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Building the zero-based culture

There's a soft side to zero-basing. Businesses that want zero-basing's changes to last ignore it at their peril.

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In sectors from aerospace to telecoms, hundreds of organizations say they're adopting zero-based budgeting (ZBB). Many will likely see the significant cost reductions that ZBB promises. Some will also see ZBB boost growth, particularly if they start using the same zero-based principles to guide reinvestment.

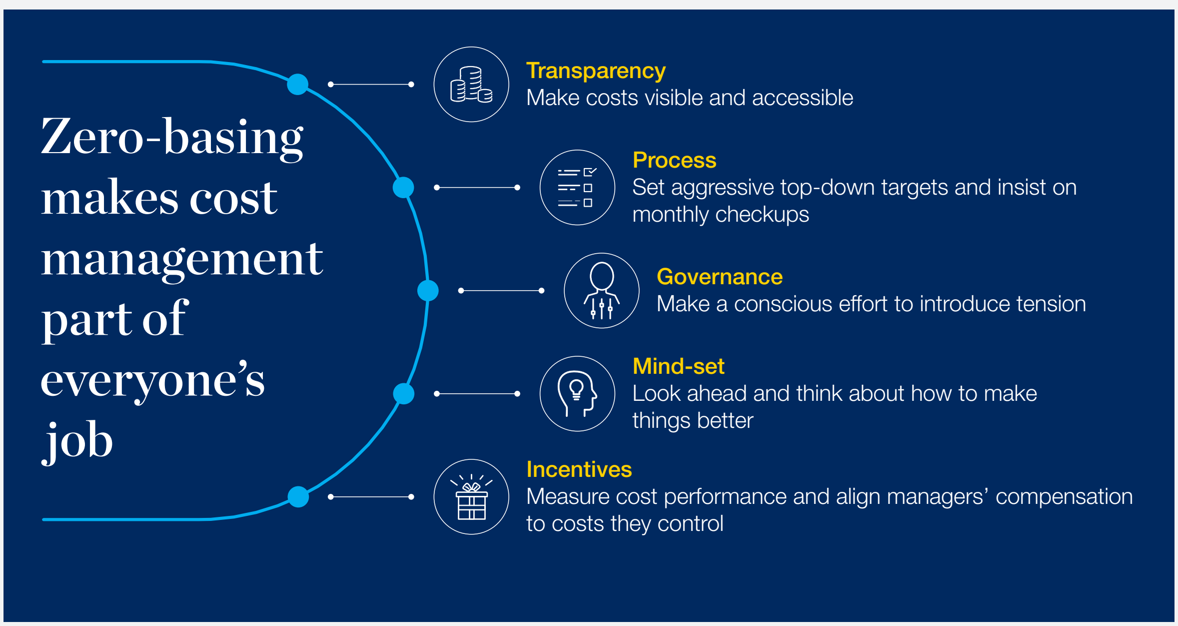
But a few will achieve much more. At these organizations, ZBB evolves into zero-based productivity (ZBP), a performance-improvement dynamo that transforms the entire enterprise—achieving the ideal of fact-based, data-driven decisions that boost sales, reduce waste, and accelerate improvement year after year.

This type of long-term success is possible only if zero-basing truly becomes part of the way everyone works (Exhibit 1). In our work with organizations on zero-basing, the clear difference among the leaders is that they focus not only zero-basing's fundamental transparency and processes, but also on the governance, mind-sets, and incentives that strengthen zero-based behavior over time.

From our years of change management experience, we have found that for change to stick, organizations need to do four things consistently: (1) role modeling, (2) fostering understanding and conviction, (3) reinforcing with formal mechanisms, and (4) developing talent. That's as true with zero-basing as with any other real transformation.

With the four in place, ZBP becomes a much more significant source of competitive advantage. It's not just zero-basing indirect costs; it's zero-basing an entire company, from revenue to profit to cash. These sorts of efforts have allowed one European conglomerate to achieve more than €1 billion in savings, and a basic-materials company was able to reduce its cost base by 20 percent while still driving growth in future technologies and core markets.

