

SIZING UP ZERO-BASED BUDGETING

A closer look at a promising alternative to traditional fiscal planning



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to traditional fiscal planning:**

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This Budgeting Brief is designed to provide finance executives with a fresh look at zero-based budgeting (ZBB) as an alternative or adjunct to traditional baseline (or incremental) budgeting – for improved sustainability in today’s challenging economic times.



Topics include:

- Reasons to consider ZBB
- Benefits of a ZBB approach
- Tips for getting started
- An example of ZBB in practice
- Is ZBB right for you?

Traditional baseline budgeting has long been a go-to process for many organizations. A simple and straightforward method, **baseline budgeting uses the previous year's budget as a starting point and adds incremental changes** for factors such as inflation, new business, and projected costs, materials, and revenue.¹

While baseline budgeting can work quite well in established companies that don't experience significant change,² for the majority of organizations, change is the only constant.

And in today's competitive and economically challenging climate, companies and institutions from every sector are seeking innovative ways to tie business strategy into budgeting.

Here's where innovative approaches like zero-based budgeting (ZBB) deserve a closer look. **ZBB is a needs-based method that allocates funding based on program efficiency and necessity rather than budget history.**³ This can be a game changer for organizations struggling for sustainability or a competitive edge.

*For the majority of organizations,
change is the only constant.*

*Zero-based budgeting supports
fluctuating business needs.*



Traditional Budgeting vs. ZBB

Baseline Budgeting

- ☐ Best for organizations with little change
- ☐ A historically based process
- ☐ Budget components are not easily modified
- ☐ Analyzes only new expenditures
- ☐ Incremental increases over previous budgets (e.g., 2% increase in spending)
- ☐ A top-down approach

Zero-based Budgeting

- ☐ Best for dynamic organizations
- ☐ A needs-based process
- ☐ Items can be added or eliminated as necessary
- ☐ Analyzes old, recurring & new expenditures
- ☐ Starts from zero and requires cost justification for all items
- ☐ A bottom-up approach that calls upon expertise and insight of budget managers

How ZBB can improve your bottom line.

While ZBB has long been utilized in the public sector, more recently private businesses and organizations have begun to adopt the practice because of its potential benefits – including the ability to successfully integrate strategic goals into the budgeting process (an elusive but essential task).⁴

Adopting a ZBB process can have impressive impact.

ZBB provides an opportunity to mitigate risks and support growth through deep cost reduction and the reassessment of both short- and long-term strategies.

Studies show that ZBB in combination with targeted budget-cutting strategies has increased profit for some companies by as much as 60 percent.³

Top 10 Benefits of a ZBB Approach ^{3, 4, 5}

1. Encourages broader collaboration across the organization.
2. Creates a culture of budgeting equality - eliminating entitled or entrenched approaches to budgeting.
3. Increases cost management among employees.
4. Fosters innovation, creative thinking & flexibility.
5. Discourages “use it or lose it” spending mentality.



Top 10 Benefits of a ZBB Approach ^{3, 4, 5}

6. Improves operational efficiency by rigorously challenging assumptions.
7. Supports cost reduction by avoiding automatic budget increases.
8. Encourages saving strategies by identifying priorities at the department or project level.
9. Allows for top-level strategic goals to be implemented into the budgeting process.
10. Results in a well-justified, strategically aligned fiscal plan.

Getting Started: A Culture Shift



Moving from traditional budgeting to ZBB is more than just a shift in business practices – it is also (and maybe more so) a shift in an organization's *budgeting culture*. Making such a shift takes careful planning and coordination – plus buy-in from senior leadership.⁶

Implementing ZBB?

Be prepared⁵ to:

- ☐ Gain top level support from the CEO, president, or board.
- ☐ Carefully review each and every dollar in the budget.
- ☐ Develop deep visibility into your cost drivers, and use that visibility to set aggressive yet credible budget targets.
- ☐ Be as detailed, structured, and interactive as possible.
- ☐ Facilitate meaningful financial discussion among managers and executives.
- ☐ Task multiple owners with managing performance and continuing the healthy debate on cost management throughout the year.
- ☐ Utilize process controls and engagement tools (e.g., incentives, user-friendly software, etc.) to motivate all employees to make cost management a part of their daily routine.

