Zero-based Budgeting versus Baseline Budgeting

Approaches and pros & cons

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XLERANT

Goals

- Understand the differences between zero-based budgeting and baseline budgeting in concept and in BudgetPak
- Understand the pros and cons of each approach
- Determine the best approach for your organization

Topics

- Definition of zero-based budgeting versus baseline (traditional or incremental) budgeting
- Pros and cons of each approach
- How does zero-based budgeting work in BudgetPak?
- How does baseline budgeting work in BudgetPak?
- What is the user experience for both?

Zero-based budgeting

- **All expenses – both old and new - must be justified for each new period based on demonstrable needs and costs**
  - Each budget line item starts as $0
  - Puts the onus on the budget managers to justify each line item in order to receive funding
  - Aims to drive value by optimizing costs and not just revenue
  - Goal of not only controlling expenses but identifying cost-reduction opportunities

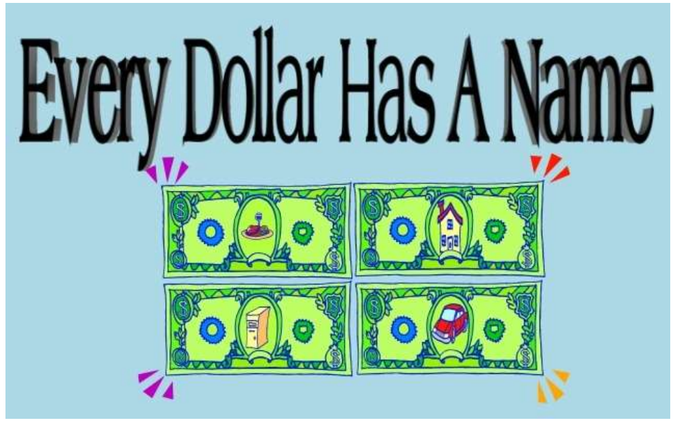
Pros

- **Supports cost reduction by avoiding automatic increases to a prior period's budget**
  - Allows savings to be taken to the bottom line or redirected to more productive areas that will drive future growth
- **Can build a culture of accountability and cost management**
  - Could increase organizational efficiency by encouraging stakeholders to work together to analyze operations
  - Improves operational efficiency by rigorous challenging of assumptions
- **Resulting budget is well justified and aligned to strategy**
  - Help to align resource allocations with strategic goals

Zero-based budgeting

Pros

- **Supports cost reduction by avoiding automatic increases to a prior period's budget**
- **Can build a culture of accountability and cost management**
- **Resulting budget is well justified and aligned to strategy**



Cons

- **Creation of a structured process**
  - Potentially time consuming
  - Sets detailed savings targets for the next budgeting cycle
  - Rigorous review of every dollar in the annual budget
  - Manage financial performance on a monthly basis
  - Systems and processes need to be in place for detailed reporting
- **Changing attitudes towards costs**
  - Cutting costs that are core to the customer's experience could harm how the organization's reputation and backfire

Baseline (traditional or incremental) budgeting

- **Begins with the current year's budget (or forecast) as a starting point**
  - Adjusted according to:
    - Actual spending in the new year
    - Inflation
    - Projections for new expenditures
    - Increases or decreases in labor costs
    - Additional capital expenditures

Baseline budgeting

Pros

- **Simple and easy to setup and understand**
- **Stability**
  - Requires limited fluctuations in the allocations of funds, so departments are operated in a consistent and stable manner for longer periods of time

