Beyond Budgeting - a new management model for new business and people realities

Ambition to Action - the Statoil journey

Bjarte Bogsnes
Vice President - Performance Management Development
Chairman - Beyond Budgeting Round Table Europe
Outline

• The case for change - what is the problem?
• The Beyond Budgeting principles
• The Statoil model - Ambition to action
• Next steps
Statoil in brief

- Turnover and market cap approx. 75 bn. USD
- 20,000 employees in 34 countries
- World’s largest operator in waters deeper than 100 metres
- Second largest gas exporter to Europe
- World leader of crude oil sales
- Listed in New York and Oslo

• Current production of oil and gas
## Fortune 500 ranking (2011)

### Social responsibility

<table>
<thead>
<tr>
<th>Rank</th>
<th>Company</th>
<th>Industry rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Statoil</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>Ferrovial</td>
<td>4</td>
</tr>
<tr>
<td>3</td>
<td>Walt Disney</td>
<td>1</td>
</tr>
<tr>
<td>4</td>
<td>Edison</td>
<td>3</td>
</tr>
<tr>
<td>5</td>
<td>ENI</td>
<td>6</td>
</tr>
<tr>
<td>6</td>
<td>Whole Foods Market</td>
<td>2</td>
</tr>
<tr>
<td>7</td>
<td>Total</td>
<td>5</td>
</tr>
<tr>
<td>8*</td>
<td>Hochtief</td>
<td>6</td>
</tr>
<tr>
<td>8*</td>
<td>Nestlé</td>
<td>1</td>
</tr>
<tr>
<td>10*</td>
<td>NextEra Energy</td>
<td>1</td>
</tr>
<tr>
<td>10*</td>
<td>Weyerhaeuser</td>
<td>1</td>
</tr>
</tbody>
</table>

*From the March 21, 2011 issue*

### Innovation

<table>
<thead>
<tr>
<th>Rank</th>
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<th>Industry rank</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>Apple</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>Google</td>
<td>1</td>
</tr>
<tr>
<td>3</td>
<td>Nike</td>
<td>1</td>
</tr>
<tr>
<td>4</td>
<td>Amazon.com</td>
<td>2</td>
</tr>
<tr>
<td>5</td>
<td>Charles Schwab</td>
<td>1</td>
</tr>
<tr>
<td>6</td>
<td>3M</td>
<td>1</td>
</tr>
<tr>
<td>7</td>
<td>Statoil</td>
<td>1</td>
</tr>
<tr>
<td>8</td>
<td>Exxon Mobil</td>
<td>3</td>
</tr>
<tr>
<td>9</td>
<td>Walt Disney</td>
<td>1</td>
</tr>
<tr>
<td>10</td>
<td>Whole Foods Market</td>
<td>2</td>
</tr>
</tbody>
</table>

*From the March 21, 2011 issue*
Statoil financial performance - as we define it

Total shareholder return 2011

Return on capital (ROCE) 2011
Managing traffic performance - one alternative

Who is in control?

Based on which information?
Managing traffic performance - another alternative

Who is in control?

Based on which information?
Which is most **efficient**?
Which is most **difficult**?

In which are **values** most important?
What is your view on people?

Theory X?

- People prefer to be directed, do not want responsibility, and have little or no ambition.
- People have an inherent dislike for work and will avoid it whenever possible.
- People must be coerced, controlled, directed, or threatened with punishment in order to get them to achieve the organisational objectives.
- People seek security above all else.

Theory Y?

- Work is as natural as play and rest.
- People will exercise self-direction if they are committed to the objectives (they are not lazy).
- Creativity, ingenuity, and imagination are widely distributed among the population. People are capable of using these abilities to solve an organisational problem.
- People learn to accept and seek responsibility
- People have potential.

The world has changed – what about the way we lead and manage?

Business environment

- Dynamic
- Stable

"Theory X" ← "Theory Y" → People

Traditional management
Taking reality seriously - both business and people

Management processes

Dynamic world

Relative and directional goals
Dynamic planning, forecasting and resource allocation
Holistic performance evaluation

Stable world

Rigid, detailed and annual
Rules-based micromanagement
Centralised command and control
Secrecy, sticks and carrots

“Theory X”

“Theory Y”

Beyond Budgeting

Leadership

Values based
Autonomy
Transparency
Internal motivation
Europe's most cost effective universal bank

