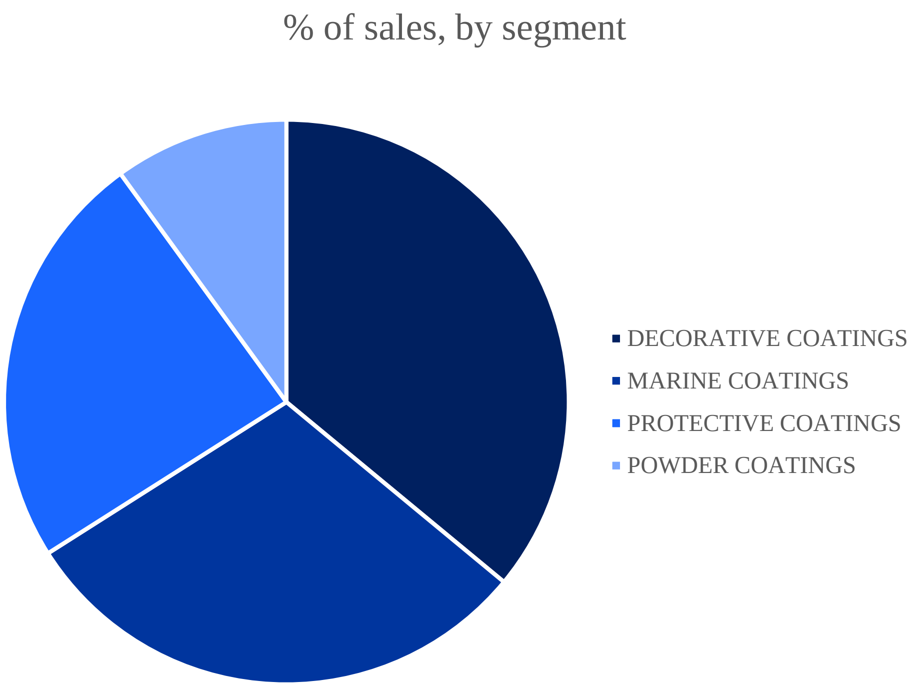


Figure 4: % of sales, by segment.

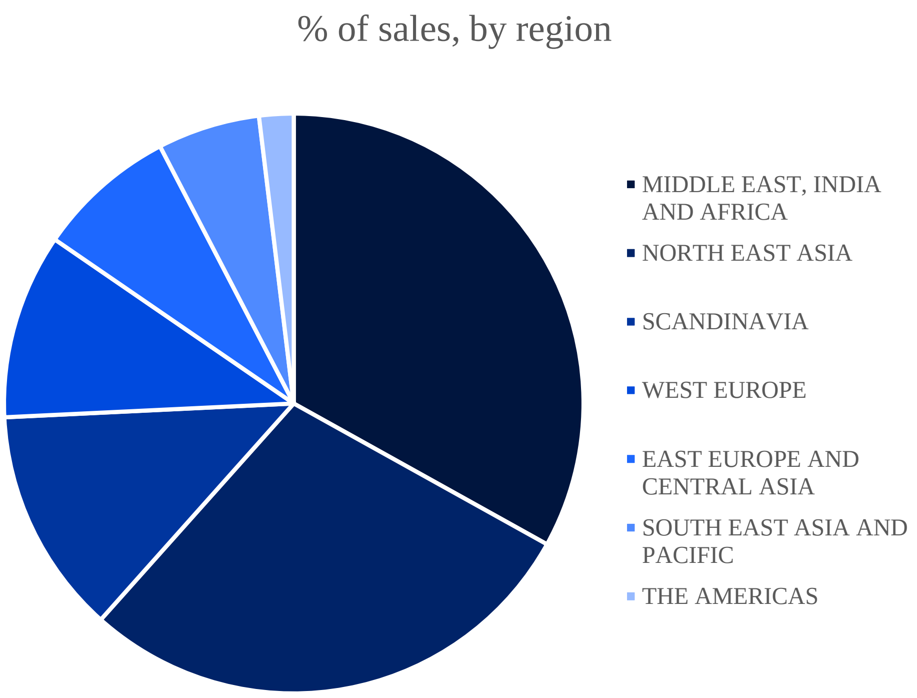


Figure 5: % of sales, by region.