Baseline budgeting

Pros

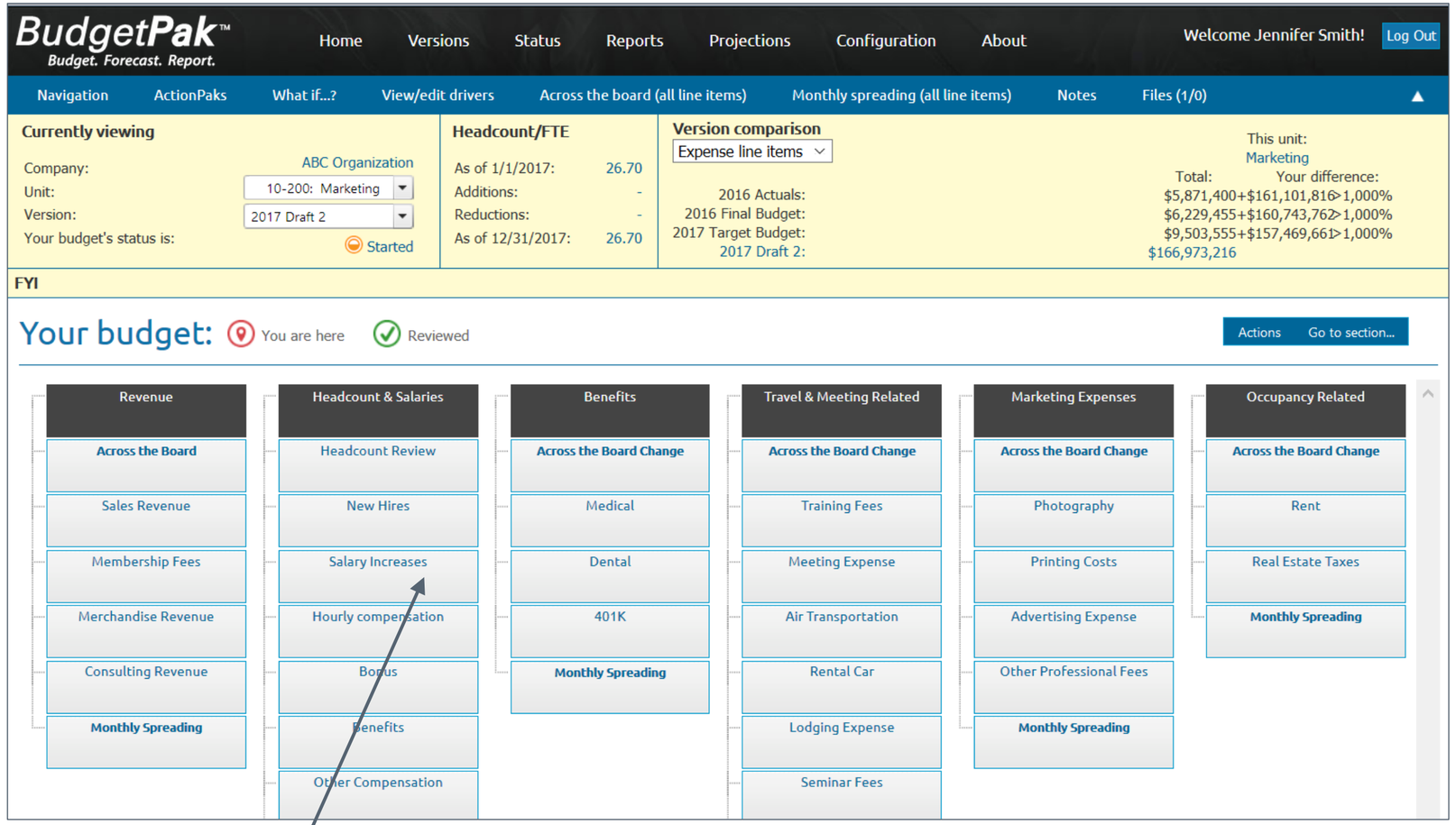
- **Simple and easy to setup and understand**
- **Stability**

Cons

- **Status quo approach to business**
  - Could breed waste
  - Could encourage people to try to increase their budget each year, even if they don't need it
  - 'Spend it or lose it' mentality
- **Does not encourage innovation**
  - Doesn't respond to changing circumstances
- **Perpetuates misallocations of resources**
  - Funding will be allocated to the same areas in the future even if they no longer needs as much funding, or if other areas require more funding.
- **Little incentive to conduct a comprehensive review of the budget**
  - Inefficiencies and budgetary slack are automatically rolled into new budgets