Handelsbanken

Companies on a similar journey
# The Beyond Budgeting principles

<table>
<thead>
<tr>
<th>Change in leadership</th>
<th>Change in processes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Values</strong> - Govern through a few clear values, goals and boundaries, <em>not</em> detailed rules and budgets</td>
<td><strong>7. Goals</strong> - Set relative goals for continuous improvement, <em>don’t</em> negotiate fixed performance contracts</td>
</tr>
<tr>
<td><strong>2. Performance</strong> - Create a high performance climate based on relative success, <em>not</em> on meeting fixed targets</td>
<td><strong>8. Rewards</strong> - Reward shared success based on relative performance, <em>not</em> on meeting fixed targets</td>
</tr>
<tr>
<td><strong>3. Transparency</strong> - Promote open information for self management, <em>don’t</em> restrict it hierarchically</td>
<td><strong>9. Planning</strong> - Make planning a continuous and inclusive process, <em>not</em> a top-down annual event</td>
</tr>
<tr>
<td><strong>4. Organization</strong> - Organize as a network of lean, accountable teams, <em>not</em> around centralized functions</td>
<td><strong>10. Coordination</strong> - Coordinate interactions dynamically, <em>not</em> through annual planning cycles</td>
</tr>
<tr>
<td><strong>5. Autonomy</strong> - Give teams the freedom and capability to act; <em>don’t</em> micro-manage them</td>
<td><strong>11. Resources</strong> - Make resources available as needed, <em>not</em> through annual budget allocations</td>
</tr>
<tr>
<td><strong>6. Customers</strong> - Focus everyone on improving customer outcomes, <em>not</em> on hierarchical relationships</td>
<td><strong>12. Controls</strong> - Base controls on relative indicators and trends, <em>not</em> on variances against plan</td>
</tr>
</tbody>
</table>
Start of the Statoil journey - solving a serious budget conflict

<table>
<thead>
<tr>
<th>The budget purposes</th>
<th>Step 1</th>
<th>Step 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Budget =</strong></td>
<td><strong>Separate</strong></td>
<td><strong>Improve</strong></td>
</tr>
<tr>
<td>• Target</td>
<td>Target</td>
<td>• Ambitious</td>
</tr>
<tr>
<td>• Forecast</td>
<td>Forecast</td>
<td>• Relative KPIs where possible</td>
</tr>
<tr>
<td>• Resource allocation</td>
<td>Resource allocation</td>
<td>• Holistic performance evaluation</td>
</tr>
<tr>
<td>“Same number – conflicting purposes”</td>
<td>&quot;Different numbers&quot;</td>
<td>“Event driven - not calendar driven”</td>
</tr>
</tbody>
</table>
Key principles – Ambition to Action

Performance is ultimately about performing better than those we compare ourselves with.
Statoil financial performance - as we define it

Total shareholder return 2011

Return on capital (ROCE) 2011

Target: Above Peer Average

Target: 1st Quartile
Key principles – Ambition to Action

Performance is ultimately about performing better than those we compare ourselves with.

Do the right thing in the actual situation, guided by the Statoil Book, your Ambition to action, decision criteria & authorities and sound business judgement.

Within this framework, resources are made available or allocated case-by-case.
The CFO on cost culture

We could easily put in place a cost program instructing all business areas to reduce cost by a given number. However, I believe this would work against building a cost-conscious culture. If we want to become more fit, a crash diet does not work. It takes a change of lifestyle.

I believe Statoil is made up of competent, responsible and commercially oriented people who will make the right cost decisions. This means always working on reducing bad cost while protecting good cost. You know better than me what these are and where they are.

CFO Torgrim Reitan
The mindset required…..
– cost conscious from the first dollar

Do I have a budget for this?

Is this really necessary?
What is good enough?
How much value is this creating?
Is this within my execution framework?

OK?
OK?
OK?
OK?
OK?
....and the tools available

<table>
<thead>
<tr>
<th>Traditional cost budget</th>
<th>Absolute KPIs</th>
<th>Relative KPIs</th>
<th>No KPIs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Detailed and annual</td>
<td>Ambition level / burn rate</td>
<td>Unit cost input/output</td>
<td>Unit cost vs peers</td>
</tr>
<tr>
<td>xXx</td>
<td>&quot;USD/bbl&quot;</td>
<td>&quot;1. quartile&quot;</td>
<td>EBIT RoACE (abs/rel)</td>
</tr>
<tr>
<td>xXx</td>
<td>&quot;USD/customer&quot;</td>
<td>&quot;Better than average&quot;</td>
<td></td>
</tr>
<tr>
<td>xXx</td>
<td>&quot;USD/employee&quot;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1003,4</td>
<td>~1000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Select based on what works best in your business

Monitoring of actual development, intervention if needed only
Key principles – Ambition to Action

Performance is ultimately about performing better than those we compare ourselves with.

**Do the right thing** in the actual situation, guided by the Statoil Book, your Ambition to action, decision criteria & authorities and sound business judgement.

Within this framework, **resources** are made available or allocated case-by-case.

Business follow up is **forward looking and action oriented**.

Performance evaluation is a **holistic** assessment of delivery and behaviour.
The CEO on Ambition to Action

We have a management model which is very well-suited to dealing with turbulence and rapid change. It enables us to act and reprioritise quickly so that we can fend off threats or seize opportunities. This is much more difficult in a traditional ‘budget world’.