8.5 INTERVIEW GUIDE LOCAL OFFICES

Introduction

1. Introduction of the interviewers
   a. Names, the purpose of the research etc.
2. Information regarding the interview
   a. Anonymous, we want your personal opinion on the cost budgets and their potential effects
   b. The interview is divided into three parts: Responsiveness, discipline and gaming.
3. The interviewee presents itself
   a. Describe your role in the organization, what are your responsibilities, and for how long have you held your role?
   b. In which way have you worked with cost budgets, such as preparing, reviewing or receiving them?
4. What roles or functions do you experience that the cost budgets fill? What is it to you?

Responsiveness

By responsiveness we mean the company's ability to adapt to changes in the environment or circumstances, such as changing prices, competitor actions or new technology.

Example if asked for: With a budget, it may be difficult to expand output to take advantage of raising market prices in the market.

1. How adaptive and responsive do you consider Jotun to be towards change?
2. Are the cost budgets ever revised to adapt to changing conditions, or do they stay fixed throughout the whole period?
3. To which extent is there sufficient scope of action and autonomy to respond to changing conditions, be that a threat or an opportunity, even if this would make costs exceed the cost budgets?
4. Do you consider cost budgets to be a more responsive model than traditional budgets in terms of responsiveness to change?

Discipline

By discipline we mean that a tool or mechanism helps or instructs divisions, managers or employees to avoid unnecessary costs.

Example: Usually, some form of approval would be needed to incur costs that exceed a budget.

1. Are funds more easily spent if the costs incurred so far during the year are below what was forecasted in the cost budget?
2. And what if the actual costs so far are higher than the cost budget?
3. What are the consequences, if any, if actual costs exceed what was forecasted in the cost budget?
4. Do you consider the cost budget to be an allocation of funds in the way that once the cost budget is approved by a supervisor, one is allowed to spend that amount?

Gaming

Gaming relates to wilful actions that is expected to benefit the manager or employee, even if it disadvantages the company. It isn't necessarily illegal, but rather taking advantage of opportunities for one's own gain, thus leading to sub-optimalization.

Example: A division may over-spend at the end of the year to make sure their budgets aren't cut next year.

1. Sometimes, the requirements for funds will turn out to be less than forecasted in the cost budget. Might employees or managers overspend at the end of a period to avoid cuts in the next period?
2. When preparing a cost budget, there is usually a lot of uncertainty. How common do you think it is to estimate too high costs rather than too low, just to be on the safe side?
3. What sort of discussions or negotiations take place between a supervisor and his or her subordinates when the cost budget has been prepared?
4. How are bonuses, promotions or other incentives directly linked to the cost budgets?

8.6 INTERVIEW GUIDE CFOS

Introduction

1. Introduction of the interviewers
    a. Names, the purpose of the research etc.
2. Information regarding the interview
    a. Anonymous, we want your personal opinion on the cost budgets and their implementation
    b. The interview is divided into five parts which we will go into in more detail on as we go along

Management accounting systems

1. Can you briefly explain how the finances are managed in your region?
2. What kind of reporting and data is requested by the corporate office in Norway?
3. What are bonuses in your region based on?
4. How adaptive and responsive do you consider Jotun to be towards change?
5. Do you consider Jotun to consist more of manual labor workers or knowledge-workers?
6. To which degree do you believe Jotun's management accounting is affected by the large number of manual labor workers?

STPs

1. Are you familiar with the term STP?
2. How are the STPs developed?
3. How much time do you spend developing the STPs?
4. How does your region deal with the STPs?
5. Are the STPs mostly a forecast, target or resource allocation mechanism to you?
6. Is there a difference in the way cost and sales numbers are perceived in the STPs?
7. In your experience, what does the corporate management use the STPs for?
8. To your understanding, what purpose do the STP numbers serve for Jotun?