At first this may seem like a lot to tackle, but here's the good news: because ZBB is, at its core, a *structured and repeatable effort*, once the initial plans are set, subsequent budgeting seasons will more easily fall into place.



Planning for Potential Risks

ZBB risks – and how to mitigate them.

Doubts and criticisms of ZBB are common in financial publications, and understandably so – the idea of adopting the antithesis of the “old standard” can be a daunting proposition. Often financial executives are concerned about the true value of “starting from zero” or that ZBB might overwhelm their business and prevent important work from being done.⁵

Realistically, as with the adoption of any new system, ZBB does carry potential risks. But with the right mix of strategies and tools, the benefits of a successful ZBB process are within reach. Here are three top concerns, including tips for avoiding their impact.

Risk #1

Fully committing to ZBB can be a gamble for organizations when the potential effort is high and the potential savings are uncertain.³

Resolution: *The “Staged” or “Hybrid” Approach*

For businesses that are keen on the principals of ZBB – but are leery of going all-in – a staged or hybrid ZBB approach can be an excellent first step. *Many* ZBB principles can be borrowed and applied to *certain* costs within a traditional budgeting framework.

Leveraging *some* of ZBB’s core concepts can force the organization to think about budgeting alternatives without incorporating all of ZBB’s labor-adding exercises.⁷

Risk #2

ZBB is a more time-consuming, complex process than traditional budgeting, as ZBB budgets are rebuilt from scratch annually and require justification for all components.

Resolution: *Leverage Today's Technology*

Look for new technologies that make ZBB less burdensome, such as user-friendly budgeting software designed to facilitate ZBB by guiding financial *and non-financial* users through the allocation and justification process and streamlining data collection and reporting to save time and resources.⁸

Risk #3

Because it requires extensive data collection and more time overall to execute, a ZBB process can be daunting for finance teams that manage numerous cost centers or budget managers, particularly those with budget cycle timing constraints.³



Resolution: A Rolling ZBB

For organization with many budgeting participants, ZBB may work best as a rolling process over several years, with only a few functional areas reviewed at a time by managers or group leadership.⁴

Applied Theory: A Case Study in ZBB

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“Implementation of ZBB in a rotating cycle provides opportunities for all budget managers to dive deep into their finances once every 5 years and maintains a balanced workload for finance and budget managers.”

- Courtney Bonnell
Director, Budgeting and Planning
A.T. Still University

A real-world example of ZBB can be found at A.T. Still University of Health Sciences (ATSU), a non-profit, private graduate school focusing on health sciences and osteopathic medicine, dentistry, and health management.

ATSU has 6 colleges or schools with university support, and 150 departments. *This made the idea of ZBB both intimidating and seemingly unfeasible.*

Courtney Bonnell, Director, Budgeting and Planning at ATSU, explains how they incorporated a hybrid, rolling ZBB model – and made it manageable:

*“At ATSU we use zero-based budgeting to ensure that all of our expenses are justified for each new period to facilitate cost containment and strategic alignment. Because we have 104 budget managers across six colleges, **we do a rotating schedule of zero-based budgeting** with each college taking a turn once every five years.”*

Testing, testing...

Because our budgeting software allows us to do baseline, ZBB, or a mix of the two, we've been able to test a couple of different scenarios:

T1.

For the first iteration, we chose to zero out every line (with the exception of headcount) so that budget managers would be required to build everything from scratch.

Working from a 'true zero' was a useful but *time-intensive* process.

T2.

For subsequent budget cycles, in an effort to save time, we decided to make the baseline budget visible as a reference point – but we required budget managers to build their budget without simply carrying the previous year's numbers forward.

Lessons learned!

We've found this hybrid method is a time-saving modification to a pure ZBB model. Every line or bucket of the budget has to be adjusted using line-item detail so that finance can see how everyone plans to spend money (and in many cases it should be less than the prior year, since one of our goals with ZBB is to eliminate unnecessary “fluff”). Our software's built-in justification feature lowers the potential for simply copying last year's numbers.

