

# Zero-based budgeting—The dos and don'ts of lasting change

Getting the most from zero-based budgeting requires deft action from the start. Here are some crucial lessons from the front lines.

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A few years ago, we saw a resurgence in zero-based budgeting (ZBB), fueled by success stories from the consumer-goods industry. Since then the resurgence has become a become more of a flood, with more companies across more sectors recognizing that ZBB is not only more achievable than ever—it's also more critical as a way to fuel growth (Exhibit 1).

But not all efforts have proved equal. Some organizations rolled out ZBB to great fanfare but produced only modest results. Others saw their progress slip over time. The disparities have left managers, investors, and analysts scratching their heads: Why are some ZBB transformations greatly outperforming others?

To find the answers, we analyzed 20 ZBB programs across industries. From those companies'

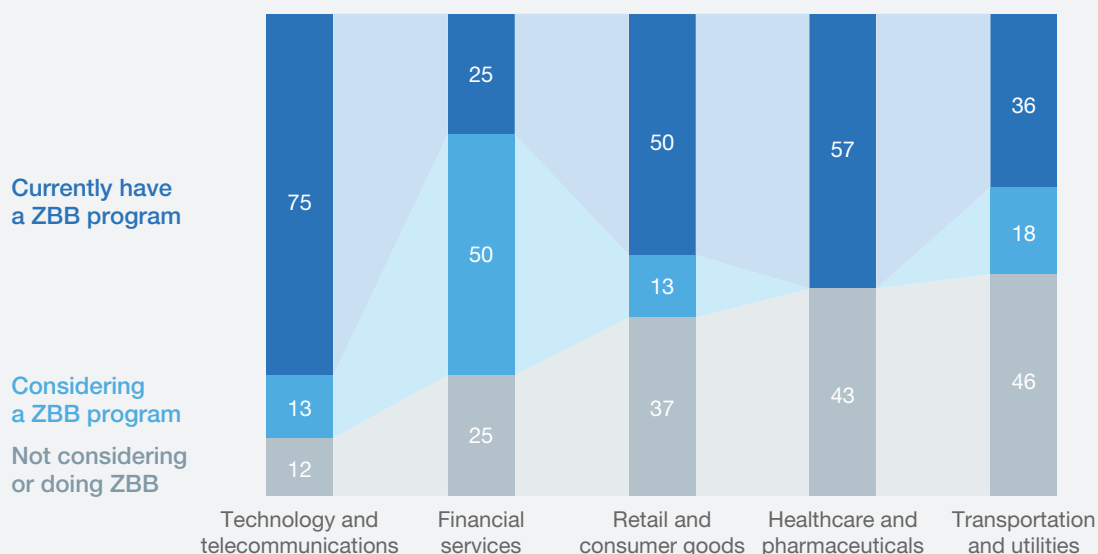
experiences, we identified five ZBB dos and don'ts that are essential to get the full value ZBB can generate.

- **Do: Communicate and role model.** For any transformation that's worth the name, there's almost no such thing as too much communication from leaders about what the transformation is trying to achieve—and why. That's especially important with ZBB, which upends long-standing assumptions about how budgets and funding decisions should work.

But to lead to real change, communication takes real work. When employees don't understand the goals the company is trying to achieve with ZBB or the rationale, they won't do much more than comply with what leaders ask them to do. Few

## Exhibit 1 Zero-based budgeting is expanding across industries.

Zero-based-budgeting (ZBB) program implementation by sector, % of respondents



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will adopt ZBB whole-heartedly as a new way of working. Instead, they're much more likely to look for the first opportunity to revert back to the old way of doing things. ZBB becomes a one-time event rather than a lifestyle change.

That means building both understanding and conviction. One multinational manufacturer took up the challenge by rolling out a detailed communications plan for all employees. Online training—reinforced by posters, email campaigns, videos, newsletter articles and in-person presentations by leaders—helped employees change their individual mind-sets. Simple messages made a big difference in behaviors, such as encouraging better procurement practices: “Did you know that in 2017, late supply orders cost us an extra \$X million for rush delivery?”

Crucially, it wasn't just talk, recognizing that communication by action counts at least as much as by words. Leaders at the manufacturer gave up their fast-lane, “executive” IT help desk, and replaced their annual retreat with working meetings at headquarters.

