Zero-based budgeting: 3 keys to success
Only about half of companies achieve the promise of zero-based budgeting

Zero-based budgeting (ZBB) is a budget model where finance and the business develop the next period’s budget from a zero base, instead of basing it off the previous period’s budget. How effectively a business justifies the need for a cost largely determines whether that cost makes it into the budget. Finance is interested in ZBB because evaluating spend without the limitations of historical assumptions and targets should, in theory, help finance identify cost savings, rightsize head count, and allocate resources more efficiently.

However, many finance teams don’t achieve these expected results when they implement ZBB at their organizations. Almost half of the companies that implemented ZBB did not experience significant decreases in SG&A growth, nor significant margin improvements.

Moreover, the results from those who used ZBB did not differ substantially from those who used traditional budgeting. This data suggests companies were not much better off using ZBB than they would have been with traditional budgeting, in terms of cost-reduction improvements.

A primary reason behind these result shortfalls is few companies actually put a process in place that stays true to ZBB principles. While 34% of companies think they’re doing ZBB, fewer than 20% are actually implementing ZBB. Often, finance believes it’s doing ZBB when it pressure-tests bottoms-up budget proposals with tough questions. However, few actually adopt critical ZBB components, such as taking on ownership at the cost-center level to control costs and maintaining year-round ownership and accountability for spend.
Adopt a zero-based spending approach to maximize value from zero-based budgeting

Companies doing true ZBB and reaping the full benefits go beyond zero-based budgeting; they do zero-based spending. Zero-based spending is a year-round cost optimization exercise that:

- Distributes cost ownership throughout the organization
- Emphasizes maximizing the value of the corporate dollar
- Promotes ongoing strategic resource allocation decisions based on risk and potential upside

The focus on spend optimization outside of the budget prevents cost leakages such as 4Q spending sprees and unplanned emergency spend. Moreover, the ongoing cost accountability helps businesses rightsize costs in areas where suboptimal spending decisions would have typically occurred.

To drive maturity from zero-based budgeting to zero-based spending, organizations must:

- Create shared cost ownership. Move from placing cost ownership solely on the budget owner to sharing cost ownership between budget and “package” owners.
- Make messaging revolve around maximizing value. Don't frame ZBB as a cost-reduction exercise; instead, emphasize ZBB as a way to maximize the value gained from each corporate dollar spent.
- Focus on strategic cost trade-offs. Instead of focusing on detailed line-item spending, provide a framework to enable more strategically aligned spend decision making, both during and after the budgeting cycle.

Zero-based budgeting: 3 keys to success

1. Create shared cost ownership

In many companies, cost accountability rests solely with the budget owners. This becomes problematic in cases where the budget owner has conflicting incentives and priorities. For instance, a budget owner in a revenue generating business unit might overspend on travel to increase customer engagement and pursue new sales opportunities, not recognizing that the traveling costs surpass the revenue realized from face-to-face interactions.

Finance can prevent this overspending by applying an additional layer of cost ownership that cuts across different businesses, as shown in Figure 1. One way to do this is through a package owner. A package owner is somebody who owns overall cost targets for key line items that go across budget owners (for example, travel, legal expenses, consulting engagements, etc.). The package owner should be someone who has a good eye for details, extensive business experience, the ability to challenge senior business leaders, and is willing to go beyond immediate departmental responsibility for the good of the company. Some organizations appoint small workstream teams as package owners, rather than having only one employee per cost package. Regardless, package owners' responsibilities include:

- Monitoring spend in their spend category and approving purchase orders
- Helping stakeholders think strategically about how to optimize their costs
- Updating stakeholders and leadership about the cost package's current and future projected progress
This dual cost ownership helps identify enterprise-wide efficiencies. It also creates a healthy tension that prevents competing priorities (such as revenue generation, employee engagement, internal customer servicing abilities) from overshadowing the importance of continuous cost discipline.

2. Make messaging revolve around maximizing value

If the business is not sufficiently engaged during the ZBB process, then it will not take its spending decisions seriously throughout the year, thus undermining the results from ZBB. Finance often believes the business lacks engagement because the effort-intensive nature of ZBB leads budget owners to see the process as more of a burden than a value-added exercise. However, the messaging around ZBB—rather than its effort-intensive nature—contributes more to the perception that ZBB is a burden; thus, it is ZBB messaging that drives down business engagement.

Typically, ZBB messaging has an overt focus on cost cutting, framing ZBB in a negative light; business leaders seldom engage with ZBB under such circumstances. To increase business engagement, one top-performing company de-emphasized ZBB as a one-time cost-reduction exercise and instead, emphasized ZBB as an ongoing value maximization exercise. It did this by:

- Branding its budgeting approach as Value-Based Budgeting instead of Zero-Based Budgeting.
- Leading budgeting conversations with an emphasis on getting the most value from spend, as opposed to finding the most cost reductions.
- Emphasizing how the budget would help achieve operational goals as opposed to financial goals.
- Highlighting how the budget process would identify more opportunities for the company to fund business innovation, as opposed to highlighting expected cost-reduction gains for the company.

