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FEATURE ARTICLE

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Handelsbanken: A radical business model transforms a conservative bank

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In 46 of the last 47 years, Sweden's Handelsbanken has met its corporate goal of achieving a higher return on equity than peer banks and weathered worldwide financial crises largely unscathed. Its success can be attributed to an organizational model that replaced traditional top-down, centralized management guided by an annual budget with decentralized operations that gave decision-making authority to frontline branch employees with intimate knowledge of customers' preferences. The new system also abolished the annual budget process and allowed managers to make resource requests as needed. Corporate goals were simplified, branch performance measures were tied directly to the new targets, and a profit-sharing plan was designed to treat all employees equally. The benefits that the bank reaped from this radical approach prompted other organizations to follow its lead and continue to inspire replication of the beyond budgeting concept.

1 | INTRODUCTION

Most large organizations are typified by a hierarchical, highly centralized management structure in which goals are developed at the highest levels and communicated downward to operating units. Control is achieved through budgets that specify targets to be met and the way resources will be allocated in the coming year. Little discretion is given to lower level managers, whose actions primarily are aimed at hitting the budget numbers. Management receives bonuses when the budget numbers are reached, even if changing conditions have rendered the budget irrelevant. During the early 1970s, the managers at Sweden's Handelsbanken decided things did not have to be this way. Vowing to avoid repeating the mistakes of other companies where decisions were made by committees far removed from the customers, employees were hamstrung by fixed budgets, and employee initiative was frowned upon, Handelsbanken's officials embarked on a radical plan to decentralize, eliminate budgeting, and give all employees a sense of ownership. With its "beyond budgeting" concept, the bank became one of its sector's greatest success stories and today leads its peers in numerous areas, such as return on equity, customer satisfaction, and low loan loss rate.

2 | BANKING ON INNOVATION

Handelsbanken was established in 1871 when eight board members of Stockholm's Enskilda Bank resigned and formed a new bank to provide deposit and loan services to support business activity in Sweden's capital. Profitable from the outset, Handelsbanken became a major player in the Swedish financial sector, and in 1873 it listed its shares on Stockholm's stock exchange.

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The bank's first decade was marked by expansion, with new branches in and around Stockholm outpacing the growth of competitors. Like its competition, however, Handelsbanken suffered during a downturn of the Swedish economy in the late 1880s and early 1890s. A new managing director, Louis Fraenckel, who was appointed in 1893, took advantage of a rebound in the local economy to return Handelsbanken to profitability. Fraenckel led the bank through two decades of expansion, and Handelsbanken went from being the tenth largest commercial lender in Sweden to the second largest.

The 1920s and 1930s were marked by various challenges and uncertainty as the worldwide economic crisis strained businesses and the banks that supported them. Increasingly, Sweden's banks consolidated. By the start of World War II, 25% of Sweden's bank branches were part of Handelsbanken. The firm continued it acquisition strategy during the late 1940s and into the 1950s and expanded into new services, including mortgages, leasing, factoring, and mutual funds.

An early adopter of computer technology in the 1960s, Handelsbanken established its own computer center to process the rapidly growing number of customer transactions. By the mid-1960s, it was developing an online system to connect its branches to a central computer through the telecommunications infrastructure available at the time. Handelsbanken eventually would go on to introduce ATMs in the 1970s, telephone banking in 1991, and online banking in 1997, and to operate in Sweden, Denmark, Finland, Norway, the Netherlands, and the United Kingdom (Handelsbanken Historical Society, 2015). Much of the groundwork for the bank's development during the last 50 years resulted from a new management strategy adopted in the 1970s.

3 | A NEW CEO, A NEW PHILOSOPHY

In the late 1960s, the future of Handelsbanken seemed uncertain. Profits were disappointing, and the executive director and several members of top management left the bank because of disagreement with regulatory agencies over the handling of some of the bank's foreign currency activities. In 1969, the bank hired a new CEO, Jan Wallander.

