

IMPLEMENTING ZERO-BASED BUDGETING SUCCESSFULLY

WITHIN MANUFACTURING TO MAKE YOUR INVESTMENT IN TIME AND RESOURCES COUNT

BY MELVIN BOSSO

“Myrtle’s ZBB Excellence Approach gives companies standard but flexible methodology to optimize and monitor the critical corporate process of capital allocation.”

ABSTRACT

In an effort to minimize waste and strategically spend every dollar, more and more companies are exploring Zero-Based Budgeting (ZBB). As opposed to incremental budgeting, where last year’s budget serves as the primary driver for budget allocations for the coming year, ZBB allocates funds based on the merits of each department’s policies, goals, and spending justifications. However, transitioning to a ZBB process within manufacturing can be challenging and labor-intensive for organizations and their teams. Built on three core pillars of People, Process, and Performance, Myrtle’s ZBB Excellence Approach is designed to enhance the effectiveness of the ZBB work process and achieve all of the advantages and insights of ZBB while minimizing workload, confusion, and frustration. Myrtle’s ZBB Excellence Approach gives companies a standard but flexible methodology to optimize and monitor the critical corporate process of capital allocation to ensure operational success.

INTRODUCTION

In a time characterized by global economic volatility, price fluctuations, and intense competition, businesses are forced to work harder than ever to maintain profitability. A method designed to allocate capital based on very specific, clear plans, and objectives, ZBB is experiencing a resurgence among companies.

Consider an example: In a company using an incremental budgeting process, the maintenance team reaches fourth quarter and sees that they have \$250,000 unspent in their budget. Understanding that they must “use it or lose it” based on the incremental budgeting process, they invest in an assortment of tools and parts. However, the purpose and results of this maintenance investment are not measured or tracked, and the money would have likely been better spent elsewhere. At the company using ZBB, the maintenance team must justify each program in the overall budgeting plan at the beginning of the year and once again when it comes time to use the funding. Short on staff, the maintenance department failed to execute an equipment refurbishment campaign over the summer. As a result, they simply skip that campaign with no concerns of losing budget the following year and instead save the company \$250,000 in expenses.

Companies using ZBB benefit from clear and consistent insight into the details of departmental activities and how those activities contribute to the business’ objectives. Out of fashion for a long time, ZBB is now gaining momentum among companies that champion accountability, metrics-driven decision making, and performance/results.

This white paper will help companies consider the ZBB approach to budgeting, understand the challenges and benefits, and explore best practices associated with successful implementation.

THE FOUNDATIONS OF ZERO-BASED BUDGETING

With Zero-Based Budgeting, all budgetary allocations for the financial year are set at zero. Every department seeking financial allocations for the coming year must then present complete data justifying their projected expenditures. The result is a careful review and analysis of each and every item on which money is spent, something that fails to occur in most businesses. Zero-based budgeting has had a long and somewhat controversial history in the public sector. Zero-based budgeting first rose to prominence in government in the 1970s when U.S. President Jimmy Carter promised to balance the federal budget in his first term and reform the federal budgeting system using zero-based budgeting, a system he had used while governor of Georgia. In 1973, President Carter, while still governor of Georgia, implemented the system for the entire executive budget for the state. After a difficult beginning, zero-based budgeting was largely hailed as a success when introduced to Congress in 1977, but was discontinued by President Ronald Reagan when he took office in 1981.

Interest in ZBB had been on the decline for many years. The large amount of paperwork and data that ZBB generates, along with doubts about the method’s ability to fully meet its theoretical promises, were at least partially responsible. Also, the improving economic conditions from the low points of the late 1970s and early ‘80s in the United States, and the early ‘90s in Canada, reduced the perceived need for what was largely regarded as a “cutback budgeting” strategy.

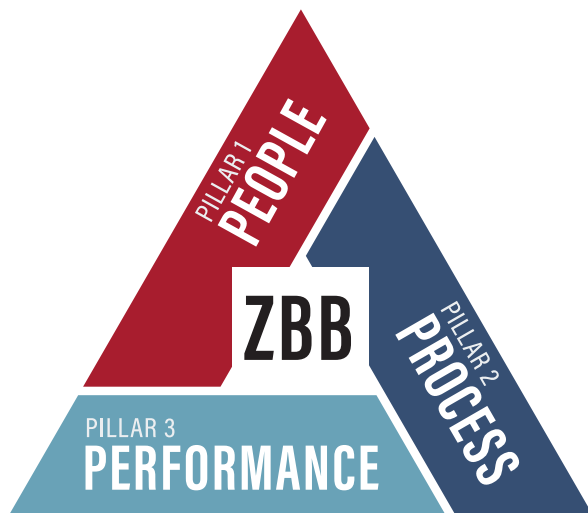
However in recent years, ZBB has experienced a resurgence. According to an April 2020 Gartner Inc. survey, 26% of over 300 global finance executives said they were going to move to zero-based budgeting during the COVID-19 pandemic. Whether driven by new leadership, a turnaround effort to improve a company’s poor financial performance, or a way to drive positive cash flow and profitability, ZBB is driving lower expenses, better knowledge, and results-oriented management in companies around the globe.