Exhibit 1



Making zero-basing a way of life

When an organization first commits to zero-basing, its focus is naturally on overcoming initial hurdles. Many of them are technical: creating new links between previously isolated financial-data systems, or integrating thousands of spreadsheets into a single budgeting platform.

There's no question that this "hard" side of zero-basing is essential, and it takes a lot of work to get right. But there's also no question that it's insufficient, particularly as time passes. With hardware, time is a help: Once an IT system is implemented, it stays implemented (especially if the old system is retired). The "soft" side—the culture—is different. If people haven't been fully convinced to change, or given the time and practice that new behaviors need in order to feel natural, they'll revert to their earlier patterns and adapt the shiny new IT to inefficient old habits.[1]

What organizations must plan for is that the core of zero-basing's culture is hard for many people to crack. The idea of being completely open about budgets is unsettling for people used to protecting themselves by hiding funds in budget lines no one examines. Revealing those habits, and then committing to aggressive cost and value targets, can seem frightening at first.

We have found that if fears such as these aren't successfully addressed from very early on, zero-basing's gains are much less likely to endure. Instead of the lifestyle changes that come from a well-designed fitness plan, the organization gets a crash diet, followed by a rebound that may leave it in worse shape than when it began.

Instead, the goal must be to build a zero-based perspective into the way everyone gets their work done. That way people stop seeing zero-basing as an extra burden, something additional they need to do. Instead, it's just part of how they do what they do every day. And to get to that point, zero-basing must become a routine: one that's demonstrated from the top, communicated constantly, reinforced by genuine accountability, and supported by new capabilities.

Zero-basing's heroes: leaders as role models

The changes zero-based thinking involves make it hard to overstate the importance of having senior leaders act as role models. Any sense that leaders aren't making the same sacrifices that they're asking of everyone else can doom the undertaking from the start by creating a two-class corporate culture. But a well-known manufacturing company illustrates how a seemingly small step, establishing a cadence of regular meetings led by the CFO, becomes an essential glue to help the zero-based culture stick.

To the casual observer, the meetings appear to be nothing more than ordinary management updates, where function heads brief the CFO on progress against zero-based targets. But closer inspection reveals the full range of messages that are all being conveyed at once.

Show how much ZBP matters. The first and most basic is ZBP's importance. In most organizations, function- and business-unit heads rarely (if ever) meet the CFO. Reprioritizing calendars so that the CFO can individually check in with every one of these leaders every month is a major change, both symbolically and substantively.

Foster collaboration. The second, and more subtle, message centers on the intersection among accountability, trust, and cooperation. To prepare, the function heads must understand not only what their costs are, but why, identifying the specific factors that pushed spending higher or lower than planned. With the data in hand, the CFO can provide higher-quality feedback to the function head: finding peers who have resolved similar cost blowouts, or suggesting partners for promising investments needing extra funding. Function heads therefore come to view the CFO as a coach, and their colleagues more as teammates than as competitors.

Show how it's done. This type of experience builds confidence in the process, leading to the third (and arguably the most significant) message: how to conduct these conversations at every level of the organization. In order to engage productively with the CFO, each leader will need to hold similar discussions with their direct reports, with the CFO meeting as template. The whole cycle of meetings thus shines new light into the deepest recesses of the organization.

Constant communication

Helping people understand why new behavior is important is essential in any transformation, particularly when the change involves giving up things that people may have become used to. Just as a great new product may see its sales collapse without sustained advertising, a great new way of working may collapse without sustained communications.

Early-stage messaging centers on what zero-basing is, and why the company is undertaking it—often highlighting situations where waste is obvious. The European conglomerate started with easy-to-understand examples, such as comparisons between how much money was spent on catering for internal meetings with how much food was thrown away.