A doctor of economics, Wallander had 10 years of experience as the managing director of Sundsvallsbanken, a provincial bank in northern Sweden. He had also worked at two prominent research institutes, the Industrial Council for Social and Economic Studies and the Industrial Institute for Economic and Social Research, and been an associate professor of economics at the University of Stockholm (Office for the Jan Wallander Prize, 2019; Prabook, 2019). Before joining Sundsvallsbanken, said Wallander, he "did not have any practical business experience and knew nothing about banking." But after 10 years, he "had learned a lot and developed some firm ideas about how to run a bank with a large network of branch offices" (Wallander, 1999, p. 405). Wallander accepted the Handelsbanken offer on the condition that he will be given carte blanche to manage the bank as he saw fit (Pflaeging, 2013). As for Handelsbanken, its senior managers had one goal: to be more profitable than their peers in their home market (Olesen, 2013).

Decentralization would change the way decisions were made, elimination of budgets would transform planning and evaluation, and an innovative profit-sharing plan would create a sense of belonging among all employees.

Wallander's management philosophy was simple: To be successful, an organization must trust and respect both customers and employees. In his view, the creativity, insights, and judgment of employees represent the only sustainable competitive advantage available to an organization (Olesen, 2013). Implementing this philosophy would require sweeping changes in the way the bank operated, however. Decentralization would change the way decisions were made, elimination of budgets would transform planning and evaluation, and an innovative profit-sharing plan would create a sense of belonging among all employees.

3.1 | Decentralizing to boost satisfaction

The decision to decentralize in 1970 was predicated on the belief that a centrally controlled bank could not adequately serve the needs of vastly different customers who are geographically dispersed. Complete decentralization, however, was not practical, because Handelsbanken's larger customers needed specialized support that could not be provided by an individual branch. As a compromise, regional banks were formed, with each overseeing approximately 70 branch offices.

Each of the regional banks operated with a great deal of autonomy, and many of the central bank functions were transferred to them (Handelsbanken Historical Society, 2015). Adequately staffed, they were well equipped to handle any type of banking function for any size customer. The only limitation placed on the regional banks and their branches was that they operate within the bank's general policies. Exactly how they do so has been left to the regional directors (Wallander, 1999).

Each region and branch exercises control over its own strategy and marketing. Decisions on which customers to serve and the type of products to offer are made by the individual branch managers, as they have the best understanding of the local environment and customers. Their intimate knowledge of local customers also allows them to better identify risky customers. As a result, they can be more selective about granting loans, resulting in relatively lower loan losses than those of the bank's competitors.

When bad loan decisions are made, the branch approving the loan is responsible for absorbing the loss. Branches also conduct their own marketing, and the bank conducts virtually no centralized marketing campaigns (Olesen, 2013). The decentralized nature of the bank also reduces the need for mid-level managers and functions, further helping to keep costs low (Handelsbanken, 2019). Regulated by an internal market, the centralized staff functions must “sell” their services to the branch and regional banks. Those receiving the services, which include technology support, webpage development, and other services, which are more cost-effective to centralize, can challenge or reject the costs if they seem out of line (Dugdale & Lyne, 2011).

The logic behind decentralization is irrefutable. Customers want to work with people they know in their own community. They want any decisions affecting them to be made by people with intimate knowledge of their situation and needs, and not by disconnected corporate bureaucrats hundreds of miles away. Handelsbanken's decentralized operations provide its customers with what they want: decisions made quickly, locally, and based on the customer's individual situation, not corporate policy. To that end, approximately 50% of the employees at Handelsbanken branches and regional banks have independent lending authority (Wallander, 1999). As stated in the bank's most recent annual report, “Our customers are always able to meet the person who will make the decision, not a messenger” (Handelsbanken, 2019, p. 10).

Handelsbanken's model is grounded in the belief that employees want to do their jobs well, become more skilled, and seek and overcome challenges. All they need is room to do so. Therefore, employee development is paramount. All staff members take part in their unit's business-planning process. Once the plan has been established, the manager maps out individual competencies and conducts performance reviews with each employee. The goal is to develop personalized action plans with both long-term and short-term goals and assignments that will benefit both the employee and the bank. Performance against the action plans is continually assessed and serves as the foundation for an annual salary review meeting between employees and their manager (Handelsbanken, 2019).