When senior leaders keep operating as usual, taking advantage of visible perks such as gold-plated relocation packages, it's hard for the rest of the organization to take ZBB seriously. Conversely, when executives take up their responsibility to be role models, visibly change their own behavior, and are the face of the ZBB effort, the people they lead are much more likely to be willing to make their own changes as well.

- **Don't: Make too many exceptions.** ZBB can be controversial, especially at first. That makes it tempting for leaders to ignore or even wall off certain areas where resistance is likely to be high or the rollout is likely to be especially complex. But every exception to the ZBB rule undermines its legitimacy. Cost leaks from the parts of the

business that are in ZBB's scope to those that aren't. And discussions end up focusing more on how to qualify for an exception than on how to get the most from ZBB.

For an appliance manufacturer, the sacred cow was R&D, seen (with good reason) as the lifeblood of the business. The CEO nevertheless included R&D within ZBB's scope, despite significant pushback from the function's leadership. His persistence, combined with the visibility ZBB provides, led the R&D team to discover that the function was still spending money on high-risk moonshot projects that supposedly had been stopped more than a year earlier. ZBB's insights enabled the team to rebalance its R&D funds across the innovation portfolio, freeing up significant funds (and talent, an equally rare commodity) to improve core products while still funding long-term bets at a more sustainable level.

- **Do: Choose the right tools for the job.** New technologies are essential for ZBB to work on a day-to-day basis. To make well-informed spending decisions, managers need the ability to move funds as their business needs change, something they can't do when the only data available are months out of date, and in categories that are too broad to be helpful. Rather than trying to stitch together thousands of individual spreadsheets, with all of the attendant delay and risk of inaccuracy, advanced organizations are using cloud-based tools that allow for real-time updating at line-item detail.

At their best, these tools assemble and standardize vast pools of data from a wide range of sources—not just general-ledger systems but also accounts payable and purchase orders. Advanced analytics then match vendor names to categories and follow digital breadcrumb trails to yield detailed insights. For a North American distribution business, the resulting apples-to-

apples comparisons led to a complete revamp of its spending, which previously had been impossible because each business unit followed its own accounting practices.

Customizing these systems and training people to use them take time and resources. One medical-device manufacturer tried to rush its implementation without sufficient time to adapt the new tools to its core systems. Consequently, leaders couldn't tell whether units had met their savings targets until one to two quarters after the fact. A consolidated financial-planning system broke through the logjam, so that leaders could view current spending performance on dozens of subcategories and intervene much more quickly when problems arose.

- **Don't: Sell your aspirations short.** Setting targets based only on current conditions can leave too much value on the table. New technologies such as robotic process automation are already achieving major productivity breakthroughs in automating many back-office functions. The result is often an entirely new way of working, such as at an insurer where complex premium notices that once took two days to issue can now be done in 30 minutes.

To help your organization bank all of the savings that these breakthroughs promise, start building them into your planning now. A large retailer recently designed its program with targets set at "full potential," not just what was achievable in the current year. That gave the entire organization an incentive to look for innovative solutions now, rather than wait until all of the external constraints (such as store leases) were dealt with first. And to guide savings capture in future years, the company assigned initiative owners and drafted project charters from the very beginning, so that individuals were accountable for progress.

- **Do: Dig into detail—consistently.** With ZBB, the value is in the details. What you don't know can hurt badly, while understanding true cost drivers can uncover real opportunities and help you avoid potential land mines. Cutting too deep in the wrong places can cause lasting harm to the business, so make sure teams have sufficient resources and expertise to adapt benchmarks and set intelligent targets to account for differences in industry, geography, and business model. For example, make sure that steering committees and budget negotiations include diverse representation so that as many potential issues as possible are raised sooner rather than later.