Once people start zero-basing in their own work, the message must evolve from "what" and "why" to "how." The conglomerate's later messages therefore contrasted total spend when marketing is fragmented among different agencies, against the savings generated by consolidating into a single account—an example that applies by analogy to wide range of procurement decisions. As part of this evolution, zero-basing gradually shifts from being the main focus of a few, high-visibility campaigns to playing a supporting role across much of what the company communicates. A North American retailer built zero-basing into every internal discussion of performance, from small working cells up to monthly enterprise-wide meetings where the CFO and business-unit leaders reported on their use of zero-based productivity to meet their targets.

As initial excitement fades, communications if anything becomes even more important. Once people have already seen major cost savings, they may need to see a different type of impact, such as the potential for zero-basing to drive new investment. A natural-resources company therefore emphasized how its decision to rebuild its production equipment resulted from zero-basing. The new machines would combine two production steps into one, reducing processing time by half and costs by more than 10 percent. Starting from a blank slate led to investment that paid for itself in less than two years, raising overall profitability.

Reinforce performance expectations

As important as routines and communications are in buttressing zero-based practices, the most advanced organizations give an additional boost in the place employees often notice first: their wallets. Longstanding research confirms that the combination of new performance targets with individual incentives makes transformation programs more than four times as likely to succeed as those that are missing those two elements. In addition to helping the behaviors take root, the incentives also make it easier for the organization to retain high-performing people. But the design of incentives requires careful attention to minimize unintended consequences.

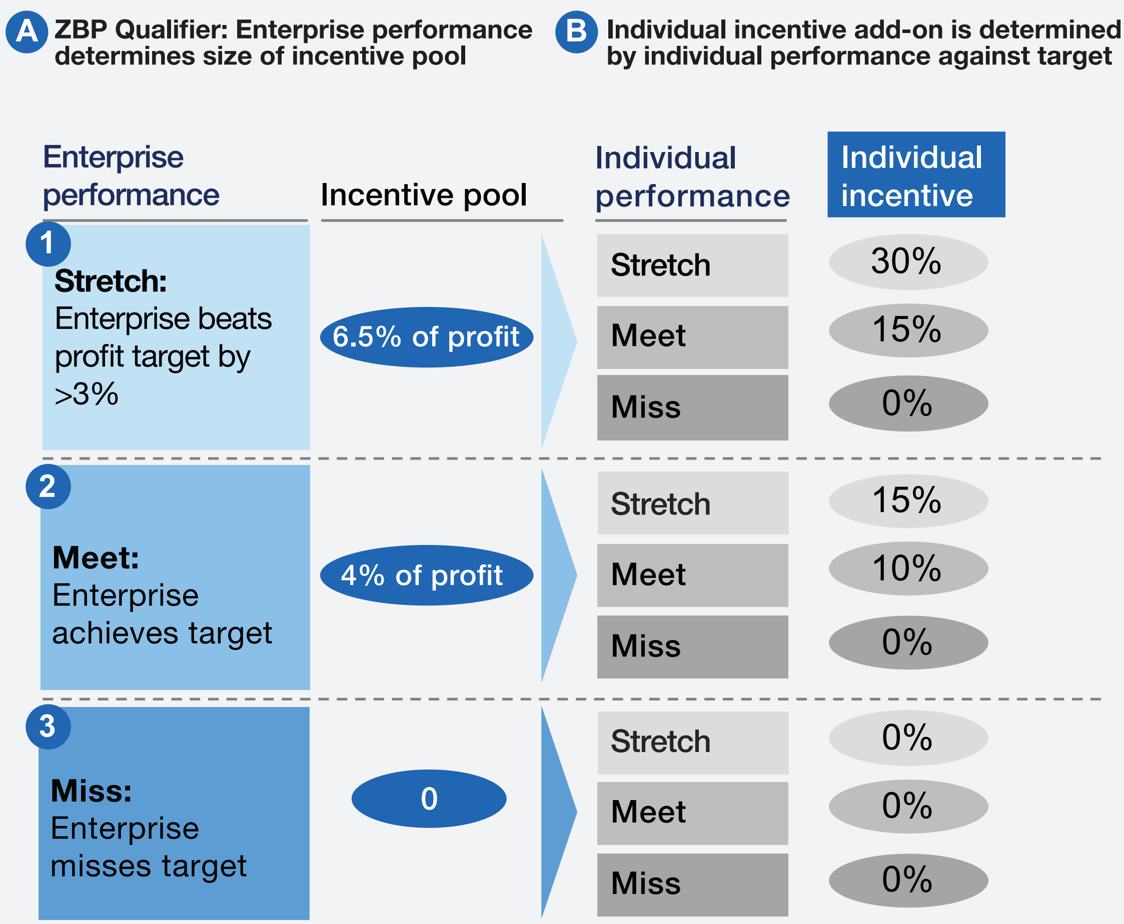
Set an initial target for the enterprise … One company in the transportation sector found the right formula through a mix of bonuses keyed to specific thresholds at the enterprise and individual levels. The first threshold, or "ZBP qualifier," is a profitability target for the whole company: if the qualifier isn't met, then no one gets a bonus. The target should be set high enough to encourage people to stick to the new behaviors and practices they have learned, and find new improvement opportunities as well.

