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Zero-based budgeting then and now: Technology remakes the ZBB rules

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Zero-based budgeting then and now: Technology remakes the ZBB rules

Traditional zero-based budgeting is as demanding as it is effective. New digital technologies make implementing it much less taxing.

While the concept goes back half a century, zero-based budgeting (ZBB) has clearly found its time thanks to a handful of high-profile companies—particularly in consumer sectors—that have successfully achieved billions of dollars in lasting cost reductions. Yet despite these examples, many leaders remain daunted by the misconceptions that we detailed and debunked in our article "Five myths (and realities) about zero-based budgeting"—especially the fear that ZBB is so difficult and all-consuming that it keeps a business from doing anything else.

Companies therefore avoid taking the first step toward ZBB. And, hoping to limit complexity, even those that do embark on a ZBB journey too often resort to shortcuts or scope containment. What they really end up limiting is ZBB's results. A one-off effort will at best yield a one-off improvement—and it may not even achieve that.

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But, as in most other areas of business, digital disruption is tearing down walls. For ZBB, digital solutions are making it easier and faster to improve the budgeting process. Today, companies are already using digital tools to build speed, scale, and sustainability throughout the ZBB process: pursuing the long tail of untapped savings opportunities, establishing a replicable and adaptable way to manage cost, and creating a new cost-conscious culture with distributed accountability.

That's making ZBB easier to adopt and—even more important—to support over time as simply the way the business operates. With the efficiency boost from new technologies, companies that adopt ZBB typically achieve sustainable savings in fixed and semifixed costs of 10 to 25 percent, often within 12 months (see sidebar, "Four pillars of zero-based-budgeting success"). The result is not just cost reduction but also new resources available for reinvestment in top-line growth, margin expansion, or a mix of both.

Three sources of opportunity technology brings to ZBB

Technology amplifies ZBB's impact in three ways at once, operating over both the short and long term.

Finding 'traditional' savings more efficiently and effectively. Historically, even in well-defined and fairly limited cost categories, such as travel or human resources, applying ZBB meant developing detailed templates and collating hundreds of spreadsheets. By contrast, today's integrated planning platforms allow planners to make complex trade-offs balancing policy considerations preferring, say, nonrefundable tickets with variables such as fares, average lodging costs, time of year, country, and seniority of the traveler. Instant financial and key-performance-indicator (KPI) aggregations, currency conversions, and the like provide a fast track to meaningful budget negotiations.

Budget preparers can now focus on understanding business requirements, such as what trips are needed and why, and thinking through trade-offs. Depending on whether these categories have been targeted previously,

Four pillars of zero-based-budgeting success

The leading cases show that technology is just one of the four essential elements of successful zero-based budgeting (ZBB):

- **Targets.** Knowing what could or should be achieved through ZBB—a North Star for the budgeting process—is essential to creating the stretch aspirations and, ultimately, the results an organization needs. Targets can be based on industry benchmarking coupled with internal qualitative and quantitative benchmarking.

- **Organizational alignment.** Establish a dual cost-ownership structure (P&L and cost-type owners) for each spending area and build the right incentive models.

- **Ongoing accountability.** Tracking spending should involve more than a financial report. Business owners need to be held accountable for cost-driving activities, with systematic tracking of actions and decisions to manage against plans.

- **Technology.** New or old, technology is only a tool. It cannot replace the other success factors—instead, it can free up leaders' time and attention for addressing them.

companies typically see as much as 30 to 50 percent savings the first year—and these savings are sustainable because they are based on new business policies rather than short-term spending freezes.

Taking the long view, now. In areas such as maintenance, logistics, freight, and certain IT costs, category savings are often difficult to realize immediately because of long-term contractual commitments or the lead time required to make the change. The lack of immediate value realization typically pushes these cost categories out of scope when companies try to manage a laborious, spreadsheet-based traditional ZBB effort.

Technology makes it easier to take these efforts on, enhancing transparency and enabling decisions today that may not produce savings until sometime in the future. While these categories typically see only 0 to 10 percent savings in the first year, meatier savings of 20 to 40 percent become much more likely in years two and three (Exhibit 1).

Pursuing the long tail of smaller opportunities. Because of technology's scale and efficiency, cost categories that previously were too small to be worth pursuing with ZBB are now ripe targets. One company's ZBB scope included more than 75 cost categories, over half of which offered less than 10 percent savings individually. But together, they yielded more than $50 million in sustainable savings.