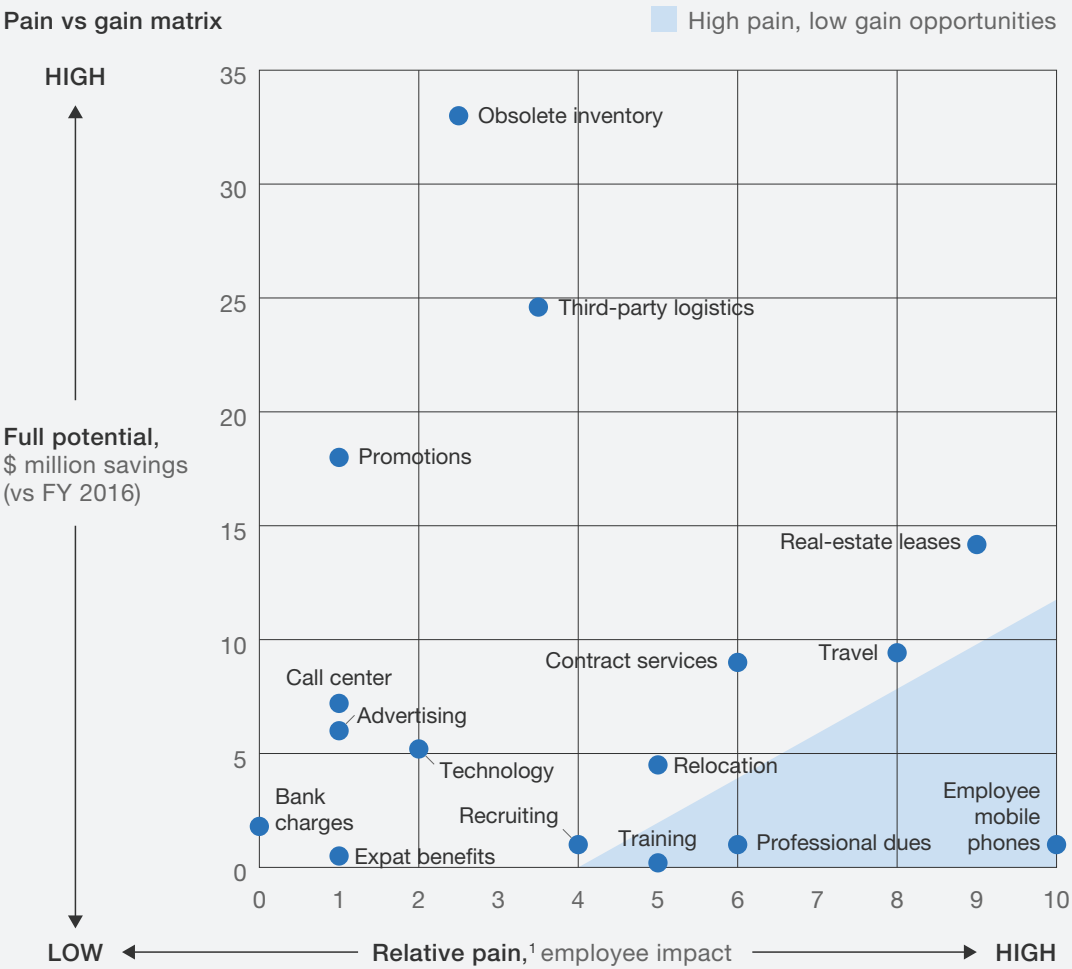
Once the facts are known, the process must be consistent. Base targets on sound analysis and insights, so that people with budget responsibility can be confident that they are being treated fairly. Likewise, conduct budget negotiations to a uniform standard, with the burden of proof on the requestor. A strong governance structure, also adhering to fact-based inquiry, then deals with disputes and reinvestments.

One service company balanced adaptation and consistency by plotting each potential opportunity on a "pain versus gain" matrix, designed to make sure that gains in financial savings would be worth the pain to employees and customers in the specific business. At the end of the target-setting exercise, leaders looked at all the opportunities on that matrix and consciously chose to pass up some high-impact opportunities that risked destroying employee morale (Exhibit 2).



Clearly there is not a one-size-fits-all approach to ZBB. It's important for the leadership team to make these thoughtful choices early on in the program, communicate them to the organization, and keep an

**Exhibit 2** A pain versus savings matrix shows that some opportunities aren't worth their impact on morale.



<sup>1</sup>Estimated impact on employees. Scale based on number of affected employees and degree of impact.

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open mind to adapt and adjust as it learns along the way. While following these dos and don'ts will not guarantee a successful ZBB program, we believe that they do set an organization on the path to achieving significant and sustainable savings. ■

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