Decisions

Zero-based budgeting in BudgetPak

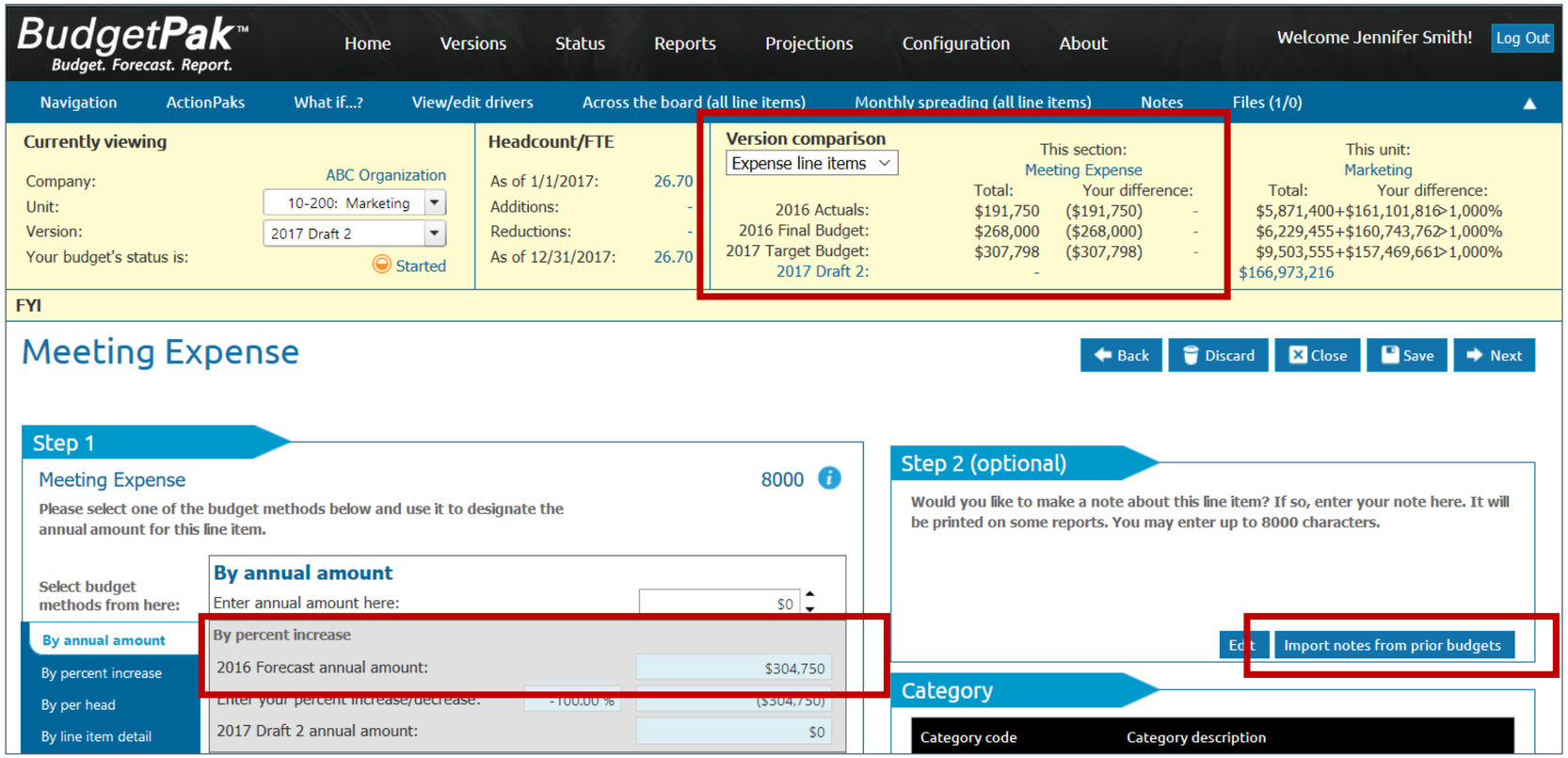


Nothing is completed; no checkmarks

Starting point for zero-based budgeting in BudgetPak

- Finance sets the default budget creation to 'start my budget from scratch' or bulk starts all budgets from scratch
- All sections are blank/have no values when user begins their budget

Zero-based budgeting in BudgetPak



Helpful features for zero-based budgeting in BudgetPak

- **Guidelines in 'Version comparison watch box'**
- **Guidelines in budget method 'by percent increase'**
- **Import and use:**
  - Line item details
  - Notes
  - ActionPaks

Zero-based budgeting in BudgetPak

Version code	Version	Note	Your description
FY2017-B-3	2017 Draft 1		2017 Draft 1
FY2017-B-5	2017 Draft 2		2017 Draft 2
FY2017-B-11	2017 Draft 3		2017 Draft 3
FY2017-B-6	2017 Final Budget		2017 Final Budget
FY2017-D-15	2017 Budget - Growth Plan		2017 Budget - Growth Plan
FY2017-D-16	2017 Budget - Conservative Plan		2017 Budget - Conservative Plan