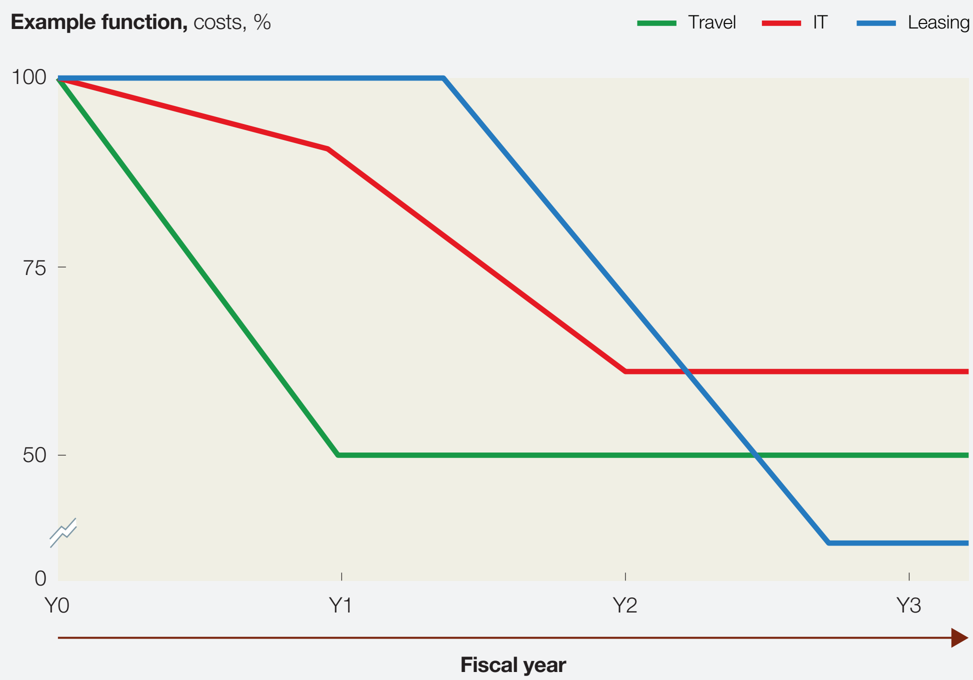
Integrated, insightful, and iterative

A successful ZBB process should yield an aligned plan, not just a number. And new planning platforms allow more integrated, insightful, and iterative planning processes than are possible through the traditional spreadsheet-based approach.

Integrated means efficient—perhaps even more efficient than your current budgeting processes. Centralizing rates, variables, and

Exhibit 1

Zero-based budgeting yields early wins—and later ones, too.



Source: McKinsey analysis

assumptions allows budget preparers to focus more on the business outcomes they want to achieve from their consumption plans rather than just the financial numbers they need to meet. Instead of arguing that because hotel rates are rising the travel budget should increase by 10 percent, the tool calculates what it should cost to achieve the business goal of ten sales trips to particular cities. The budget discussion then centers more on whether ten is the right number of trips and less on which hotel chain to use. Operating on a single platform also avoids the need for tedious and error-prone aggregation of numerous spreadsheets, which usually accounts for about 80 percent of the time staff spends on manipulating data.

Insightful means making better business decisions through focused discussion. Traditional budgeting processes are often drawn out by multiple rounds of politicized negotiations over targets such as how much to spend on internal events. When tech enabled, the details underlying the headline numbers become a dashboard showing not only total spending but also the number of events, their type, their cost per attendee, and so forth.

The details help inform better decisions focused on the value the meetings are generating. Rather than blindly cutting the most expensive events or imposing strict per-head limits, the company might find that some events are too critical to employee engagement to be changed, while others could be kept at lower cost and still others canceled entirely. Full transparency on the factors underlying cost can also inspire creative and effective cost-saving measures; for example, a professional-services company reduced travel costs dramatically by noting high spending on travel between its largest offices and installing videoconference units at those locations.