One of the main principles in our Ambition to action concept is that Statoil consists of mature, professional and able people who both can and want to accept responsibility.

CEO Helge Lund
Ambition to Action - purpose and process

- Translating strategy - from ambitions to actions
- Securing flexibility - room to act and perform
- Activating values and leadership principles

**Strategic objectives**

**KPIs**

**Actions & forecasts**

**Individual or team goals**

Where are we going – what does success look like?
- Most important strategic change areas
- Medium term horizon

How do we measure progress?
- Indicative measure of strategic delivery
- 10-12 KPI’s, shorter/longer term targets

How do we get there?
- Concrete actions and expected delivery (forecast)
- Clear deadlines and accountabilities

What is my or our contribution?
My Performance Goals
- Delivery
- Behaviour
Ambition to Action example

<table>
<thead>
<tr>
<th>Strategic objectives</th>
<th>Key performance indicators (* linked)</th>
<th>Actions (top 5 in period)</th>
</tr>
</thead>
<tbody>
<tr>
<td>People &amp; organisation</td>
<td>Living the values</td>
<td>Accelerate performance, people development and mobility (31.12.11)</td>
</tr>
<tr>
<td></td>
<td>P&amp;S process</td>
<td>Secure strong ownership to compliance and ethics on all levels (30.12.11)</td>
</tr>
<tr>
<td>Health &amp; safety/环境</td>
<td>Serious incident frequency</td>
<td>Implement learning 5 from major external and internal incidents</td>
</tr>
<tr>
<td></td>
<td>Climate</td>
<td>Improve the quality of HSE risk management at all levels (6/12.11)</td>
</tr>
<tr>
<td></td>
<td>TTS Observations and actions</td>
<td>Ensure technical integrity for health and well (15.12.11)</td>
</tr>
<tr>
<td>Operations</td>
<td>PE NCS (Required) Production of Statoil share</td>
<td>Fully implement our health and wellness environment strategy (25.12.11)</td>
</tr>
<tr>
<td></td>
<td>Cost efficiency DCS (PA)</td>
<td>Operationalise climate</td>
</tr>
<tr>
<td>Market</td>
<td>Reserve replacement funds (RRF)</td>
<td>Deliver ramp-up of Lelsemor demo, Peregrino, Marcellus and Eagle Ford according to milestones (d/t) (30.12.11)</td>
</tr>
<tr>
<td></td>
<td>Downstream NOI (NOK b)</td>
<td>Ensure sufficient oil and gas production for Shetkman Final Investment Decisions</td>
</tr>
<tr>
<td></td>
<td>Finding cost</td>
<td>Deliver on technology programme to enhance value in the oil sands and Pal Kongen (01.03.13)</td>
</tr>
<tr>
<td></td>
<td>New Resources from Exploration</td>
<td>Sustain NCS production through improved regularity, optimised rig capacity, well deliveries, IHR and the fast-track initiative (30.11.13)</td>
</tr>
<tr>
<td>Finance</td>
<td>Retain financial robustness</td>
<td>Secure petroleum activities in Northern NCS areas and high impact exploration opportunities globally (30.02.12)</td>
</tr>
<tr>
<td></td>
<td>Competitive shareholder return and value</td>
<td>Mature new resources to booking, including Mariner Bressay, Luva and commercialisation of Snart Deniz (30.11.13)</td>
</tr>
<tr>
<td></td>
<td>Relative ROACE</td>
<td>Deliver onshore manufacturing improvement programme (01.08.13)</td>
</tr>
<tr>
<td></td>
<td>Relative Shareholder Return</td>
<td>Secure cost efficient procurement and project deliveries (01.08.12)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>US bond issue (15.12.11)</td>
</tr>
</tbody>
</table>

Where are we going?
“Strategic objectives”

How do we measure progress?
“Key Performance Indicators”

How do we get there?
“Actions”
More than 1200 "Ambition to Action’s" across the company

.....and more
Delivery goals are based on Ambition to Action - directly or indirectly

Ambition to Action

Manager or the whole team

Manager /Team member without own Ambition to Action

"Other employees"
A broader performance language - from narrow measurement to a holistic assessment

Ambition to Action

Pressure testing KPI results:
- Deliver towards the strategic objectives?
- How ambitious KPI targets?
- Changed assumptions, with positive or negative effect?
- Agreed actions implemented, or corrective actions initiated as needed?
- Delivered results sustainable?