… and a stretch target, with a multiplier for individuals … To encourage people to find really big performance improvements, an additional level is set. The "ZBP stretch qualifier" is set significantly higher than the qualifier; if the company meets it, the bonus pool increases by 60 percent. Once the qualifier is met, then individual performance matters, through a multiplier that's based on the individual's results. With the stretch qualifier, the highest performers can be awarded more than 25 percent of their base compensation as a bonus (Exhibit 2).

… and are tough enough at senior levels to spur growth. Crucially, for much of the senior leadership (particularly at the very top of the organization), stretch earnings targets should be more aggressive than can be achieved through

Exhibit 2

Incentives should be determined by both company and individual performance.



cost controls alone. The idea is to encourage smart reinvestment of savings to gradually boost growth. Alternatively, separate cost and revenue targets can achieve the same goal, particularly in functions such as marketing or product development that have traditionally focused narrowly on just cost or revenue rather than both.

The program's specifics will naturally vary depending on the situation and will need to evolve. A business at the earliest stages of zero-basing may be still be addressing data-quality issues, so its targets may need to be more flexible. But one that's in financial crisis might be more rigid and make its outperformance incentives much higher, so that people try as many ideas as possible as quickly as possible.

Moreover, financial incentives are themselves only part of the equation. For many employees, opportunities for career advancement are even more important than compensation. At the transport company, managers who excel in their zero-based performance see accelerated eligibility for advancement, either within a business or by joining the central ZBP team.

Building human capabilities

To make these career pathways achievable, people will need access to good training on ZBP concepts throughout their careers. For example, the European conglomerate developed a comprehensive set of detailed developmental programs, not only for the central ZBP team but also at the local level and for functional experts in fields such as finance and logistics. As the process was rolled out, and as more and more people were exposed both to the ZBP methodology and the philosophy behind it, the trainings became more formalized and more methodical. After a year, the HR department collected the classroom and practical training into a formal Zero-Basing Academy, whose coursework culminated company-backed certificate of ZBP expertise.

Increasingly, companies incorporate explicit requirements for zero-based experience and certification into talent-management planning. To be eligible for promotion, candidates must demonstrate how they have used zero-based methodologies in achieving their results. These criteria help ensure that managers are promoted more on skill than on just having a lucky year in a growing business.

Building for the future

When the four elements work together to create a zero-based culture, the performance gains that zero-basing achieves keep compounding year after year. Early zero-basing adopters have already seen almost a decade of competitive advantage over their peers. That's important not only because of the simple financial impact, but also because these organizations are better-positioned to take advantage of rapid technological advances in almost every sector. That's the ultimate result of zero-basing: an organization that's not just leaner, but better. ■

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[1] Phillippa Lally, Cornelia H. M. van Jaarsveld, Henry W. W. Potts, and Jane Wardle, "How are habits formed: Modelling habit formation in the real world," European Journal of Social Psychology, 2009, https://onlinelibrary.wiley.com/doi/abs/10.1002/ejsp.674.

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