CFO
An argyle Company

HURON

ZERO-BASED BUDGETING

Enabled by new technologies, an old idea gains new currency for its ability to reduce costs—and promote growth

Enthusiasm for zero-based budgeting (ZBB) has ebbed and flowed over the four decades since President Jimmy Carter famously tried to use it—without much success—to overhaul federal government spending in the late 1970s. Because it calls for businesses to build their budgets from the ground-up each year rather than simply tinkering with last year's blueprint, it can be a time-consuming and difficult process for some managers. Done poorly, it can even harm the business if budgeters fail to anticipate how paring or completely defunding some activities might impact operations or the customer experience.

> In addition to telling employees why zero-based budgeting has been adopted and what it's intended to accomplish, companies need to devote resources to managing the resulting changes.

Today ZBB is "in," though, thanks in large part to its high-profile application by Brazilian buyout firm 3G Capital, which has won acclaim in the business press for using it to wring costs out of H.J. Heinz and Kraft Foods after merging the food and beverage companies in 2015. Within two years of that merger, the newly combined company, Kraft Heinz, was reported to be posting the highest profit margins in its industry.

Despite its historical emphasis on cost-cutting, ZBB has evolved since Carter's day and is now viewed by its most enthusiastic champions as a strategic management tool with a broad range of objectives. Sure, many companies still want to use it to save money, especially if they're established competitors in mature industries where growth is hard to come by. It is not unusual for a new adherent to trim more than 10 percent from its operating budget within the first quarter following implementing a ZBB program. But today, many companies looking to cut costs also want to use some of those savings to fund innovation and growth. Indeed, at the enterprise mentioned above, more than one-third of the money saved was allocated to new sales initiatives and other customer-facing activities.

At the other end of the maturity spectrum, fast-growing innovators are embracing ZBB to ensure they're directing their capital to areas that can best enable growth. And yes, private equity firms are turning to ZBB to facilitate the process of creating integrated budgets for businesses they've acquired or combined through mergers and acquisitions.

But there's even more to today's ZBB story. In its current iterations, it also is being used to:

- Influence the funding and operation of stratified corporate functions, such as procurement, supply chain, and travel and expense management, that too often go unchallenged by traditional budgeting
- Support decisions that challenge inefficient processes and organizational structures, including siloed operations
- Improve visibility and transparency into costs
- Create an atmosphere of accountability that links costs to business drivers
- Enable executives from across the enterprise to participate more effectively in building an efficient budget that promotes long-term growth and financial sustainability

In fact, a 2017 article by Reuters found that the number of U.S. companies using zero-based budgeting is "surging as they turn their spending habits upside down to boost profits and re-invest in their businesses." Among the major companies cited as having already rolled out programs were food companies Campbell Soup Co., Kellogg Co. and Mondelez International Ltd. Elsewhere, Cheniere Energy Inc., Huntington Bancshares Inc., Baxter International Inc., and Ford Motor Co. were reported to be embracing the concept, too.

Meanwhile, a report recently cited in the Wall Street Journal notes that about 300 large global companies in a broad range of industries are now using ZBB. A survey of those companies found that their use of ZBB in 2017 had increased more than 50 percent from the prior year, and that the companies are saving, on average, more than $250 million in the first year of implementing their programs.

CASE STUDY

Zero-Based Budgeting in a Fortune 100 Consumer Products Company

When a Fortune 100 consumer products company began preparing for a merger a few years ago, it was already using zero-based budgeting. The merger meant that the company's existing enterprise performance management system, along with its cloud-based planning and budgeting system, would have to be updated—quickly—to accommodate a much bigger combined enterprise, one with more than 1,000 users of the budgeting system and more than 100,000 SKUs. For help, the company turned to Huron, a global professional services firm with expertise in zero-based budgeting. Huron helped modify the company's existing technology systems to accommodate an increased workload. It also created custom workflow solutions to manage business and administrative processes, giving the combined entity the ability to see critical information in near real time and make adjustments as needed. It developed capabilities for compensation and workforce planning, and revenue planning, within the cloud-based planning and budgeting system. All this was done on an ambitious schedule—new users within the newly combined company began using the planning, budgeting and forecasting system within two months.

In the year since implementation, the combined entity saw its share price go up; its selling, general and administrative expenses go down; its working capital shrink; and its earnings before interest, taxes, depreciation and amortization accelerate. Behind the scenes, efficiencies and improvements in its ZBB process also were dramatic. Among other things, all business rules were able to be run in the new budgeting system in less than 30 seconds. Automatic price-volume-mix and comparative market analysis calculations were available down to the individual SKU and customer levels. Detailed expense and purpose-of-spend descriptions were readily available, and the new entity also was able to go beyond ZBB to create a full profit-and-loss statement within the cloud-based planning and budgeting system.

How Technology Is Making Zero-Based Budgeting More Accessible

What's driving this new appreciation for, and success with, ZBB? Some of it is technology that makes implementation less challenging, including cloud-based platforms that can make it easier and cheaper to implement, scale and leverage all the benefits that ZBB offers. Meanwhile, new software tools make it easier to drive detailed line-item budget inputs, using templates that mandate bottom-up details and restrict access to prior-year budgets that could be used as a starting point. Flexible new reporting tools facilitate the analysis of cost drivers, while workflow tools speed the review and approval process. Following the initial cost analyses done to create a budget—a process that can accommodate fixed, semi-variable and variable costs—the newest apps can then build cost-drivers into data-input templates, giving managers a head start on subsequent rounds of budgeting. Meanwhile, new analytics tools can be used to more quickly work through multiple business and economic scenarios to further refine budget assumptions and optimize cost-cutting and growth drivers.