Cost budgets

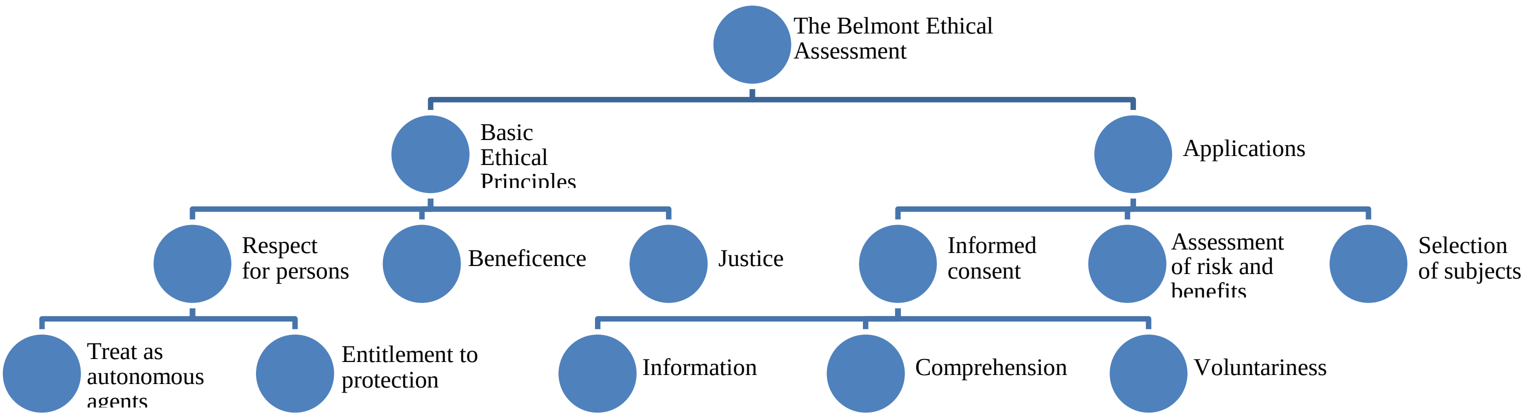
1. Are you familiar with the term cost budget?
2. What process goes on behind creating the cost budgets?
3. Are the cost budgets mostly a forecast, target or resource allocation mechanism to you?
4. Are the cost budgets ever revised to adapt to changing conditions, or do they stay fixed throughout the whole period?
5. Do you use rolling forecasts for your region?
6. How and for what do you use these rolling forecasts?
7. Do you have the impression that the purpose of the cost budgets has change in the last decade or so?
8. What are the consequences, if any, if actual costs exceed what was forecasted in the cost budget?
9. What sort of discussions or negotiations take place between a supervisor and his or her subordinates when the cost budget has been prepared?
10. In your experience, what does the corporate management use the cost budget for?
11. To your understanding, what purpose do the cost budgets serve for Jotun?

Relationship between the two tools

1. What do you consider to be the main differences between the cost budgets and the STPs?
2. Do you feel the the cost budgets and STPs work well together as they are, or do you think the purpose and content should be changed in any way?
3. Is resource allocation mainly based on cost budgets, STPs or something else?
4. Do you feel that you have been provided with sufficient information about the purpose of these tools?
5. Which of the two tools would be best suited as a benchmark for performance (e.g. to previous years, between regions, between segments, against competitors, etc.)?
6. Which of the two tools would be best suited as a basis for bonuses or other rewards?

7. To which degree do you believe Jotun's management accounting is affected by the large distances or cultural differences between the regions and the corporate office?
8. What is in your opinion the most important tools or processes for value creation in Jotun, such as the cost budgets, STP numbers, KPIs or business reviews?

8.7 ETHICS FRAMEWORK



Figur 1: Belmont Ethical Assessment