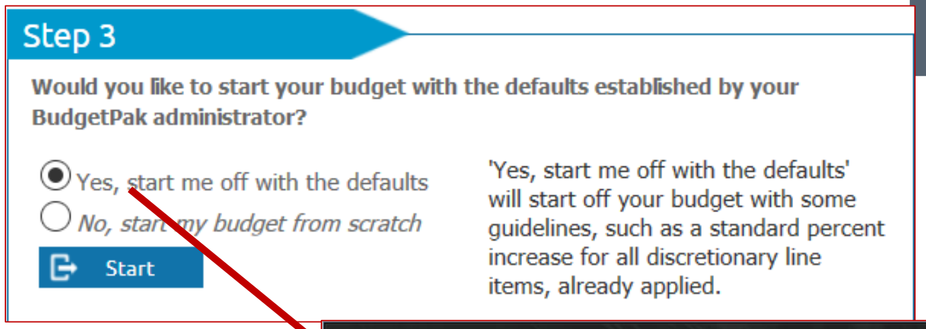
Use of Versions in Zero-based budgeting

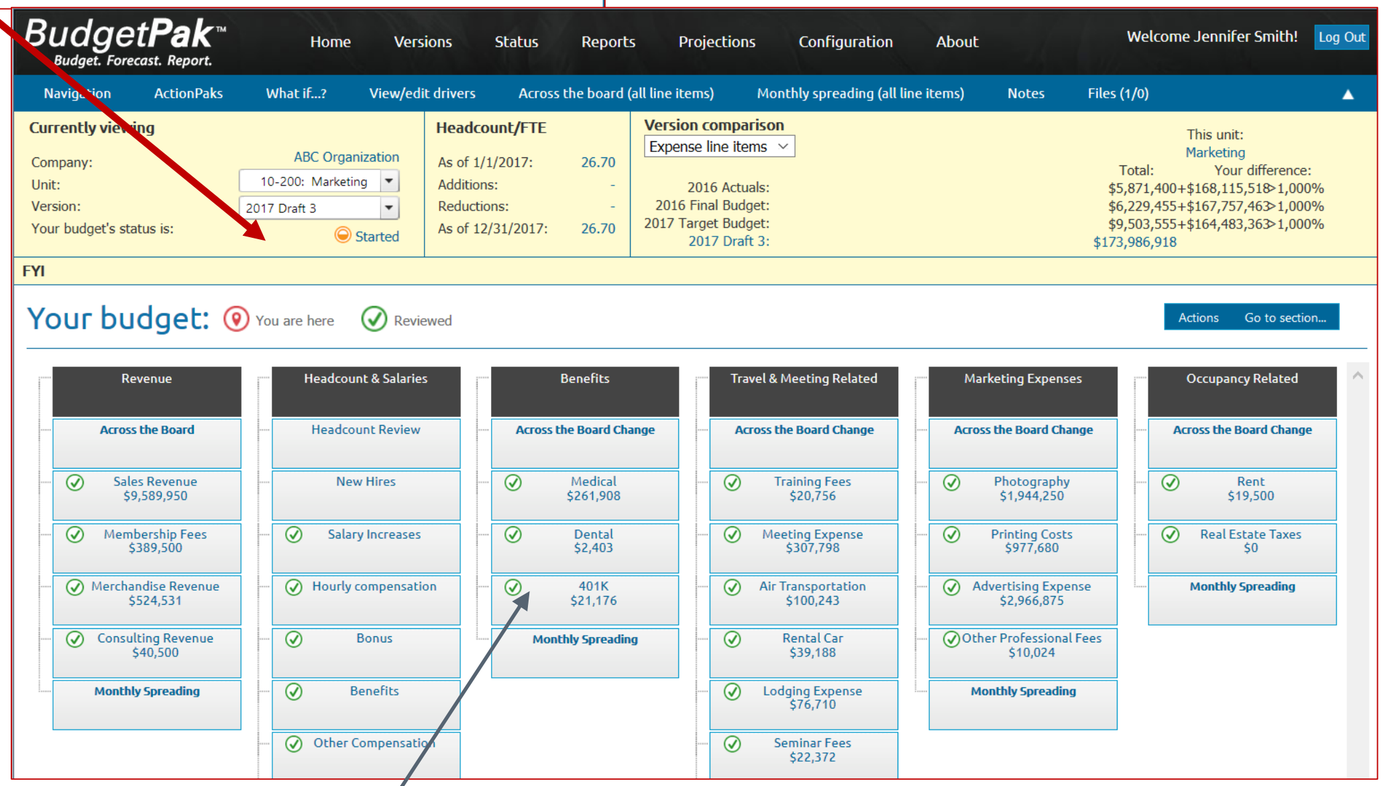
- **Finance offers multiple optional versions**
  - End users can choose to ‘try out’ different versions of the budget prior to copying to final signoff version

    E.g. Marketing decides that in Draft 1 they will not include new hires or plans for a new program

    In Draft 2, Marketing includes new hires, plans for a new program, and cutbacks to existing programs
- **Finance requests specific types of budgeting plans**
  - E.g. growth plan and conservative plan