These ZBB framing efforts led businesses to adopt and apply this value maximization mindset to their spend decisions throughout the year. As a result of having continuous cost discipline throughout the year, this company achieved $200 million in cost savings in the first year alone with ZBB.
3. Focus on strategic cost trade-offs

During ZBB, finance teams often spend too much time and effort debating granular line item spending such as:

- Low-cost line items or projects (for example, a $75,000 project in an $8 billion company)
- Marginal spend reductions such as hiring two analysts instead of three
- Nonstrategic cost categories such as office supplies or subscriptions

While these costs should not be entirely ignored, spending too much time on this detailed, line-by-line approach to picking off low-hanging fruit is unproductive and time-intensive. It misses opportunities to address bigger, more impactful costs as well as opportunities to teach the business how to think about spend trade-offs more strategically.

Moreover, this small, line-item spending can easily creep back into budgeted costs over the year. For instance, no one will notice a business unit buying more office supplies than they agreed to.

Nor will HR make a fuss about a business hiring one extra analyst, and if they do, the business will probably be able to present a strong business case that would be hard to reject.

Progressive organizations recognize this and therefore, look for ways to optimize costs more strategically. One company did this by having business units submit a heat map of areas in their businesses where they could improve efficiencies the most (see Figure 2). The heat maps require business budget owners to evaluate cost savings and risk trade-offs for potential cost-efficiency ideas and evaluate these ideas against each other.

Using the heat map framework to evaluate cost-saving ideas — instead of going line by line though all budget items — allows finance and the business to elevate budget discussions to focus on more strategic, higher-impact trade-offs. Instead of finance just pointing out areas where it thinks the business can cut costs and the business justifying why it can't, conversations are more along the lines of how to improve the efficiency of a process while accruing the lowest amount of risk, what risks the company is willing to take, how spend reductions in one area can impact other business areas, etc.

**Figure 2: Cost-Efficiency Improvements Heat Map**

<table>
<thead>
<tr>
<th>Project Line Items</th>
<th>Efficiency Savings Descriptions</th>
<th>Value of Savings ($)</th>
<th>Corporate Risk Matrix Categories</th>
<th>Evaluation of Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Plumber Claims</strong></td>
<td>Improving claim analysis, resulting in reduced payouts</td>
<td>$50K</td>
<td><strong>Financial</strong></td>
<td>Reduced analysis doesn’t necessarily give us proportionate increase in avoided claims.</td>
</tr>
<tr>
<td><strong>IT Project Consultant Specialists</strong></td>
<td>Technology upgrade, resulting in reduced need for specialists</td>
<td>$65K</td>
<td><strong>Financial, Regulatory</strong></td>
<td>Haven’t fully leveraged technology yet. The specialists still offer expertise that technology can’t help us with.</td>
</tr>
<tr>
<td><strong>Volume Reduction of Sampling and Analysis</strong></td>
<td>Reduction of sampling and testing for chemicals in drinking water</td>
<td>$120K</td>
<td><strong>Financial, Environment, Reputational, Regulatory, Safety</strong></td>
<td>Reduction of sampling is subject to board approval. Our licensing might be at risk and there are potential public safety concerns.</td>
</tr>
</tbody>
</table>

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Conclusion

ZBB can lead to great opportunities for companies to identify inefficiencies and waste, streamline processes and rightsize head count. However, finance teams often realize unimpressive cost savings when they actually implement ZBB, leading finance teams to abandon their ZBB efforts. Companies typically fail to deliver impressive cost savings because they’re just thinking about ZBB within the context of budgeting and not within the context of budgeting and ongoing spending across the year. As a result, budgeted cost savings are undermined by a lack of accountability for ongoing spending.

To effectively move from zero-based budgeting to zero-based spending, finance must:

- Increase ongoing spend accountability by creating shared cost ownership between budget and package owners.
- Help the business think about spending more strategically on an ongoing basis by focusing on higher-impact budget trade-offs instead of granular budget line items.
- Increase business engagement by emphasizing ZBB as a value-adding — not cost-reducing — exercise.

About this research

This research draws from a series of over two dozen interviews with finance leaders from Gartner’s Finance Practice. Additional insights and quantitative evidence was gathered from a survey of over 35 CFOs and heads of FP&A, as well as previous research studies.
Our priority? Helping you achieve yours.

Good governance around long-range financial planning and annual budgeting processes provides organizations a clear path to strategy execution. By instilling flexibility into what is traditionally calendar-centric and maintaining stronger alignment between resource allocation and strategic objectives outside the traditional planning cycle, finance teams can help their organizations pivot quickly when risks or opportunities arise.

But before you run to implement zero-based budgeting at your organization, baseline your understanding and expectations when it comes to zero-based budgeting usage, context, organizational impact, process and strategy.

This will ensure that you’re positioned for success, no matter if the goal of zero-based budgeting is to improve resource allocation, business partnership or corporate culture.

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