The truth about zero-based budgeting: ZBB for consumer-goods players

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Ten myths and realities illustrate the power and practicalities of zero-based budgeting for the consumer-packaged-goods industry.

In industry after industry, zero-based budgeting (ZBB) is capturing the imagination of investors, analysts, boards of directors, and corporate executives as the methodology gains traction—and continues to deliver results. But nowhere has the interest been greater than in the consumer-goods sector, where industry leaders are delivering savings that would have seemed impossible a few years ago.

Skepticism remains. Some organizations' financial results have been much less impressive, expanding margins by little more than what traditional cost-cutting methods would achieve, even as executives proclaim they are "doing ZBB." In other cases, tales of draconian travel policies and underinvestment in growth have caused management teams to pause. As a result, many executives still wonder whether ZBB is an appropriate discipline for their organization—whether the results would justify the effort they envision.

The truth is that even now, several years after ZBB burst back onto the scene, many executives remain somewhat mystified by exactly how ZBB achieves and sustains its results. However, we continue to believe that this powerful methodology—formed upon simple tenets of visibility, accountability, challenge, and resource reallocation—has unprecedented potential to unlock tremendous shareholder value in the consumer-goods sector (and beyond).

By contrasting ten myths with the corresponding realities we have encountered in our discussions with a wide range of organizations, we aim to clarify 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 desired results. All of this is rooted in a fundamental belief that, when applied properly, ZBB can achieve even the highest aspirations of companies' stakeholders.

Myth one: ZBB simply means 'building your budget from zero'

Reality: ZBB is a repeatable process to build a sustainable culture of cost management.

Zero-based budgeting is much more than building a budget from zero. The most effective ZBB efforts build a culture of cost and performance management throughout the organization by using a structured approach that includes process, systems, governance, and incentives. And all of these elements must be present. For example, it is quite common for budget owners to use bottom-up budgeting to create the organization they envision. But without systematic visibility, accountability to ambitious targets, and governance mechanisms to challenge budgets and reallocate resources, breakthrough results are difficult.

Myth two: There should be only one way to do ZBB

Reality: ZBB programs vary in both rigor and results.

ZBB's reputation is making this method more popular, but not every ZBB program is equally rigorous, measured in terms of the extent of its aspirations, the discipline of its approach, and ultimately, the impact realized. The greatest impact results when the aspirations are high and the approach is thorough, with sustained top-down leadership and bottom-up organizational commitment. Moreover, the approach—which depends on cultural change—is what matters for the long run and is often difficult to achieve. When organizations don't fully embrace ZBB as a mind-set, they risk having the program turn into just another cost-cutting project whose effects fade within a year or two.

Under the umbrella of ZBB methodology, there are range of choices an organization can validly make. 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 decide how to roll out and govern ZBB—for example, whether to address the entire company at once or to start with individual functions, businesses, or regions.

But some choices can undermine ZBB's effectiveness. A few organizations have tried to omit the granular, bottom-up budgeting and resource-reallocation decisions that ZBB calls for. While we recognize that some of ZBB's principles can apply to other contexts, changing these fundamental ZBB components results in a different kind of process, which might instead be called "zero-based cost management."

Myth three: ZBB is just a more aggressive version of the productivity initiatives we have always done.

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 reduction (such as a finance team or productivity program management office) to the business leaders and frontline organizations, which must contribute both to 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 four: Implementing ZBB requires cutting 'to the bone'

Reality: The degree of cost reduction is based on the company's top-down target.

Headlines often associate ZBB with cutting costs to the bone, using any means necessary: sharing hotel rooms or centralizing trash bins, for instance. In some situations, measures such as these become part of the productivity culture, but they are by no means necessary for every company on a ZBB journey. The degree of cost management reflects the size of the specific organization's top-down savings aspiration, and efforts can be tailored to fit the business strategy and employee value proposition. We've seen year-one reduction targets range from an aggressive 30 percent down to a still-substantial 10 percent.

Myth five: ZBB will overwhelm your business and prevent it from doing anything else

Reality: Initial rollout of a new ZBB program can be facilitated by a central team and completed in four to eight months.

One executive told us, “I simply cannot afford to ask the entire company to stop what they’re doing for the year to implement ZBB.” But the idea that ZBB requires dedicated focus from every employee for a year or more is simply not true. While it takes time to embed a new cost-management culture into any organization, the requirements for setting up and rolling out the initial ZBB program are much more limited.

During the setup phase, a central coordination team develops deep visibility into costs and sets savings targets for the upcoming budgeting cycle. The team also ensures that the company’s systems and processes are in place for the detailed reporting, governance, and performance management needed for world-class ZBB. In our experience, this setup period could take anywhere from four to eight months and is primarily led by full-time support from finance and IT, with part-time involvement from P&L and cost-category owners across the company.

Organizations that are unsure about ZBB’s impact should test-drive the process. One company, for instance, started its ZBB rollout in its global finance function—the very team that would be charged with supporting ZBB across the rest of the business. This approach built team-member capabilities that were essential to drive the program more broadly, while also helping the team meet its existing budget targets.

Myth six: ZBB focuses only on SG&A

Reality: ZBB can be applied to any type of cost: sales, general, and administrative (SG&A) costs, marketing costs, variable distribution costs, and cost of goods sold.

The fundamental elements of a ZBB program—governance, accountability, visibility, aligned incentives, and a rigorous process—form a comprehensive cost-management tool kit. However, certain adjustments need to be made in particular areas. For example, when ZBB is applied to variable costs (such as cost of goods sold or distribution expenses), the budget needs to be volume adjusted in monthly performance reports.

In marketing, ZBB breaks down costs not only by type of expense but also by product or brand, clarifying the link between investment and return. Low-return investments are then rooted out and eliminated so the resources can be reused elsewhere.

Myth seven: ZBB is not designed for growth-oriented companies

Reality: Growing companies are successfully using ZBB to reallocate unproductive costs to more productive areas.

Whether an organization focuses on growth, profit, talent retention, or any number of other strategic factors, cost management remains crucial to its success—and ZBB can be a powerful tool. ZBB is not a slash-and-burn exercise that cuts costs without regard for consequences; in fact, it's the opposite. Eliminating unproductive costs allows those resources to be reallocated to whatever the company determines is more productive: back-office costs can be channeled to customer-facing activities, or real-estate expenses turned into digital investments. Every effective ZBB program we have seen has a rigorous annual process for resource reallocation. Deep visibility into costs thus enables surgical changes that cut the fat while building organizational muscle, and can even energize employees by helping drive growth and competitiveness.

Myth eight: ZBB is only about cost cutting

Reality: ZBB is just as much about performance management as it is about cost management.

Cost is the variable that managers have the most control over. Yet most CPG 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 CPG 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 also come in the form 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

CPG company might implement a warehouse-management system with the intent of reducing distribution costs through improved productivity. But 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 nine: ZBB is a static methodology

Reality: The ZBB methodology has been evolving for half a century, and recent innovations are 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 must 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 ten: Reinvested savings won't be seen on the bottom line

Reality: Reinvestment is designed to drive growth—profitable growth.

If a company reinvests €1 million in an area of profitable growth, the CFO should see that show up as an EBITDA improvement 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—separately monitoring the "ins" of productivity savings and the "outs" of reinvestment. In this way, ZBB helps companies overcome the difficulty of managing aggregated inflows and 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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