Wallander believed that it was necessary for employees to feel involved in what they are doing in order to elicit their best performance (Wallander, 1999). When employees who serve customers see the impact they are making through their decisions, their job satisfaction, as well as customer satisfaction, increases. Employees do not receive commissions or other compensation for promoting products or services. The focus is on what is best for the individual customer, not what is best for the bank or employee. Long-term customer satisfaction and relationship-building takes precedence over short-term profitability. As a result, Handelsbanken is consistently ranked as a leader in customer satisfaction. (Olesen, 2013).

One problem that decentralized organizations typically have to contend with is reduced control over operations. Although the branches have a significant amount of autonomy, they must still operate within the bank's framework of guidelines and rules. At the corporate level, Handelsbanken establishes policies and rules in several areas, including lending, sustainability, ethical standards, and human resources matters. There are also numerous companywide functions for business support and development of the bank's products and services, as well as robust control functions that both support and verify compliance with rules and guidelines (Handelsbanken, 2019).

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Handelsbanken does not set fixed performance goals, as those can quickly be made irrelevant by economic changes or competitors’ actions. Offering optimum service takes precedence over achieving arbitrary targets. The bank relies on a culture of continuous improvement and relative goals that fit its basic philosophy of outperforming its peers. As Frank Vang-Jensen, the bank's former managing director of Denmark operations (who went on to serve as president and CEO from 2015 to 2018), noted, “Managers should not sit down once a year and leave it at that. They should constantly observe how the company is doing and discuss and formulate plans for action as the performance of the company changes or changes in economic conditions give an indication that something should be done” (Olesen, 2013, p. 5).

Branch and regional managers and employees work together, share information, and learn from each other to do things better. Branch performance is benchmarked on three measures—return on equity, cost/income ratio, and customer satisfaction—and branch managers' spending decisions are driven by the desire to optimize performance in each of those areas (Bogsnes, 2018). Employees understand the interplay between managing costs and improving performance. In that way, branch activities are self-regulating. The bank does well when the individual branches perform well in their markets.

3.2 | Making budgets a thing of the past

The degree of decentralization that Handelsbanken was able to implement could only be achieved by replacing much of the top-down planning and budgeting that previously had been done at headquarters (Olesen, 2013). Wallander believed that budgets are pointless at best and disastrous at worst. In his view, they are based on either of two expectations.

The first is what he described as the "same weather tomorrow as today" principal. This alludes to situations when the variables used in the budget forecasts have been rising or falling steadily or exhibiting some type of cyclical pattern. These are expected to continue, so preparing a budget is pointless. All the effort and expense that go into preparing a budget are wasted if ultimately the plan is to continue to do business as usual.

The second expectation concerns situations when the organization is going through an entirely different experience than ever before. The usual assumption in such a circumstance is that the current condition is an anomaly and everything will return to normal. The budget is then based on normal conditions. The danger with this reasoning is that the anomaly may actually be the first ripple in a coming sea change and the usual budget will leave the organization wholly unprepared. By steadfastly following the budget instead of adapting to new conditions, managers may end up following a course that ultimately will prove disastrous to the organization (Wallander, 1999).

Wallander compared the budgeting process with a ship traveling down a river in foggy conditions. The captain has no reliable navigational charts and cannot see the other ships (competitors) on the river or the riverbanks. Nonetheless, the captain plots a course to follow for the next 12 hr and is reluctant to deviate from it. Such a strategy is futile at best. Current information is the captain's real need (Wallander, 1999).

True decentralization cannot work with budgets. Lower levels need the freedom to act independently and react quickly to changing conditions. To continue the shipboard analogy, an organization needs a well-trained and motivated crew who understands their jobs and can act independently; it does not need a course that has been plotted out without essential information.

Rather than chasing fixed goals, Handelsbanken relies on its people and their creativity, insights, and judgment to guide the company (Beyond Budgeting Institute, 2016). Control and resource allocation are achieved through the three basic performance measures used by the bank: return on equity, cost/income ratio, and customer satisfaction. Aware of the fact that success, as well as the proceeds from the company's profit-sharing plan, depends on how well the bank does in these areas, employees are highly motivated to make decisions that will enhance customer satisfaction and improve profitability. Instead of working with a fixed allocation, each responsibility center can request resources, but their use will be monitored. Hoarding or wasting resources would reduce the cost/income ratio and be detrimental to the manager's performance evaluation.