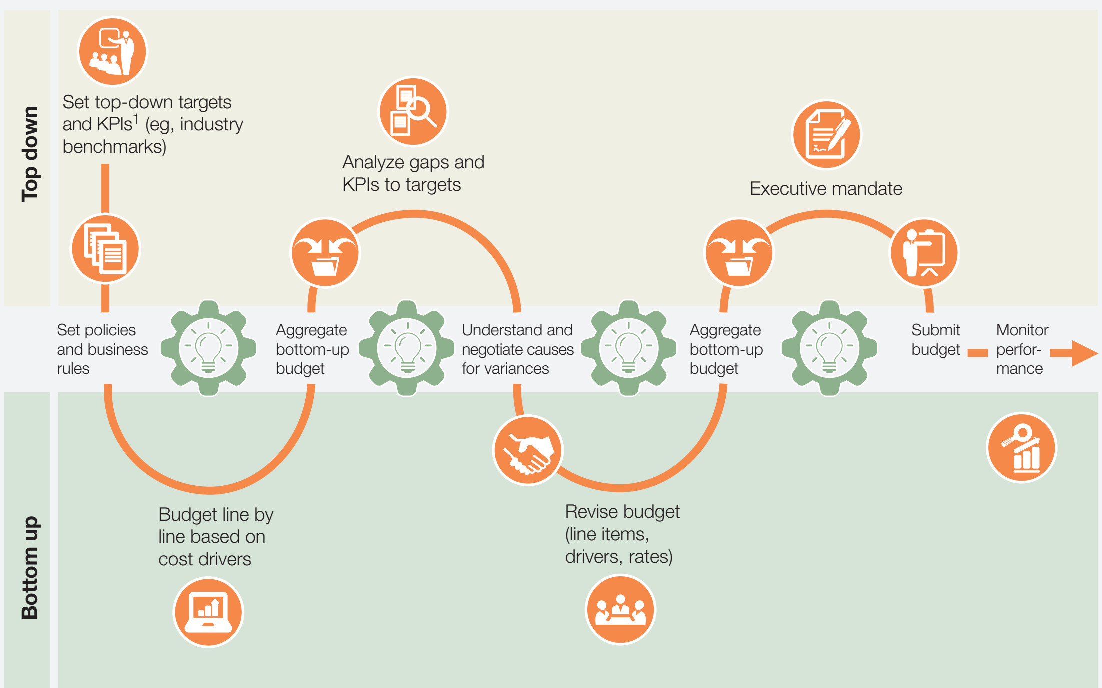
Iterative means everyone owns and is accountable for the budget plan. Traditional spreadsheet "harvesting" of detailed plans from the bottom up doesn't inform (let alone produce) much output. Seeing only aggregated data, executives make broad-brush changes from the top down to yield a company-wide budget plan that too often is unrecognizable to the budget preparers who produced the original calculations—and untranslatable into tangible actions.

In contrast, an integrated planning platform allows for easy iteration of individual plan components in any direction: top down, from executives to planners, and vice versa, in a tight cycle (Exhibit 2). The result is a budget rooted in detailed insights, with clear personal accountability for each item. Moreover, since iterations are more informative—based on modifying a business policy, for example—the alignment process often takes less time, avoiding constant rounds of "Urgent! Find X percent more savings!"

The ideal ZBB platform

The cases we have seen to date highlight six capabilities common to the ideal ZBB planning platform.

Exhibit 2 **Technology enables faster iterations for budgeting, negotiations, and managing performance.**



[1]Key performance indicators.
Source: McKinsey analysis

Integrated: Modeling plus data gathering. Planning tools often focus on aggregate modeling but struggle with large-scale and diverse data gathering, relying on spreadsheet templates as their primary tools. At one consumer-packaged-goods (CPG) company, multiplying the number of customized ZBB templates by the number of budget preparers would have resulted in 12,000 spreadsheets. A better tool replaces them all in a single, integrated platform.

Scalable and fast. ZBB is rich on detail and data. Retaining the details, rather than aggregating and consolidating them, maintains the insights into what business requirements are driving cost, with a real-time view of how top-line numbers change with those assumptions. The CPG company, for example, now can process billions of cells of data that refer to one another in real-time calculations.

Easily configurable. The ability to tweak the solution reactively offers considerable value. The insights from the detailed budget often trigger new ideas, with template modifications that can be done in hours and not days, weeks, or months.

User friendly. Platforms that can be supported without extensive expertise generally prove to be more sustainable, as business users are empowered to improve and adapt the solution continually to maintain its relevance. "When we changed the sourcing for one of our most important spend categories, I was able to modify the template in just a few minutes," one of senior executive reported.

Easily deployable. Although cloud-based technology has limited value without the features above, it helps ease companies' transition from prototypes to live pilots to global deployments, without the need to revise the solution's architecture.

Neutral and flexible. Although the ZBB methodology has a common foundation, it needs the flexibility to be tailored to unique business requirements and processes. Tools that are either add-ons to existing software or purpose built for very specific planning processes might seem enticing, but they often constrain the ZBB process by being too prescriptive, providing off-the-rack guidance rather than a custom fit.

■ ■ ■

Zero-based budgeting is enjoying a resurgence in part as a result of a need: companies and industries with stale performance are looking for ways to expand margins, reinvest in new growth, or both. Lately those forces have been enough to make companies willing to undertake what once was a daunting process. But with appropriate technology investment, ZBB processes can actually accelerate the overall budgeting cycle, replacing protracted debates with insightful decisions and spreadsheet aggregation with performance analysis. These advances alone create irreplaceable value, but they're accompanied by a new cost discipline that becomes simply the way the company works. ■

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