The Myrtle ZBB Excellence Approach

Organizations large and small are assessing what ZBB could mean for them. Once they better understand the process of ZBB, many companies abandon the initiative, fearful of the amount of work and preparation required. For this reason, Myrtle has developed its ZBB Excellence Approach, designed to streamline the process, put critical infrastructure in place, and establish complete results tracking to ensure success. Successfully implemented in large, complex environments, Myrtle's ZBB Excellence Approach leads companies through the challenges of implementing ZBB, helping them successfully transition it from concept to reality.

Myrtle's ZBB Excellence Approach is built on three pillars, each designed to reduce the effects of a set of common bottlenecks, obstacles, and hindrances that can arise before, during, and after ZBB implementation.

ZERO-BASED BUDGETING



Myrtle's ZBB Excellence Approach provides tactical-level training of skills including, but not limited to:

- + Navigating the ZBB hierarchy. How each team rolls up to others and with whom to collaborate.
- + How to select a driver. Depending on the nature of the activity, the driver could be dictated by strategy, volume of throughput, company policy, or regulations.
- + How to navigate the matrix decisions structure with ZBB. It is critical to clearly define the roles and responsibilities of the stakeholders. The key will be to decouple the responsible (doer) and the accountable (owner of the final decision).

Training empowers managers to prepare and justify budgets and how to get the help they need, minimizing frustration.

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- PILLAR 1** | People are trained, empowered, & supported
 - PILLAR 2** | Templates and best practices for developing and justifying budgets are put in place, streamlining the budgeting process
 - PILLAR 3** | Systems for providing structure and discipline validate the process and ensure a 360 feedback loop

PILLAR 1

PEOPLE | Organize and train

Unfortunately, in the short-term, ZBB not only exposes existing skill gaps but can even create new skill gaps. Few companies are aware of it, but the single largest hindrance to improved performance may be the tendency for employees to default to intuitive decision making rather than consistently pursuing rational, fact-based courses of action. Planning programs, projecting expenses, and forecasting results are time- and labor-intensive processes that require effort and training. Planning and projecting for departments such as production, engineering, and maintenance can be particularly difficult. Budget allocation must be made according to detailed, well-built and thoroughly justified plans that are, in turn, connected to results metrics. This is an intensive process but one that ensures that each and every program and activity is designed to support the larger goals of the business.

For all of these reasons, the ZBB Excellence Approach requires training of ALL managers and staff on the concepts and implementation of zero-based budgeting. A general familiarity with the process and the rationale behind it helps set expectations.

PILLAR 2

PROCESS | Prepare, plan, and provide visibility to successes

Common complaints about implementing ZBB include the drastic increase in preparation time, expense, and labor required to prepare budgets. Creating a zero-based budget from the ground up on a continuing basis calls for an enormous amount of analysis, meetings, and reports, all of which require additional management staff. Many companies believe that the investment of time, cost, and resources associated with justifying every expense is simply not feasible.

These frustrations are symptomatic of the lack of root-cause analysis culture in organizations. It is virtually impossible to build a budget from the ground up when a company does not routinely investigate performance gaps. The operational review mandated by zero-based budgeting requires a significant amount of management's time. Initially, managers may see this time investment as overwhelming and/or unproductive. However, in order to accurately track the effectiveness of programs on which money was spent, ZBB requires a diligent feedback loop that demands ongoing performance evaluation complete with metrics.

The Process Pillar is designed to provide insight and best practices that reduce the burden of the budgeting process by breaking it into manageable pieces and offering a clear and proven methodology for putting together budget justifications and plans.

The preparation process is organized into two work streams: direct costs and indirect costs.

Direct costs - A Key Performance Indicator (KPI) analysis is used to define a baseline for performance. An analysis of historical performance will help model best, most likely and worst case performance scenarios. These three scenarios are used to define the range of process and cost performances. The calculated correlation between cost and performance provides an indication of the predictability of the costs. For example, historical performance may indicate that, on average, one needs 3 ounces of water to produce 11 ounces of juice. The best performance could be 2.5 ounces of water and the worst might be 4 ounces. In the budget for the following year, the numbers cited above will be used as a baseline but will be corrected for expected impact of potential investments, dilution due to potential increased volume of production, and/or major planned shutdown of production.