Since we rotate ZBB through our university, **we encourage each college to start digging into their baseline numbers a year or so beforehand**, to alleviate the pressure on their ZBB year. There's so much information that if you wait until it's your year to dig in and line item detail every single line of every single department, it's a lot of work.

One of the most challenging aspects of ZBB has been the facilities department. There is always quite a bit of unanticipated repair work, but detailed reporting has been helpful with this. By going back a couple of years to see where the costs were, and then anticipating what might be coming up, finance gets enough information to know the numbers are not simply a placeholder being carried forward from last year's budget.



Benefits – cost savings, accuracy & insight

“As for the benefits, we have seen cost savings, especially in the first year.

Not only have we experienced savings with this implementation, but our budget managers, deans, and administration have learned immensely from this process. Although I do find what tends to happen with ZBB is that *budget managers discover not only savings but also needs.*

As time has gone by, I’ve learned to ask questions like, ‘Should this request be in the regular budget, or should it be categorized as a special initiative?’

And when nine out of ten departments tell me they need more adjunct money, I have to take a closer look.

ZBB requires a deep dive on finance’s part too.”

Next Steps

With thoughtful implementation (and within the right-fit organization), **ZBB can help build a culture of cost management, accountability, and long-term stability.**

So how do you know if ZBB is right for you?

The following checklist can help point you in the right direction.





TO ZBB, OR NOT TO ZBB: THAT IS THE QUESTION

If you answer “yes” to any of these questions, then we think ZBB is definitely worth a closer look.

- ☐ Are you concerned about your organization’s viability, growth, or competitiveness?
- ☐ Are you interested in doing business in the most cost-effective way?
- ☐ Are you struggling to incorporate strategic goals into the budgeting process?
- ☐ Would you like a fresh view of company operations?
- ☐ Do you desire improved communication, accountability, and visibility?
- ☐ Do you want to engage your budget managers in effective budgetary planning?
- ☐ Would you like to build a culture of cost containment and critical thinking?
- ☐ Do you want to minimize waste and rise above a ‘use it or lose it’ mentality?
- ☐ Would you like a more strategic alignment of resources and stop automatic allocation of funding to the same areas regardless of need?
- ☐ Do you want to not only control expenses but identify cost-reduction opportunities?
- ☐ Do you want to increase collaboration and accountability by encouraging stakeholders to work together to analyze operations?



Helping Organizations Achieve Budgeting Success with an Award-Winning Purpose-Built Solution

Whether you prefer traditional baseline budgeting, zero-based budgeting, or something in between – Xlerant, Inc. helps organizations allay the frustrations of Excel-based budgeting.

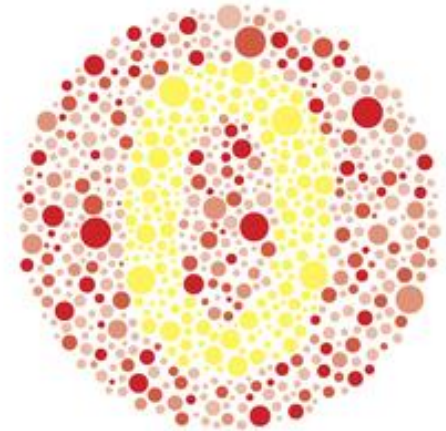
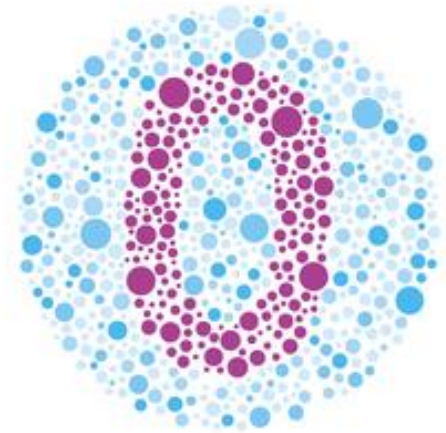
Xlerant's premier product, BudgetPak, is a cloud-based budgeting solution that has received high honors for outstanding ease-of-use, ease of implementation, and customer service.