Baseline budgeting in BudgetPak



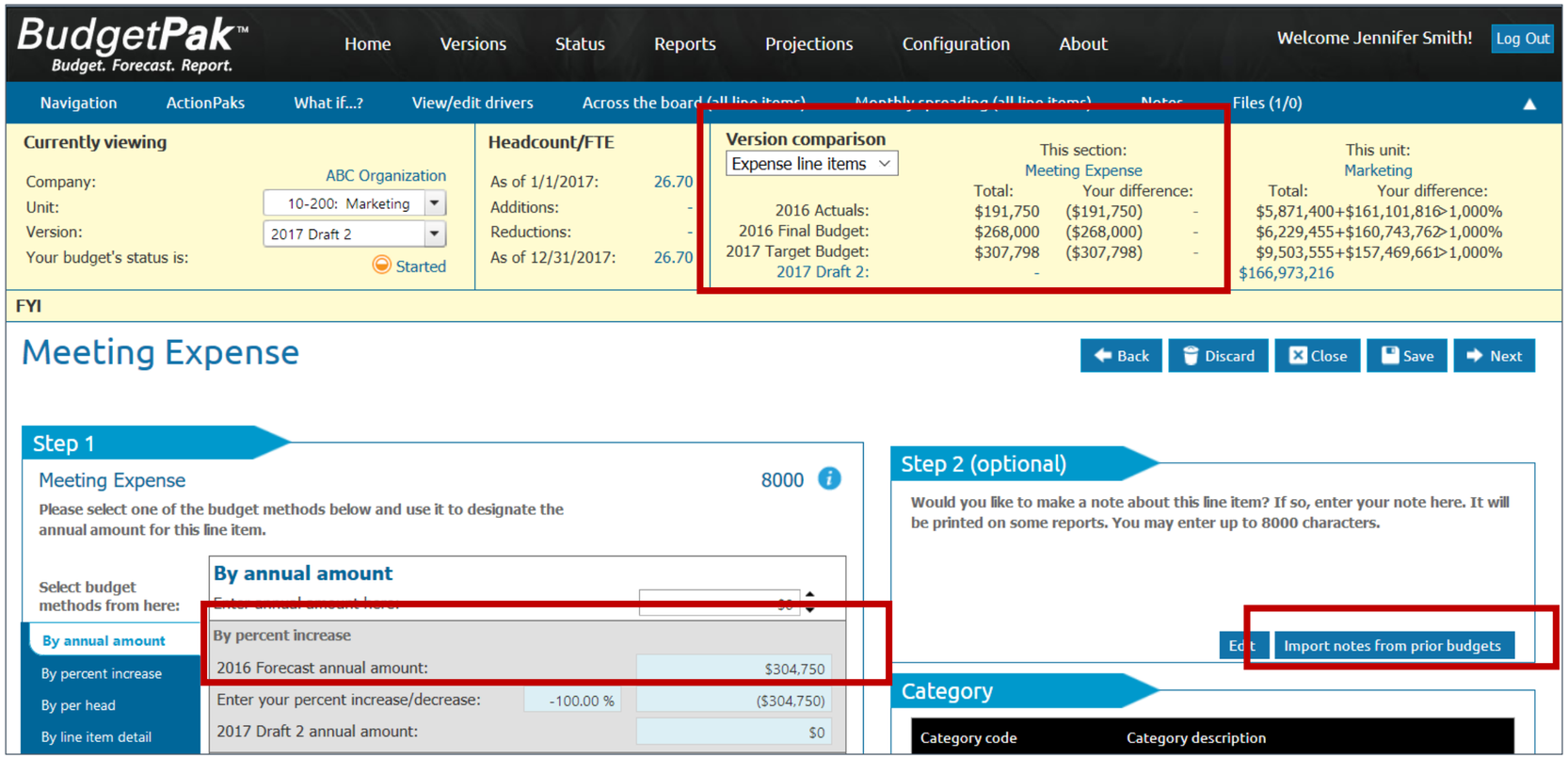


Most sections are competed and have checkmarks

Starting point for baseline budgeting in BudgetPak

- Finance uses a specified version as the starting point (e.g. budget, forecast or actual)
- All of the sections, except for headcount review, assets, shared ActionPaks, and spreading are pre-filled with the default values

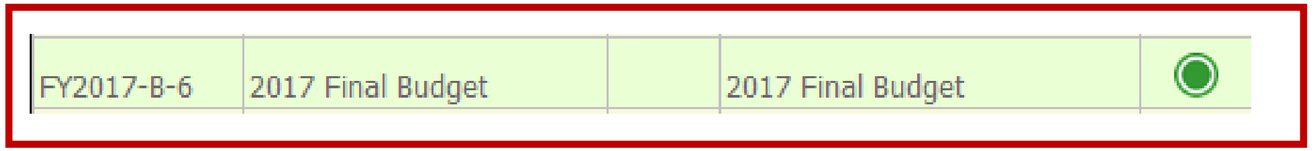
Baseline budgeting in BudgetPak



Helpful features for baseline budgeting in BudgetPak

- **Budget Manager only has to address the accounts that they want to**
- **Can still use all of the features for zero-based budgeting:**
  - Guidelines in ‘Version comparison watch box’
  - Guidelines in budget method ‘by percent increase’
  - Import and use Line item details, Notes, and ActionPaks