50/50

Living the values
- Day-to day-observations
- 360°/ 180°/ 90° surveys
- People survey

Ambition to Action

Delivery

Behaviou

• Development plan
• Rewards
The journey continues...
The controller and the fisherman ...
Ambition to Action – new principles
From calendar-driven to business-driven

No annual versions
• Update when necessary, triggered by external or internal events (“big for you”)

Simple change and coordination controls
• Seek approval if big, inform if small. Inform other affected units

Varying time horizons
• Target and forecast horizons reflecting urgency and lead times

People@Statoil
• No change, but consider taking Ambition to Action further out
Considering changing a KPI target?
Questions to ask yourself first

**Motivation?**
- Target still have a motivational effect?

**Your track record?**
- A balanced history of changing targets both ways?

**The real problem?**
- The KPI itself, and not the target?

**Significance?**
- Big enough to justify a change?

**Holistic performance evaluation?**
- Can changed circumstances instead be handled in the holistic performance evaluation?
Towards a simpler, more dynamic and self-regulating Ambition to Action process

More cost conscious
- less «cost cutting»

More event driven
- less calendar driven

More translation
- less cascading

More relative
- less absolute KPIs

"Giving Ambition to Action back to the line"
Simpler and better …
… but not necessarily “easier”

“Simple, clear purpose and principles give rise to complex, intelligent behavior.
Complex rules and regulations give rise to simple, stupid behavior.”

(Dee Hock - founder and former CEO of Visa)

Good news for those who want to lead, drive and perform!

Bad news for those who want to be instructed on what, how and when?
## A systematic change of the whole process

<table>
<thead>
<tr>
<th>Target setting</th>
<th>&quot;Annual command and control&quot;</th>
<th>More dynamic &amp; flexible</th>
<th>A new performance language</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Equal to plan – &quot;what we can deliver&quot;</td>
<td>Aspiration driven – &quot;what we must deliver&quot;</td>
<td>The whole Ambition to Action</td>
</tr>
<tr>
<td></td>
<td>Only KPI targets</td>
<td></td>
<td>Relative targets</td>
</tr>
<tr>
<td></td>
<td>Absolute targets</td>
<td></td>
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</table>

### Planning

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<tr>
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<th>A new performance language</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Plan = target, forecast and resource allocation</td>
<td>Plan = forecast only (actions and expected performance)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Gaps vs targets hidden</td>
<td>Gaps vs. targets visible</td>
<td></td>
</tr>
<tr>
<td></td>
<td>One outcome only</td>
<td>Main uncertainty spans</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Very detailed</td>
<td>Less detailed</td>
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</table>

### Resource allocation

<table>
<thead>
<tr>
<th>Target setting</th>
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<th>A new performance language</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Annual pre- allocation through budgets</td>
<td>Resources available when needed, but within KPI targets</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Budgets &quot;an entitlement – my money&quot;</td>
<td>+ mandates + decision criteria. Monitoring of</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>development</td>
<td></td>
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</table>

### Business reporting

<table>
<thead>
<tr>
<th>Target setting</th>
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<th>A new performance language</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Backward looking</td>
<td>Forward looking</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Variance vs. YTD budget</td>
<td>Forecast vs. targets, and actions to close gaps</td>
<td></td>
</tr>
</tbody>
</table>

### Evaluation/rewards

<table>
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<th>A new performance language</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Only based on budgets and KPIs</td>
<td>A holistic evaluation: &quot;Ambition to action&quot; + Behaviour</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Pressure testing KPI results</td>
</tr>
</tbody>
</table>
Implementation advice

• Create problem understanding before talking solutions
• What’s the real risk – upside vs downside
• Design to 80% and jump
• A ”pull-based” approach
• ”One war but a thousand battles”
• Involve HR
• Don’t become a fundamentalist
Thank you for listening!

Questions or comments – now or later?

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Beyond Budgeting Round Table
www.bbrt.org
Want to hear more?

1. The problems with traditional management
2. The Beyond Budgeting model
3. The Borealis case
4. The Statoil case
5. Implementation advice

Out on Wiley (US)
Available from Amazon.co.uk
Back up
A forecast – what we think will happen
- whether we like what we see or not!

... not a promise, not an application for resources
A forecast is a call to action

Get issues on the radar screen early enough ...

... to be able to take corrective actions
A target – what we want to happen

• Relative where possible
  – Input/output or benchmarking

• Translation - not cascading
  – Must all targets add up?

• Ambitious - without overstretching
  – Remember Aristotle

• SMART*
  – but not too SMART

*SMART: Specific, Measureable, Achievable, Realistic, Timebound

“Our problem is not that we aim too high and miss, but that we aim too low and hit”

Aristotle
Performance is ultimately about performing better than those we compare ourselves with.

Do the right thing in the actual situation, guided by the Statoil Book, your Ambition to Action, decision criteria & authorities and sound business judgement.

Within this framework, resources are made available or allocated case-by-case.

Business follow up is forward looking and action oriented.

Performance evaluation is a holistic assessment of delivery and behaviour.

The Execution framework

Dynamic resource allocation - more freedom but still boundaries.