



5 best practices to zero-based budgeting

Introduction

In recent months, leaders at some of the world's largest consumer packaged goods (CPG) companies have spoken publicly about how ZBB is helping them save on overhead costs, which can then be used to reinvest in growth through innovation or bolster their margins. As consumers increasingly have more choices, these companies are finding their margins squeezed, and with direct expenses already trimmed back to the bare minimum, the only place to look is sales, general and administration (SG&A), and other overhead expenses.

Clearly, a traditional budgeting process based on extrapolating last year's spend fails to provide the detailed insight needed to achieve a material change in the cost base, particularly when line item expenses are already high-aggregated. But ZBB can (see side-panel), and that's what's driving its increasing adoption during these volatile economic times. ZBB is becoming the accepted go-to approach for any consumer-facing company struggling to maintain margins at a time when prices are largely capped.

Because of its ability to quickly restructure the costs of new acquisitions, ZBB has always been favored by private equity firms that need a quick turnaround. But it is also gaining adherents with manufacturing, advertising, and hospitality companies. Continuing austerity in government funding has also led to a resurgence of ZBB in the public sector, with 50 percent more U.S. federal government agencies and departments using ZBB or ZBB components now than before the 2008 recession.

ZBB explained

- Budgets are not linked to prior year spend—they are built from the bottom up.
- To fully justify all expenses, managers need to routinely review the most cost-effective way to deliver their activities, programs, and levels of service; keep their resources in step with workload; and eliminate any expense that is not aligned with strategy.
- Costs do not need to be cut to the bone or even across all departments. You can soft pedal and still benefit from building a more cost-conscious culture.
- While the largest savings of up to 25 percent are found in SG&A costs, ZBB can also be applied to operating expenses, marketing costs, and capital expenditure.
- ZBB is not just about cutting costs. By eliminating wasted and unproductive spending, ZBB frees up cash that can be reinvested to fund organic growth or acquisitions. As such, ZBB can be a catalyst for growth.

Best practice approaches to implementing ZBB

Because ZBB is a coordinated enterprise-wide initiative that starts by prioritizing core activities and processes, there is less risk of compromising an individual business function's ability to execute or deliver an agreed level of service. Planning is also central to the ZBB process with all organizational activities—everything from the way orders are fulfilled, to individual marketing campaigns, to IT, and to legal are rigorously reviewed so funding for each activity can be recalibrated. (See Figure 1.)

ZBB is also less likely to have a negative impact on employee morale than successive rounds of across-the-board cost cutting. However, while well-planned internal communication and supporting collaborative technology will bring change in thinking needed before managers embrace this new approach to planning, ZBB does present challenges and must be implemented using today's best practices along with the right planning and modeling technologies available today.

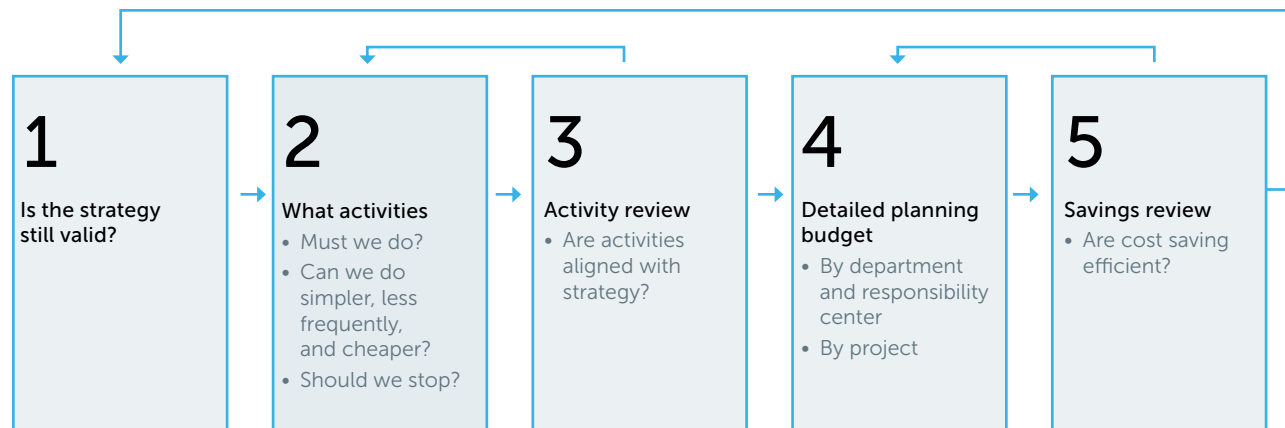


Figure 1: Zero-based planning and budgeting process

BEST PRACTICE 1:

Integrate ZBB with core FP&A processes

ZBB should not be seen as an alternative to current planning and budgeting cycles, but as an auxiliary process carried out every couple of years to refocus spending on strategically important activities and initiatives. Prioritizing activities and building a budget from scratch takes time and is best tackled during a less frenzied period of the year.

Another reason why ZBB only needs to be a periodic process is because the savings identified in subsequent rounds are unlikely to match those identified during the first iteration. It is a process that first brings about a step-change in an organization's cost base, which then has to be sustained through routine forecasting, planning, and analysis (FP&A) processes.