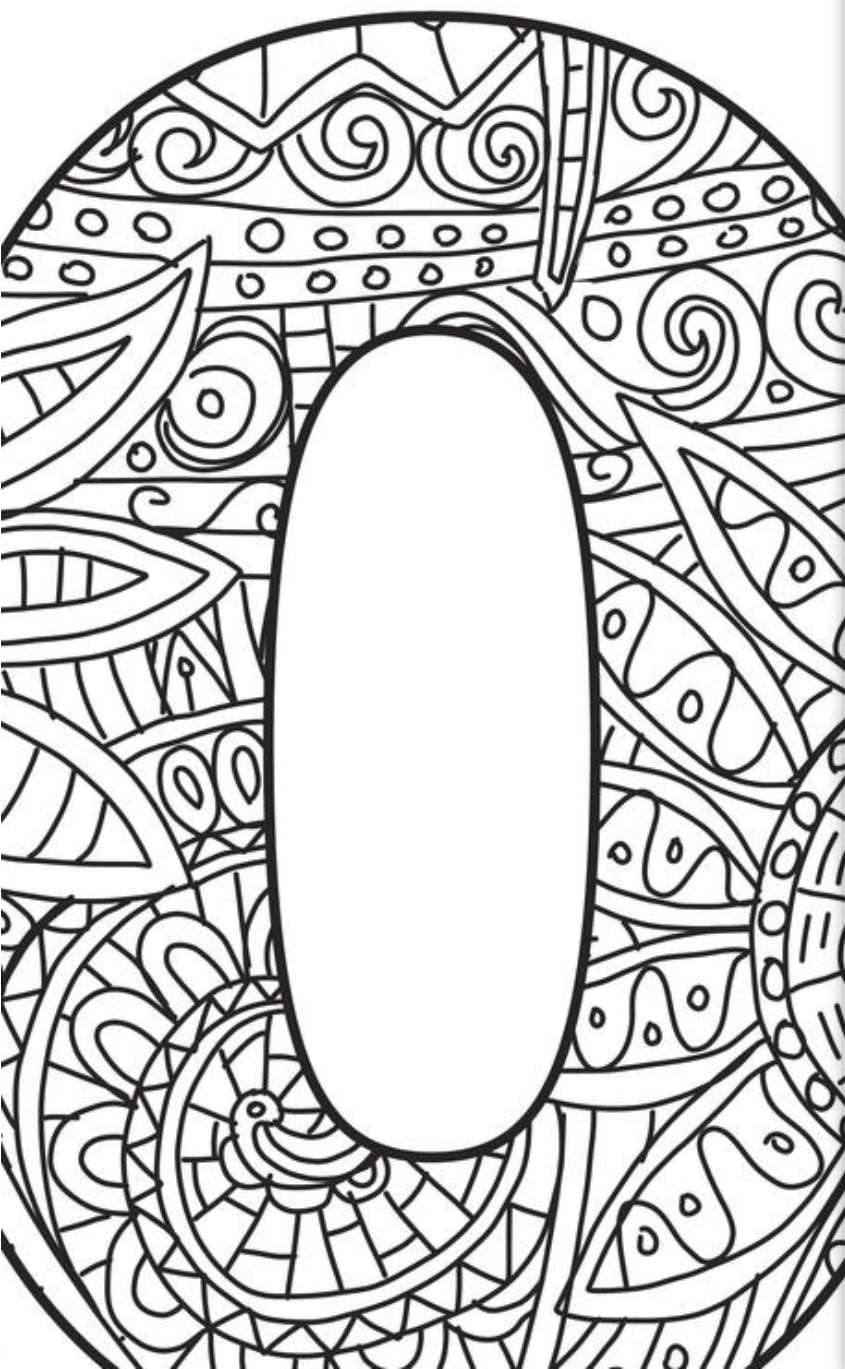
BudgetPak's user-centered design and built-in intelligence pave the way for accountability and transparency by offering the tools for flexible and reliable budgeting, forecasting, and reporting.

This user-friendly solution does more than make the process easier – it provides a platform for communication of the organization's annual objectives and ensures department heads and budgeting managers are building their budgets in line with those objectives.

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Contact us to learn more about how we are helping organizations like yours successfully incorporate zero-based budgeting methodologies.

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