3.3 | The Oktogonen

Like their colleagues in other organizations, Handelsbanken's leaders want to motivate employees to perform in ways that will benefit the company. Unlike many other organizations, however, the bank does not offer typical bonus programs. Management believes that bonuses are inappropriate in risk-taking operations, because they incentivize risky decisions that run counter to the bank's philosophy of controlling risk to the extent possible. Handelsbanken takes a much more radical approach. It offers a profit-sharing program designed to foster the feeling that all employees, regardless of rank or location, are fundamental to the bank's success, and to emphasize strategic thinking and long-term value creation over short-term profits. Called the Oktogonen, the system rewards all employees equally when the bank prospers.

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Started by the bank's trade union club, the Oktogonen Foundation was formed in 1973 to administer its profit-sharing funds (Handelsbanken Historical Society, 2015). In each year that the bank produces a higher return than the average of its peers, one third of the excess is paid into the fund, with an equal amount allocated to each employee so that each worker has an equal stake in the bank's success. As a further incentive to employees, the funds are held in the form of Handelsbanken shares, making the Oktogonen one of the bank's largest shareholders (Olesen, 2013). Employees do not have access to their portion of the fund until they turn 60. This reduces the temptation to make ill-advised decisions aimed at creating short-term profits to achieve an immediate reward.

Almost all the bank's employees, 98%, are covered by the fund, which has been immensely successful. Excess profits have been allocated to the fund in all but 3 years since its inception (Handelsbanken, 2019). Some long-term employees retiring in the mid-2010s received individual payouts equivalent to approximately USD 2.25 million (Wall, 2014).

4 | AN ENDURING LEGACY

After more than 40 years, the corporate culture and philosophy initiated by Jan Wallander remains intact. The reason is obvious. The Handelsbanken way has proven to be an unparalleled success. The bank's achievements (Handelsbanken, 2019) include:

- Meeting its goal of having a higher return on equity than the average of its peer banks for the past 47 consecutive years.
- Consistently having a return on equity in excess of 12% per year.
- Only one unprofitable year in the past 47 (2009, during the worldwide banking crisis).
- Consistently lower cost/income ratio than peer banks.
- Consistently lower loan loss ratios than peer banks.
- Equity per share grew at an annual rate of 15% over the past 9 years.
- Consistently higher customer satisfaction ratings among both individual and corporate customers than peer banks as reported by an independent survey organization.
- Consistently lower staff turnover than peer banks.
- Continued profitability during the worldwide banking crisis of 2008–2010.
- Loan losses of only 0.2% during the banking crisis—one fifth the rate of peer banks.
- The only major Swedish bank not forced to consider a government bailout during the Swedish banking crisis of 1980.

Perhaps, the greatest legacy of Jan Wallander is the beyond budgeting concept. The Chartered Institute of Management Accountants describes beyond budgeting as "a set of guiding principles that, if followed, will enable an organisation to manage its performance and decentralise its decision making process without the need for traditional budgets" (Chartered Institute of Management Accountants, 2007, p. 3). According to the Beyond Budgeting Roundtable, the principles underlying beyond budgeting are:

- Goals—Relative and self-imposed key performance indicator (KPI) aspirational goals drive sustained competitive success, not fixed annual targets that drive short-term actions.
- Rewards—Team-based rewards build a one-team attitude, and peer pressure drives continuous improvement, not individual incentives that build a "defend your own turf" attitude and "meet the target" mindset that drives irrational behavior.
- Plans—Event-driven strategies support a sense-and-respond or customer-first approach to strategic management, not annual plans that support a make-and-sell or company-first approach.
- Resources—On-demand resources enable fast response capabilities and reduce waste, as opposed to centrally allocated resources that inhibit fast response and encourage waste.
- Coordination—Dynamic linking of customer demands provides fast, seamless solutions that meet customer needs, whereas centrally linked budgets provide slow, disjointed solutions that often fail to meet customer needs.
- Controls—Multifaceted and multilevel information systems provide patterns of information that inform strategic decision-makers, as opposed to financial comparisons of actual expenses to budget, which provide a poor basis for learning (Hope & Fraser, 2001).

