

The Case for Zero-Based Budgeting (ZBB)

by **Carl Seidman**

CPA/CFF, CSP, CFE, CGMA, CIRA, AM



Seidmanfinancial.com

Many large corporations believe zero-based budgeting (ZBB) only applies to small companies that have the time to complete such a granular task.

They often don't see the benefit that ZBB can bring to their organizations since those organizations feel the desire to focus more on big-picture planning.

This article will emphasize that ZBB is not exclusively for small businesses. The content expressed herein was previously shared in collaboration with FP&A Trends.

I discuss zero-based budgeting as a tool that can be used to improve a company's understanding of its processes, risks, and opportunities.

ZBB does not need to be applied to every line or department impacted in the budget.

At one Fortune 100 company we engaged with, a single department embarked upon ZBB, separate from the rest of the organization, and conducted the exercise every 3 years.

The pressure of globalization and agile decision-making requires companies constantly advance their business models. This may translate into a focus on top-line growth and process improvement.

For certain, companies must also have excellent visibility into their costs. A powerful process for identifying cost drivers and ensuring they are managed prudently is through a procedure called zero-based budgeting (“ZBB”).

Zero-based budgeting postulates a budget can be built most effectively from the ground up.

Rather than trust last year's performance as a justified starting point, ZBB involves analyzing cost driver categories, discounting what happened in the past, and approaching the future with a fresh set of eyes.

Resource needs are identified almost as if the company is forecasting for the very first time.

At its core, ZBB invites cost control since it erases pre-determined assumptions.

At face value, ZBB sounds appealing but the idea frightens many large-company executives.

Many assume this means discarding the budget and starting over every year. Since many companies already spend a quarter or more on the budgeting process, executives fear zero-based budgeting will take far longer.

This is misguided. It's true that ZBB is a laborious process; however, if done correctly, its benefits often far outweigh its costs.

The common practice in budgeting is the roll-forward of prior-year results as a baseline for the next year. While there's nothing wrong with this approach, per se, it doesn't adequately consider whether last year's performance was optimized.

Just because an organization appeared financially healthy, doesn't mean it's established strong cost control. As a consequence of this roll-forward, companies commit planning errors by setting financial targets early in the process and backfilling operating activities to meet those targets.

This is backward, reactive, and doesn't appropriately address activities necessary to drive the business. Worse yet, it encourages bias and sandbagging to meet arbitrary targets.

Instead, with zero-based budgeting, the company may determine which activities align with strategy and the financial performance that can be expected as a result.

By holistically focusing on cost drivers, eliminating unproductive costs, and managing performance throughout the year, companies can realize significant savings in a very short matter of time.

ZBB quickly becomes more than a cost-savings exercise; it becomes a process by which a cost-conscious culture is developed and maintained.

From a cultural standpoint, a company needs to ensure the tone is set from the top. Leadership should meet with departmental managers to ensure they understand the importance of ZBB and are fully bought into the process.

Leadership should allay staff concerns that the process will be time-consuming and compensation will be tied strictly to the budget.

Instead, staff should understand ZBB means they'll have greater control in setting their own departmental goals.

This contrasts with having targets dictated to them from the top.

Accountability for adherence to goals should be high.

Companies large and small and across any all industries can immensely benefit from zero-based budgeting. The gains come from increased cost visibility, disciplined spending, and strong governance.

ZBB is an extremely valuable procedure that reinforces that budgeting should not merely a routine of rolling forward last year's figures.

About Carl Seidman

Principal, Seidman Financial

Carl Seidman is a trusted business advisor specializing in financial planning & analysis (FP&A), business strategy, and finance transformation. He advises Fortune 500 corporations and middle-market companies, helping establish effective FP&A practices, processes, and teams. At the same time, he supports financial professionals, positioning them for greater control over their careers by helping build their competence and confidence while eliminating time-wasting activities and mistakes.

Carl's FP&A development methodologies and curriculums have been implemented by leading organizations as part of their financial leadership development programs (FLDPs) for top talent and emerging leaders. More than 13,000 corporate finance professionals globally have attended his training programs, workshops, and seminars. Carl also serves as an FP&A, CFO advisor, and management consultant to entrepreneurial businesses throughout North America and Europe and assists them with strategic financial planning, value enhancement, and revitalization.

Carl is a Certified Public Accountant (CPA) has earned other professional credentials including the CIRA, CFF, CFE, CGMA, AM (Accredited Member in Business Valuation), Certified Speaking Professional (CSP), Certified Anaplan Model Builder, and was a National Association of Certified Valuators and Analysts (NACVA) 40 Under Forty honoree. He holds a BA in finance and economics and an MS in managerial accounting.

Carl lives in metro Chicago with his wife and twin sons.

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