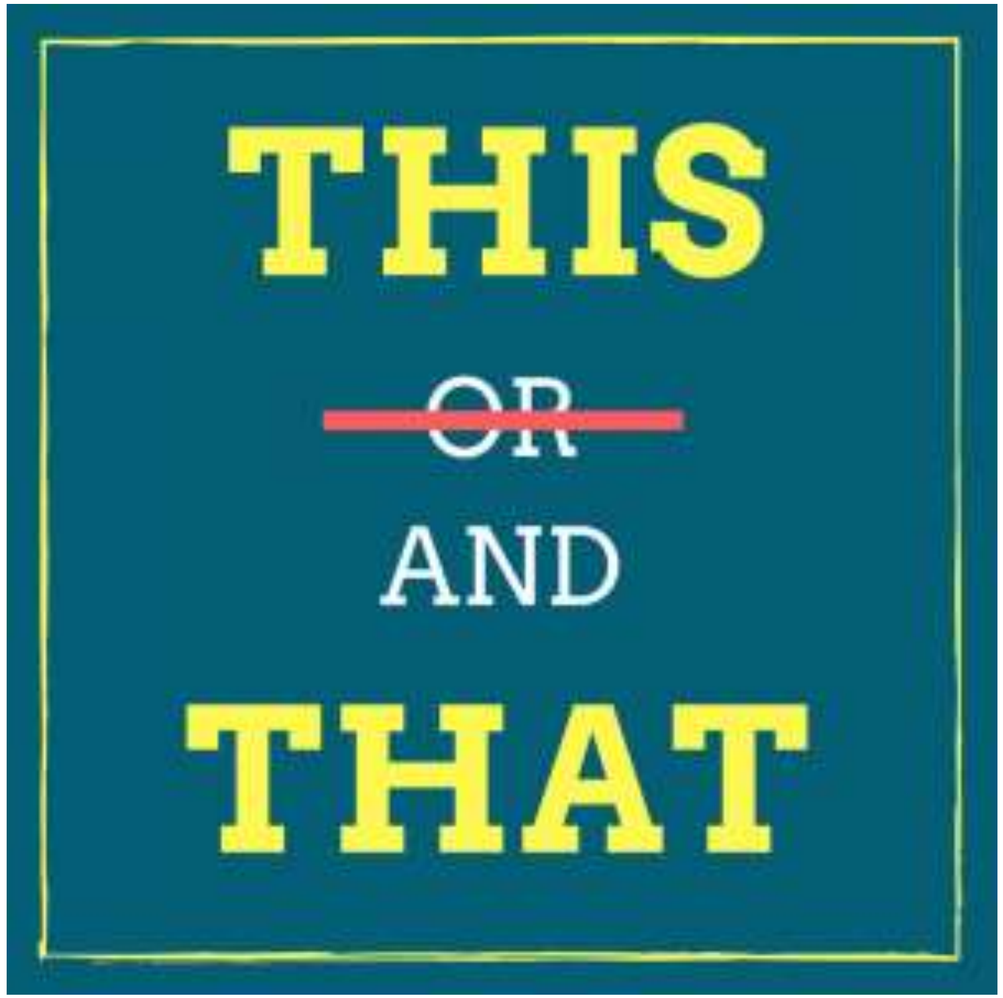
Baseline budgeting in BudgetPak



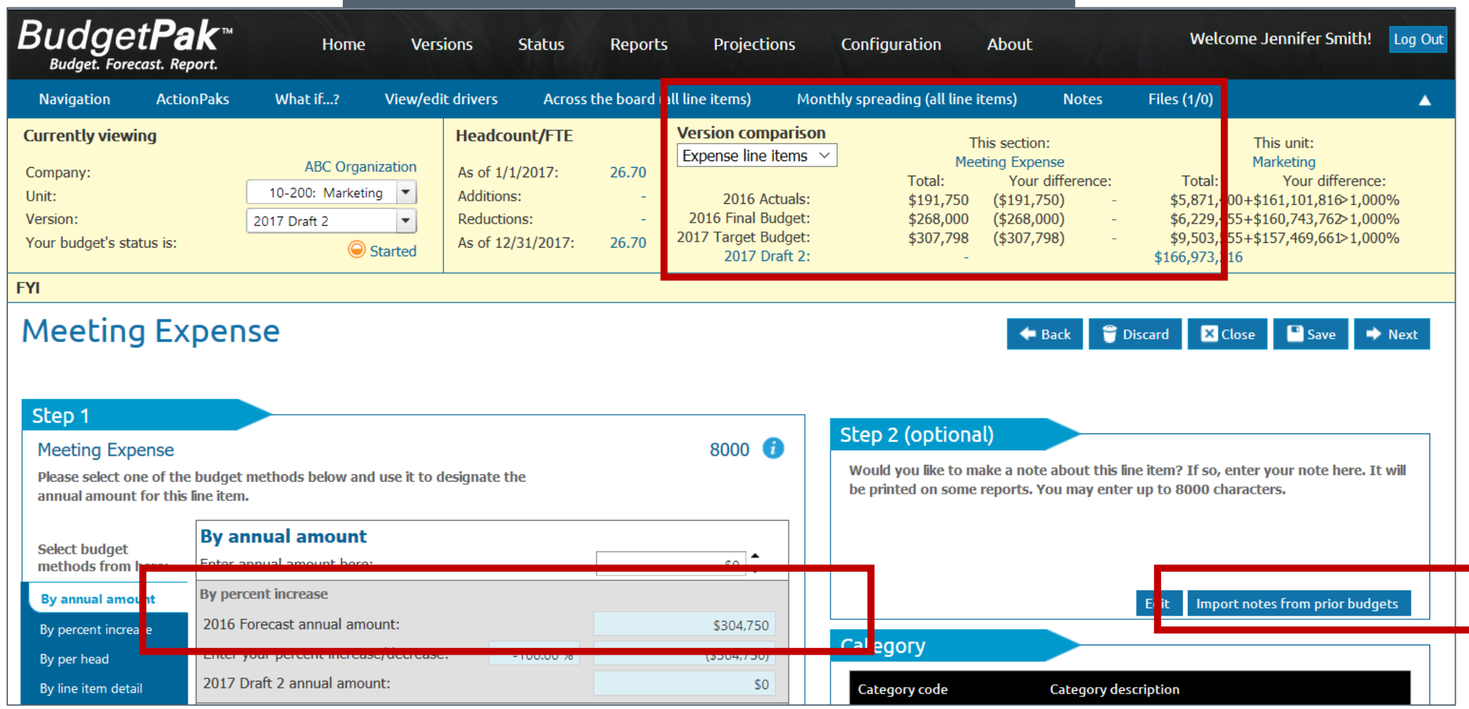
Use of Versions in baseline budgeting

- **Finance offers one version – the Final/sign-off version**
  - Since each budget is being pre-filled with specific values for each account, one version is sufficient and eliminates confusion

Which approach?



Hybrid approach



Hybrid approach

- Each unit can start with either zero-based budgeting **or** baseline budgeting
- Budget manager can decide:
  - Incremental budgeting for some accounts

    Keep baseline amount or

    Use ‘by percent increase’ budget method
  - Zero-based budgeting for other accounts

    Use most appropriate budget method

Goals review

- ✓ Understand the differences between zero-based budgeting and baseline budgeting in concept and in BudgetPak
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Q&A

Thank you!

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