Indirect costs - Examples of indirect costs include travel and expenses (T&E), G&A, taxes, insurance, and benefits. A full review of company policies and their indirect costs will determine the scope of the drivers. Then each driver will be quantified together with its seasonality, if applicable. Indirect expenses constitute the first area of opportunity for a company that is building a cost-reduction initiative. Those accountable for the budget will be trained to challenge the status quo and review company policies accordingly. For example, a G&A budget that is significantly higher than industry average may present an opportunity for a company to reduce administrative staff. Other companies may tighten their travel policy to save money by asking travelers to share hotel rooms or to purchase only from approved vendors that offer the best pricing.

The process of creating these budgets is one that requires planning and consideration around stated business objectives. Managers are asked to evaluate programs carefully based on analytics. The effort lends itself - not only to the success of the ZBB process - but also to an overarching awareness of how much the company is spending, on what, and with what results.

PILLAR 3

PERFORMANCE | Provide structure and discipline

For ZBB to be successful, it must become part of the culture of the company. Some managers still deride culture as a “soft” concept. However, Lou Gerstner, famed for his achievements as chief executive at IBM and before that RJR Nabisco, said: “I came to see that culture isn’t just one aspect of the game – it is the game.” When it comes to failure to implement ZBB successfully, typically one or more of the following reasons is to blame.

- 1 | Insufficient commitment and professional attitude to ensure proper implementation.
- 2 | Insufficient preparation of the justification for expenses, leaving critical items out of the budgeting process.
- 3 | Inconsistent revision of the budget and actuals on a continual basis to ensure the success of the effort.

Myrtle’s ZBB Excellence Approach requires the installation of a management system that ensures that all ZBB-related plans, templates, actions, and reviews are synced with the agreed objectives at all levels at regular intervals throughout the year. This management system serves the purpose of consolidating valuable information and delivering sustained behavioral change that supports ZBB and offers a source for continual improvement year over year. Myrtle’s ZBB Excellence Approach drives discipline, accountability, and performance, ensuring that stakeholders are actively involved and following processes, further solidifying the success of the program.

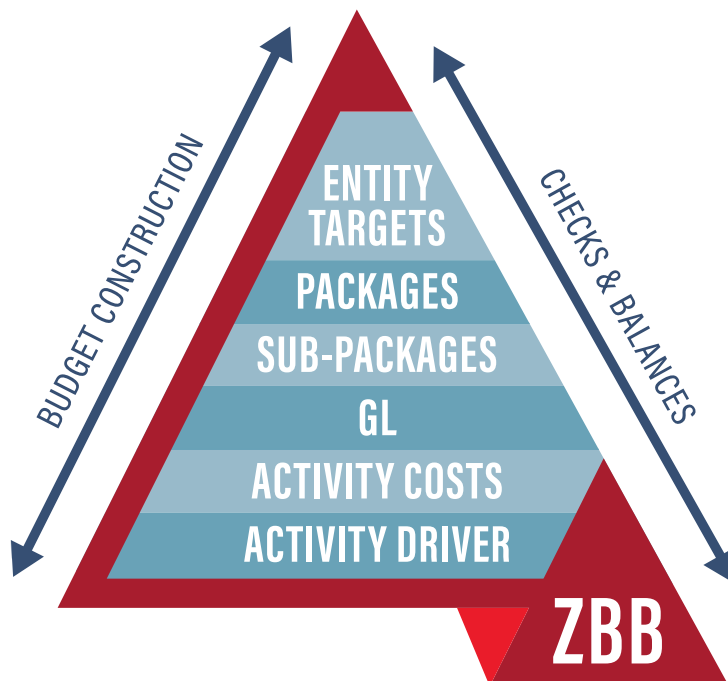
The diagram below shows Myrtle’s ZBB Excellence Approach, which includes the following components:

- + **KPI’s and KPI trees:** Key Performance Indicators (KPIs) will range from lagging indicators to leading indicators. Most organizations make the mistake of decoupling the activity drivers from the performance analysis. This often results in delayed response, incomplete root cause analysis, and ultimately failure to succeed. The people held accountable for managing operational performance typically review the leading indicators on a daily and/or weekly basis. A KPI tree integrates leading and lagging KPIs in a way that makes it easy to spot financial gaps and trace them back to operational opportunities.

KPI trees have a profound effect on people’s everyday attitudes and actions. Figure 2 shows the ZBB pyramid: the frame of the ZBB KPI tree. While the movement of the metrics in isolated KPIs shows employees how their choices impact their own operations, KPI trees show how they impact the performance of the business as a whole. KPI trees also help to counter the organizational tendency to pursue “initiatives du jour” – that is, focusing on one element of the company’s performance while losing sight of the big picture.

