McKinsey&Company

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Five new truths about zero-based budgeting

Operations August 2017

Five new myths and realities illustrate how the potential of zero-based budgeting has grown.

What could zero do for you?

In "Five myths (and realities) about zero-based budgeting," we described just how powerful zero could be in an environment where, every year, budgets start from zero rather than an increase or decrease compared to the previous year. More recently, "Zero-based budgeting then and now: Technology remakes the ZBB rules" showcased some of the breakthroughs that are making zero-based budgeting (ZBB) more practical and potent than ever. Yet even as more and more organizations commit to ZBB, doubts persist.

There's justification for a degree of skepticism. At some organizations, executives claim they are "doing ZBB," but the financial rewards have been much less impressive than the headlines promise, with margins rising by little more than what traditional cost-cutting methods would achieve. In other situations, tales of underinvestment in growth or overinvestment in elaborate spending rules have caused management teams to pause.

We continue to believe that this robust methodology—formed upon simple tenets of visibility, accountability, challenge, and resource reallocation—can unlock tremendous shareholder value well beyond the consumer sector. And it's more achievable than many executives may think. But we now see that five new myths have emerged that can keep organizations from even getting started.

The good news is that the realities we have encountered in our work with a wide range of organizations confirm what ZBB can achieve. They also show what ZBB is really all about, what changes it requires, what actions are necessary for successful implementation, and how organizations can adapt ZBB to achieve the results they need.

Myth one: If it doesn't upend the whole company from top to bottom, it isn't ZBB.
Reality: ZBB programs can vary significantly, both in scope and intensity.
The cases we have seen confirm our belief that the greatest impact results when the aspirations are high and the approach is thorough, with sustained top-down leadership and bottom-up

organizational commitment. But within those broad outlines, the ZBB methodology allows for a range of choices.

Among them are the degree and pace of savings to be attained—targets that are best determined at the CEO level to fit the company's overall strategy and financial objectives. Additionally, companies must make decisions about how to roll out and govern ZBB, such as whether to address the entire company at once or to start with individual functions, businesses, or regions.

Some choices, however, can undermine the cultural change that is essential to ZBB's long-term effectiveness. A few organizations have tried to omit the granular, bottom-up budgeting and resource-reallocation decisions that ZBB calls for. Those tasks are essential to reinforce ZBB as a mind-set, and not including them in the process risks leaving the organization with just another cost-cutting project whose effects fade within a year or two.

Myth two: ZBB is just a more aggressive version of the same old productivity initiatives.
Reality: ZBB is fundamentally different from typical cost cutting because it switches the "burden of proof" for spending.
Standard cost-cutting programs typically start with a directive to reduce the previous year's spending levels. As a result, executives naturally focus on the largest expense categories—the tallest trees in the forest. ZBB instead asks everyone to rebuild their budgets from the bottom up, with no carryover from the preceding year. This process identifies many small pockets of waste that add up to big savings. It also yields a better fit with the business's priorities by tapping broader management understanding of choices and trade-offs.

Moreover, ZBB shifts the burden of proof from those tasked with driving cost reductions (such as a finance team or productivity-program-management office) to the business leaders and frontline organizations, which must contribute to both identifying unproductive costs and eliminating them in practice. Instead of debating targets until they disappear, ZBB shifts the organization's focus to asking, "What would it take to hit the target?"

Myth three: ZBB is only about cost cutting.
Reality: ZBB gives managers an entirely new way to understand their business, with better cost management resulting from better performance management.
Cost is the variable that managers have the most control over. Yet most managers' incentives are largely based on sales and profit, with the assumption that cost, which lies in between, will take care of itself. For ZBB to be sustainable, performance standards for managers must include cost-based metrics. One consumer-packaged-goods company, for example, supported its ZBB implementation by incorporating obsolescence costs into its innovation teams' performance scorecards. With that metric in place, managers not only would be credited for increased sales from new products but also would be accountable for the downstream effects of poor product launches.

Accountability and performance management get further reinforcement from ZBB's revamp of everyday operations and decision making. Think of how companies justify IT projects by estimating how the new technology will help particular businesses or functions. A supply-chain executive might champion an automated warehouse-management system in order to raise productivity and reduce distribution costs. But today, those anticipated cost reductions are rarely translated into budgets; leaders typically just hope the financial benefits will come through. ZBB flips that process on its head: it embeds the target in the approved funding plan for the project, thus creating real accountability for managers to deliver expected results.

Myth four: ZBB hasn't changed much since it first emerged.
Reality: The ZBB methodology has been evolving for half a century, with digital innovation making it more sustainable—and easier to start.
New technologies are making ZBB less burdensome. In place of central teams coordinating thousands of spreadsheets, new digital solutions manage enormous quantities of data almost instantaneously. This not only reduces the need for cumbersome data-gathering exercises but also enables organizations to bring ZBB to scale much faster. The level of detail is far greater as well, revealing that, say, an HR organization is doing 450 relocations per year at an average cost of €65,000, with a range of €10,000 to €300,000—a much more useful insight than a simple total indicating that relocations cost €20 million per year.

Myth five: Reinvested savings won't show up on the bottom line.
Reality: Reinvestment is designed to drive growth—profitable growth.
ZBB is more than a race to zero—it's a way to put the right money behind the right projects, spending more where the returns promise to be greater. If a company reinvests €1 million in an area of profitable growth, the CFO should see that show up as an improvement in earnings before interest, taxes, depreciation, and amortization of more than €1 million. Whether to drop savings to the bottom line or reinvest in growth should depend on the company's situation and is a broader strategic consideration. When the decision is to reinvest, ZBB's granular visibility and performance-management model guide reinvestment allocations across functions and business units to the most productive areas. Leaders throughout the organization can see the results. In this way, ZBB helps companies overcome the difficulty of managing aggregated revenue inflows and cost outflows, and it increases the likelihood of profitable growth.

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When done well, zero-based budgeting can drive significant, sustainable savings and is a machine for efficient resource reallocation. But getting it right requires leadership stamina to see through initial resistance. World-class ZBB programs build a culture of cost management through unprecedented cost visibility, a unique governance model, accountability at all levels of the organization, aligned incentives, and a rigorous and routine process. When these elements are in place, ZBB lets organizations free up unproductive costs and redirect those resources toward profitable growth. □

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The authors wish to thank Matthew Maloney for his contributions to this article.