BEST PRACTICE 2:

Focus ZBB initiatives for maximum returns

Many companies limit their ZBB initiatives to SG&A and other areas of overhead, where there are large amounts of indirect costs that are less well understood, allowing them to target specific parts of their organization and gain major benefits for a limited investment without overly disrupting customer-facing business functions. Others choose to limit their use of ZBB to new business initiatives and requests for additional funding while using other methods of budgeting for ongoing activities.

No matter which approach to ZBB is adopted, it is important that it is not seen as a replacement to current FP&A processes, but as an adjunct that can be periodically deployed to realign the cost base with changes in competitive strategy.

Benefits of ZBB

- Typically delivers cost savings between 10 percent and 25 percent.
- Makes managers accountable for their spending and embeds a continuing culture of cost awareness.
- Prevents "sandbagging."
- Removes the risk of compromising service levels that comes with top-down, across-the-board cost cutting.
- Focuses on doing the right things in the most cost effective way, rather than simply doing more with less.

BEST PRACTICE 3:

Unify operational and financial data on a single platform

The success of ZBB depends on managers having both a deep understanding and visibility of the operational drivers of costs. Providing such visibility means having more granular detail of cost (right down to an individual employee, a business trip, or marketing campaign) and easy access to data around activity volumes, productivity, and resource consumption. None of this detail is contained in traditional planning and budgeting systems or even in many of the newer cloud-based solutions, which simply contain financial data that is held at a highly aggregated level. As a result, such systems need to be supplemented with considerable amounts of data from other systems, which is then usually manipulated in a plethora of standalone spreadsheets—increasing both the complexity and workload involved in any ZBB initiative.

A better alternative is to hold all the detailed operational and financial data needed for a ZBB initiative on a single enterprise planning platform, that uses an in-memory calculation engine needed to process such large volumes of highly granular data.

BEST PRACTICE 4:

Make modeling easy

The ability to model the casual relationship between activity volumes and resulting resource and headcount requirements is also critically important since managers need to make informed decisions about how changing activity volumes and different service levels impact costs. Again, if managers cannot easily model these relationships in the planning tool, a ZBB initiative will be swamped by an overabundance of disconnected spreadsheets. For a ZBB project, it is far better to use a planning and budgeting platform that allows managers to build and amend models, and create “what-if” scenarios to assess how differing service levels impact cost—on their own and without the need for specialist skills.

BEST PRACTICE 5:

Re-use ZBB models for routine FP&A processes

When an organization has already developed integrated business planning processes that use operational drivers to determine resource needs, then it already has the foundation for a ZBB model. The next step is to incorporate a dimension for activities.

On the other hand, if an organization uses an incremental approach to planning and budgeting based on the previous year's actuals, the ZBB model will be the first enterprise-wide model of causal relationships that link activities of different business functions. FP&A teams should adapt the model as needed to support the annual budgeting process and rolling reforecasts, which will become more efficient and deliver greater insight. Repurposing models in this way means ZBB is no longer a standalone exercise, but an initial step in transforming enterprise planning and budgeting that could lead to fully integrated business planning.

“The goal was to have cost-center owners planning a level of granularity they’ve never experienced before within 10 weeks—we were training 482 contributors who would plan spend for each cost center across North America.”

Head of Financial IT – Global CPG company

Conclusion

According to global consulting firm Bain's 2015 survey of management tools, just 10 percent of the 13,000 businesses surveyed currently use some aspect of ZBB. Those same companies reported a 75 percent satisfaction rate compared to those that do not use ZBB, which report a satisfaction rate of only 50 percent. This suggests that companies considering implementing a ZBB project are more likely to be satisfied with their planning and budgeting processes.

Using these five best practices and the flexible and easy-to-manage planning platforms available today have reduced the complexity and costs of undertaking a ZBB project. Companies in all sectors can now quickly realize cost savings that can simultaneously protect the margins of today's business while fueling the growth of tomorrow's.

Notes

1. Starting from Scratch; Zero-based budgeting is back in vogue, David M. Katz, CFO.com, October 28, 2015 <http://ww2.cfo.com/budgeting/2015/10/starting-scratch/>
2. Meet the Father of Zero-Based Budgeting, Wall Street Journal, David Kesmolde, 26 March 2105,
3. <http://www.wsj.com/articles/meet-the-father-of-zero-based-budgeting-1427415074>
4. Zero-Based Budgeting- Modern Experiences and Current Perspectives, Kavanagh, Shayne, Government Finance Officers Association, 2011, <http://www.gfoa.org/sites/default/files/GFOAZeroBasedBudgeting.pdf>
5. Ibid
6. Five myths and realities about Zero-based budgeting, Callaghan, Shaun; Hawke, K; Mignerey, C., McKinsey Insight, October 2014. http://www.mckinsey.com/insights/corporate_finance/Five_myths_and_realities_about_zero_based_budgeting?cid=other-eml-alt-mip-mck-oth-1410



About Anaplan

Anaplan is the enterprise planning cloud company. Anaplan brings together an unrivaled planning and modeling engine, collaboration in the cloud, and a simple interface for business users. Anaplan customers can choose from over 120 pre-built planning apps from the Anaplan App Hub or easily build their own apps. Anaplan is a privately held company, headquartered in San Francisco, CA, with global offices on four continents. To learn more, visit anaplan.com. Follow us on twitter: @anaplan



[company/anaplan](https://www.linkedin.com/company/anaplan)



[@anaplan](https://twitter.com/anaplan)



[/anaplan](https://www.facebook.com/anaplan)



[/+AnaplanInc](https://plus.google.com/+AnaplanInc)