Reports and information flow: Another key to rationalizing decision making and synchronizing improvement actions is establishing “one source of the truth.” Metrics and the reports in which the data reside must be consistent. While the bottom-line numbers are generally accurate, tracking day-to-day costs can be a struggle. Identifying a single source of communication will make the organization considerably more efficient and the work environment more conducive to excellence. Issuing reports at the right intervals is also important. Many operations teams review reports less frequently than is needed to optimize performance. A KPI tree with an appropriate decision-making flow will help regulate the moment of availability of the report.

- + **Decision making and tracking platforms:** Consistently structured reports then become the backbone of a cross-functional review process. Regularly scheduled meetings subject important decisions to the rigor of peer and management scrutiny. The ownership of the decision cycle is as follows: The packages and sub-packages owner will lead the review meetings, and the entity owner will lead the forecasting, planning, and execution meetings. They will work together to define the need and execute gap analysis both when they are ahead of or behind the target. The idea is that all learnings are kept to manage the next budgeting cycle and all sustained savings are “banked.” This ensures a short interval control on all major GL.



ZBB PYRAMID

ZBB orchestrates multiple interactions of stakeholders across the company for both the budget construction process and the validation process.

Is ZBB Right for Your Organization?

While ZBB offers extensive benefits and enormous potential savings, not every company is well positioned for pursuit of this major initiative. Here are some key questions companies can ask to assess if ZBB may be right for you:

HOW IS YOUR CURRENT BUDGETING PROCESS PERFORMING?

For companies that are dissatisfied with their current budgeting procedures because they feel they are inadequately allocating funds, or for companies who feel that programs funded are not aligned with company goals, ZBB may be a great solution that ultimately provides more visibility and control and puts more discipline around departmental budgeting and spending. For companies that have implemented ZBB with frustration and/or without much success, Myrtle's ZBB Excellence Approach may be all that is needed to jump-start the success of the program.

IS DATA USED TO EVALUATE PERFORMANCE AND TO HELP JUSTIFY FUNDING?

If the organization cannot claim significant experience with performance measures or understanding of the relationship between costs and service levels or between service levels and impact, ZBB may be a good solution. If management's experience in using data to drive decisions is limited or simply ineffective, ZBB could help instill that discipline companywide.

DOES MY COMPANY HAVE THE RESOURCES REQUIRED TO IMPLEMENT OR REVITALIZE ZBB?

ZBB involves the entire organization. Budget staff will be focused on the technical aspects of the processes. Other operations will have to be mobilized around defining metrics and baselines tied to the financials for their respective operations. Management will provide targets, checks, and balances. Start this process if you want to build an organization that is willing and able to challenge itself every day to find new ways to achieve improved profitability.

CONCLUSION

Budgeting is one of the most critical processes in any organization. All companies wrestle with the best possible allocation of resources. Gaining access to reliable and pertinent information, achieving profitability, sharing the burden of cost challenges, defining the appropriate timing of major expenses, and choosing between investing and consolidating are only a few of the challenges that come with a new budgeting cycle.

Zero-based budgeting is simply an allocation method. By itself, it won't solve a problem. It will, however, get the company to focus on how it wants to spend money. Because it is a budget built from the ground up, it relies on managers and leaders to carefully plan for all activities within the organization. Many market leaders are now adopting this new way of managing resources, partly because of the success that others have been able to achieve. It is our experience that the companies that approach ZBB not just as a budgeting philosophy – but use it in conjunction with essential management tools – will be the most successful. Myrtle's approach is designed to prepare and support your teams, provide you with the tools to make the process accessible to all, and create the management routines to enable you to get the maximum out of ZBB.

ABOUT MELVIN BOSSO

With more than 15 years experience in manufacturing, Melvin Bosso is an accomplished, versatile leader in operations and supply-chain management. An expert in supply-chains and operations, Melvin has a proven track record of leading companies' operations to superior performance by creating fact-based, data-driven management routines. Serving as the Director of Transformation at Myrtle Consulting Group, Melvin assists clients with a range of operational excellence initiatives that include ZBB, manufacturing performance improvement, supply-chain planning, Six Sigma network optimization, and SKU optimization, to name a few. Previously, Melvin led CHEP's Canadian operations. Prior to that, Melvin spent nearly 8 years with Labatt Breweries where he played a key role in the transformation to ABIs' new operating model, implementing zero-based budgeting, overseeing new plant acquisitions, and managing post-SAP deployment ramp-up.

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