These principles have been adopted by many of the world's major companies, including Ikea, Volvo, Toyota, Cisco, Maersk, American Express, Unilever, Southwest Airlines, AES Corporation, Borealis, Ahlsell, Siemans, and Guinness-UDV. For instance:

- Norwegian oil and gas producer Statoil uses KPIs developed by each segment to monitor and report on its performance toward strategic goals. KPIs are relative, comparing the performance of different segments or the use of resources deliverables. Relative performance is used to identify and address areas for improvement (Hjartåker & Kristiansen, 2012).
- Germany's Schindlerhof hotel foregoes individual bonuses. Instead, bonuses are primarily based on the performance of the entire organization, and only a small portion is related to individual work achievements (International Center for Outperformance, 2014).
- HOLT-CAT, the largest Caterpillar equipment dealer in the United States, abandoned budgets, because they considered budget targets to be the minimal acceptable outcome. Instead, they practiced a "Do the best you can do" philosophy based on reacting to customer and market needs (Essaides, 2016a).
- Statoil effectively used the resources principle to decide which projects to *not* pursue when oil prices declined. A traditional budget would have already allocated resources to projects before it became evident that they were not needed or could not be afforded (Essaides, 2016b).

- Martin Lundstedt, CEO of Volvo, described the customer-oriented strategy behind the carmaker's decentralization initiative. "This strategy has been successful and we continue to drive decentralization throughout the Group. Those closest to the customer should be empowered to make the decisions and be accountable for the result. It is great to see this culture shift happen in practice. Individuals and teams are taking responsibility and driving forward with the customer's best interest in mind" (Volvo Group, 2019).
- Buurtzorg, a not-for-profit nursing organization in the Netherlands, believes in the power of transparency and sharing of information. Nursing teams, not administrators, developed the IT system to ensure that it met the needs of patients. The system gathers and reports all manner of information on patients, including planning, scheduling, and capacity utilization. It also serves as a platform for disseminating news and information and for reporting performance metrics that are shared to facilitate self-regulation and learning (Olesen, 2016).

The successful adoption of these principles by companies in a diverse range of industries proves their value (Hope & Fraser, 2001; Namioka, 2019).

5 | THE NEED FOR LEADERSHIP

Handelsbanken was formed almost 150 years ago with the modest goal of providing deposit and loan services to businesses in Stockholm. Over the years, it grew to become a major player in the Swedish banking industry and eventually expanded into other Scandinavian and northwestern European countries. Under the guidance of Jan Wallander, Handelsbanken developed and proved the effectiveness of a radical new business model based on decentralized operations free from the confines of the traditional budgeting process. The concepts developed at the bank fueled its success and sparked a budget-free revolution among other major companies.

Handelsbanken and other companies that have implemented the beyond-budgeting model have seen customer satisfaction improvement as authority has been delegated to frontline employees who are best positioned to understand customers' needs and quickly respond to them. This employee empowerment fosters both motivation and job satisfaction. Moreover, performance improves, because employees are focused on delivering results rather than on meeting budget numbers. Allowing managers to demand resources while requiring them to show the results of their use results in less waste and lower costs and eliminates hoarding. Clear governance principles combined with team-based rewards promote open sharing of information throughout the organization and the understanding that when the company wins, all employees win. The overall goal is not to beat out other managers, but to outperform the competition.

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Implementing the beyond budgeting model is not without challenges. Centralized control and reliance on budgets are deeply ingrained in most organizations. To successfully put Handelsbanken's approach into practice, leaders must recognize the fact that the problems they are trying to solve are symptoms of larger issues and they must take an active role in the effort to address them (Úlfarsson, 2018). Simply put, mindsets need to change, and overcoming resistance to change is imperative. This can only be accomplished when senior leaders demonstrate an unwavering belief in the beyond-budgeting concept. Employees at all levels must be educated not only on the principles and benefits of the new system but also on their expanded responsibilities within it and how they will be evaluated and rewarded.

Simply put, mindsets need to change, and overcoming resistance to change is imperative.

Giving frontline employees more authority, eliminating budgets, and replacing individual rewards with identical rewards for all employees are concepts that run counter to the inclinations of most executives. As the experiences of Handelsbanken and other companies have shown, however, the benefits of embarking on such a strategy are well worth the effort.

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