

What Is Zero Based Budgeting (ZBB)?



Many organizations watch costs outpace revenue growth, and as such, expense control has become a bigger priority.

Executives are under mounting pressure to deliver productivity improvements, and practically all companies are looking to cut costs, whether it be through traditional means such as outsourcing, strategic sourcing, offshoring, or one-off cost reduction measures.

In many cases, these strategies aren't enough. Executives need larger savings that can be sustained over time.

Alas, the typical way of finding cost reduction possibilities, looking at aggregate operating expenses, is not well suited to delivering significant benefits that are lasting or realizable.

The findings are generally too high level to link to the actions that are required to get the savings. Managers can avoid taking actions by citing unique business needs and refuting the underlying business data.

With these constraints, when a business must save money, executives feel their only option is to slash and burn, arbitrarily cutting costs without changing the underlying work – regardless of how sensible and sustainable the choices may be.

The good news is, there is a sustainable alternative to cost management that works for many companies, known as zero-based budgeting (ZBB).

Let's take a closer look at what this budgeting technique is, what it isn't, and how it can benefit your organization.

What Is Zero Based Budgeting?

ZBB is a method of budgeting where all expenses have to be justified for every new period.

The ZBB process begins with a zero base, and every function within the organization is analyzed for its costs and necessity.

Budgets are developed around what is needed for the upcoming period, regardless of how the new budget numbers match up to the previous one.

A traditional budgeting method, on the other hand, calls for incremental increases over previous budgets, such as a 3% increase in spending, without the justification of both old and new expenses, as called for with the ZBB approach.

Traditional budgeting practices only look at new expenses, while ZBB starts from zero and mandates justification of all expenses.

ZBB is highly-detailed in nature, and because of this, may take a few years to fully

rollout for your organization. It may start with a few functional areas being reviewed at a time, increasing as time allows.

Companies are known to avoid using this approach because they are afraid it means 'budgeting from zero' when it's nothing more than a structured process aimed at building a cost management culture.

How Zero-Based Budgeting Good for Your Organization?

Zero-based budgeting can lower costs and drive growth by avoiding blanket increases or decreases based on the previous year's budget.

The approach does favor departments and functions that achieve direct production or revenue since those contributions are easier to justify than in departments such as research and development and client services.

ZBB is a repeatable process that organizations use to review every dime in the annual budget, while also managing financial performance every month, and build a culture of cost management with all the employees.

To develop a ZBB process for your organization, you must develop deep visibility into the cost drivers in your business and use that visibility to set aggressive, but reasonable budget targets.

The annual budgeting process starts from zero but is very structured, detailed, and interactive to spark meaningful financial debate between executives and managers.

Over the course of the year, multiple team members are tasked with performance management and cost management debate.

With the new system and process controls, along with incentive programs that are aligned with the process and goals, all employees make cost management part of their daily work within the organization.

One company realized an 11% savings in its operating budgeting within the first four months of starting their ZBB program.

Immediate savings came from increased visibility into labor costs and establishing new approval thresholds to control demand for contract labor, adjusting procurement programs to negotiate better pricing, and changing make vs. buy decisions.

The company strategically reinvested more than 40% of the savings on new sales staff and teams who spent all their time with their customers.

Though this particular company chose to reinvest their savings in the customer-facing areas of their business, other companies use the savings to fund and amplify the next stage of productivity.

And yet others allow the savings to fall to the bottom line.

What you choose to do with the savings depends on your strategic goals for the business. There's no wrong answer.

When properly executed, the zero-based budget can reduce your selling, general, and administrative expense (SG&A) by 10 to 25%, in as little as six months.

Dispelling Common Myths About ZBB

Myth: ZBB Means Building Your Budget from

Zero

While ZBB does build your budget from zero, there's much more to it than that.

The strongest efforts build a cost management culture throughout the organization, making it a part of daily activity.

It works through creating a structured approach to increase cost visibility, cost accountability, cost governance, and aligned incentives.

The culture shift happens through a step-by-step approach to ZBB implementation, and ensures all employees use cost management on a daily basis throughout the course of their work.

Myth: ZBB Overwhelms Your Business

Some executives believe the ZBB process is so time-consuming, they must ask their entire business to stop doing what they're doing for the year for implementing ZBB.

The misconception that ZBB requires dedicated focus from all employees for an entire year just isn't reality.

It does take time to embed the new cost management culture into the organization but setting up and rolling out the ZBB program has limited requirements.

In the initial setup phase, there's a central coordination team that develops the deep visibility into costs and sets the detailed savings targets for the upcoming budget cycle.

That team is also responsible for making sure the company's systems and processes are ready for the detailed reporting, governance, and performance

management that ZBB requires.

The setup period could take anywhere from four to 10 months, with full-time support from finance and IT, and part-time support from profit-and-loss owners, and cost-category owners throughout the organization.

Businesses that aren't sure of ZBB's advantages can pilot the process.

The pilot can be built as a customized plan specific to the company's objectives.

For example, one company is piloting a ZBB rollout across its global finance function, which builds capabilities within the team that can help drive the program across the entire enterprise, with the additional benefit of helping everyone reach their existing budget targets.

Myth: ZBB Means Cutting Budgets to the Bone

Much of the content available on zero-based budgeting that's available today associates the approach with deep cost cuts, through any means necessary – even going so far as to remove appliances from office kitchens to save on electricity costs.

While this sometimes happens, it's not necessary by any means.

The aggressiveness and degree of each company's cost-cutting measures is a reflection of the top-down savings target.

Even in the most aggressive situations, there have been 30% reduction targets in one year compared to other situations where organizations aim for 10% reduction targets, with the understanding that half of that will be reinvested into more productive areas of the business.

As such, the bottom line only takes 5%.

Myth: ZBB Isn't for Growth-Oriented Organizations

Zero-based budgeting is a powerful management tool for any company.

Even if your company's primary focus is on profit, growth, or talent retention, cost management is still a crucial element of success.

Removing unproductive costs allows the company to redirect the savings to more productive departments.

For instance, back office costs can be rerouted to customer-facing activities to foster growth.

ZBB is not an exercise that cuts costs without regard for the expense.

With the deep visibility into costs that ZBB requires, you can make changes to cut the fat while allowing the organization to build muscle.

Myth: SG&A is the Only Focus of ZBB

Governance, accountability, visibility, a rigorous process, and aligned incentives are the fundamentals of zero-based budgeting programs.

Certain adjustments must be made when using this tool kit in some areas of business. For instance, when ZBB is applied to variable costs, the budget must be volume adjusted in monthly performance reports.

When it's applied to capital expenses, costs must be categorized by discrete investment choices rather than types of expenses as they are with operating expenditures.

Zero-based budgeting can drive sustainable significant savings but must be

considered as more than building a budget from zero.

The best ZBB programs build cost management culture through increased cost visibility, accountability at all levels of the company, governance model, rigorous and routine processes, and aligned incentives.

ZBB frees up funds from unproductive costs, allowing those savings to be directed to more productive areas of the business or taken to the bottom line to facilitate future growth whether you're a small business or an enterprise-level corporation.

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