The latest crop of budgeting tools also make it easier for companies to connect disparate businesses and functional silos on a common platform, ensure that the data and data analytics capabilities required for enterprise budgeting decisions are complete and accessible, and check for compliance and "fair play" in the budgeting process.

CASE STUDY

Zero-Based Budgeting in a Computer Hardware, Software, and Electronics Company

A few years ago, a U.S.-based computer hardware, software, and electronics company decided to revamp its planning and budgeting process as part of an overall drive to increase visibility into its spending, reduce costs and improve operating efficiencies. The prior year, it had set a five-year goal of reducing its costs for labor, materials, outside services and indirect spend by more than $300 million annually, and to reinvest half of those savings in its business.

Working with assistance from Huron, the company quickly implemented a cloud-based planning and budgeting system that enabled it to begin producing more accurate and timely budgets, with every expenditure justified. Among other things, the new system enabled automatic calculation of price-volume-mix and comparative market analysis metrics down to the individual SKU and customer levels. Users of the system, who for security purposes see only what they are responsible for, have visibility to budgeting information in near realtime and can quickly make adjustments as needed.

Many of the firm's key financial metrics have improved since it overhauled its budgeting process. While not all improvements can be attributed directly to ZBB, the firm's selling and general and administrative expenses fell by more than 10 percent since ZBB was implemented, and the company's income from operations more than tripled.

People and Processes: The Most Critical Success Factors

Technology is necessary, but not sufficient on its own, for ZBB to succeed. In fact, many of the most critical determinants of a program's success turn on people and processes. Successful ZBB initiatives almost always incorporate these key components:

- **A master data strategy.** The old saw "garbage in, garbage out" is as true today as it was when the phrase was coined, reportedly in a 1957 newspaper article about U.S. Army mathematicians working with early computers.

No ZBB effort is likely to succeed where companies haven't scrubbed their data to ensure its accuracy, or developed systems and processes that make that data available on a timely basis to managers and others involved in the budgeting process. In today's data-rich world, it's also important to supplement internal operating and financial data with external data sources, including text, photos and video from social media and third-party data aggregators, that can bring a new richness to cost and growth analyses.

- **Training.** For almost anyone doing it the first time, helping to create a ZBB can be challenging. Companies need to train those who will be engaged in the process on its fundamental tenets, on the technology they will be using, and on strategies for doing their work efficiently and effectively.

- **Executive sponsorship.** "Leadership from the top" may be a cliché, but it remains an imperative anytime an organization tries to implement a major process transformation. If it's not important to the bosses, it's not going to be important to anyone else, either.

- **Business unit buy-in.** Major process transformation efforts also can be doomed when those with front-line responsibilities for the initiative don't buy into it. Companies need to spend time educating the people charged with ZBB about its value to their individual businesses and to the overall enterprise.

- **A communications strategy.** To promote and sustain business-unit buy-in, companies need an ongoing communications strategy that reinforces why their new approach to budgeting is being undertaken and how it will benefit the organization. These communications efforts shouldn't be restricted to senior managers, however, but should also reach out to rank-and-file employees— individuals whose daily activities will almost certainly be touched by the initiative, and whose support will be critical to its success. Companies should seek to create multi-pronged communications programs that reach each segment of their intended audience in a format and with a frequency tailored to that group's distinct needs.

- **Change-management strategy.** ZBB challenges old ways of thinking and old way of doing things. Practices that may have been in place for decades can disappear, approaches to doing business can be radically overhauled. Substantive change on this scale is seldom easy. So, in addition to telling employees why ZBB has been adopted and what it's intended to accomplish, companies need to devote resources to managing the resulting changes. This means assigning people to leadership roles, keeping stakeholders informed about what's happening, continually assessing results, addressing problems and concerns as they crop up, and helping individual employees understand what zero-based budgeting means for them. ZBB isn't just a financial exercise, it's an organizational exercise—and everyone from sales to supply chain to production to human resources has a role to play.

- **Cloud implementation, especially for widely dispersed organizations.** The more far-flung an enterprise is, the more likely it is that some of its locations won't have a fully developed IT infrastructure with all the necessary reliability and security. Different locations also may struggle to ensure they're all working on the same versions of their many software applications. Moving the budgeting process to a cloud environment allows companies to isolate apps on secure servers in stable environments, assure that everyone is working with the same version of those apps, enable the rapid deployment of updates to their budgeting tools, and make it easy for dispersed teams to collaborate and share information in real time—all with the flexibility to scale up quickly as new users or new activities are added to the project. Cloudbased systems also can lower implementation costs.

Conclusion

Many executives being introduced to, or reacquainted with, ZBB today will be surprised to learn that it is no longer a mere cost-cutting tool, but rather a strategic discipline also aimed at supporting growth, building value, and fully leveraging a firm's people, processes and technology. With today's leading budgeting and data analytics tools, companies can realize the cost savings they seek while simultaneously focusing their resources more tightly on the businesses, product lines and activities that drive sales and profits. At its best, ZBB is growth-focused budgeting.

ABOUT HURON

Huron is a global professional services firm committed to achieving sustainable results in partnership with its clients. The company brings depth of expertise in strategy, technology, operations, advisory services and analytics to drive lasting and measurable results in the healthcare, higher education, life sciences and commercial sectors. Through focus, passion and collaboration, Huron provides guidance to support organizations as they contend with the change transforming their industries and businesses.

For more information about Huron's ZBB capabilities, contact **Scott Leshinski** (sleshinski@huronconsultinggroup.com)

HURON

CFO
An argyle. Company

huronconsultinggroup.com