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# ZERO-BASED BUDGETING 2.0

## A FOCUSED APPROACH AND THE USE OF TECHNOLOGY CAN SIMPLIFY THE PROCESS AND YIELD BIG BENEFITS TO LARGE AND SMALLER COMPANIES ALIKE

By Rich Schmitt

Zero-based budgeting (ZBB) received a lot of attention recently, in part because of certain equity sponsors and investors' successful use of the process to dramatically increase profitability in acquired companies. Conventional wisdom is that it works best at larger companies, which have the resources to implement it. We believe it is time for companies of all sizes to challenge conventional wisdom.

> ZBB can negatively impact growth, without proper scoping and decision making.

Huron has successfully led ZBB efforts for a number of its clients, large and small, healthy and distressed. We find that a combination of two factors are key to making ZBB manageable and effective: realistically defining the scope of the effort, and maximizing the use of technology to simplify and facilitate the process.

## Why the Recent Interest in ZBB?

Say the words "zero-based budgeting" in a room of experienced senior executives, and you may get wary, skeptical or even pained looks from the assembled group. The operational, planning and budgeting tool has been around for more than 45 years, and it has gained something of a tarnished reputation during that time.

There are several reasons for ZBB's bad rap.

- It can be a difficult and time-consuming process for managers.
- ZBB builds all expenses from the ground up; this can seem like a significant burden to managers who have successfully managed budgets and resources for many years.
- ZBB can negatively impact growth, without proper scoping and decision making.

In spite of ZBB's doubters, a number of sponsors and investors have used it effectively in taking over companies, generating huge profitability increases. Perhaps the most prominent of the new wave of ZBB proponents is 3G Capital, the private equity firm that has acquired and merged a number of food, beverage and consumer products companies, including Kraft Heinz, Burger King/Tim Hortons, and Anheuser-Busch InBev/SABMiller. Warren Buffett's Berkshire Hathaway joined forces with 3G on some of these transactions. As demonstrated by these companies, a comprehensive ZBB approach can lead to significant value creation.

# What, Exactly, Is ZBB?

The traditional budgeting process is based on prior years' expenses, and it tends to result in momentum-based spending. Zero-based budgeting is an operating, planning and budgeting process that requires each manager to detail and justify the entire budget request.

The discipline involves starting each year's budgeting at zero for all activities rather than revert to prior year actuals. It is designed to enlist participation from managers at all levels of the company, because they are in daily contact with the products and services of the organization and they are the experts in their departmental activities. This process is designed to prioritize those things that drive business success.

The primary strengths and weakness of the ZBB process can be summed up as follows:

### STRENGTHS

- Assists with eliminating unnecessary costs
- Helps to determine the optimal way of performing an activity
- Can be applied to discretionary costs and support activity
- Can be used for those activities where there is no clear relationship between input and output
- Helps curtail activities by creating a questioning attitude
- Helps confront conventional thinking and resource allocations by challenging every line item and assumption

### WEAKNESSES

- Time-consuming and therefore expensive to implement
- May create undue tension amongst managers
- Cutting costs deemed noncore to a company's operations that are in fact core to its customers' experience could harm the brand and decrease value.

For example, one large multinational's ZBB efforts encompassed more than 1,000 budget managers around the globe despite being rolled out in a relatively short four-month window. With that model as context, it is easy to see why many companies tend to shy away from ZBB, because they believe it will require more resources and time than they can dedicate to the process.

# Making ZBB Manageable

Although opinion varies on how many basic steps are necessary to implement ZBB, successful projects include the following three steps:

1. Identification of organizational decision units such as cost centers, functions, activities, etc.
2. Construction of decision packages, the critical information necessary to make judgments on program direction and resource requirements
3. Ranking of decision packages and allocation of resources based upon decreasing benefit or importance to the organization

Focusing on the decision units with the greatest potential to provide meaningful savings through the ZBB process allows leaders to maximize the effectiveness of ZBB efforts while minimizing disruption to the organization. A "ZBB light" approach is especially useful in companies that need to quickly improve their profitability or those that are already initiating restructuring efforts. The initial work can be completed in weeks rather than months.

In these cases, Huron serves a number of roles, including:

- Developing decision packages and training materials.
- Implementing ZBB, including technology improvements and leading the process as necessary.
- Enacting profitability improvement or restructuring activities associated with or identified through the ZBB process.

## Leveraging Technology to Lighten the Load

In addition, Huron enables companies to leverage technology to support a rollout of ZBB. Technology-enabled ZBB enhances the adoption and efficiency of a ZBB project at both large and smaller companies.

Specific ways this approach enhances the process include:

- The ability to drive detailed line item, not account-based, budget inputs.
  - Use of security on budget input templates can mandate bottom-up detail for key cost elements and restrict access to prior year budgets for "seeding" and/or comparative purposes.
  - Provide flexible reporting to allow users to more easily analyze cost drivers at a granular level.
  - Speed budget finalization through workflow-based review and approval processes.

- Enabling driver-based analysis and more robust versioning/scenario analysis to foster adoption of ZBB and ownership of ZBB budget submission.
  - After initial cost analysis, driver relationships minimize offline work by being built into required input templates.
  - Cost drivers are optimized at organizational decision units and then applied to centrally driven global assumptions to quickly develop budget submissions.
  - Version/scenario capabilities allow corporate teams to further analyze potential budget variances by applying indexed cost drivers at operational levels to alternative sets of global assumptions.

- Multiple learning methods that support technology provide training content, documentation, simulations, job aids, etc., to foster understanding of the goals and mechanics of the process.

## Using the Cloud to Enhance ZBB

Cloud-based technologies are an even more efficient way to drive ZBB broadly across large and smaller organizations due to lower cost and rapid deployment to large or dispersed user populations.

- Cloud applications allow rapid deployment and modification to ensure budget inputs reflect the most relevant cost elements. For example, as cost analyses shift focus to new or more relevant drivers, cloud-based systems immediately reflect the latest thinking.
- Scalability of cloud technologies fosters use across the organization.
- Lower implementation costs and central administration of cloud applications allow smaller companies to realize the benefits of adopting a ZBB approach.

## Worth the Effort

ZBB still requires thoughtful and disciplined work to be successful. However, by focusing the scope of the process and using technology to lighten the load, companies can minimize the disruption to their ongoing business workflow while maximizing the benefits to profitability and value creation.

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