GETTING AHEAD BY CUTTING BACK

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USING ZERO-BASED BUDGETING TO FUEL GROWTH

Digital has challenged the way business is run down to its core. Markets are characterized by rapid change—where new rivals enter seemingly from nowhere, offering paradigm-shifting products and services. It's anything but "business as usual."

But most companies today base their cost management approaches on exactly that—setting budgets based on what happened last year. Against a backdrop of increasing volatility, it's time to reimagine cost structures based on what's needed in this new, disruptive environment. Using zero-based budgeting (ZBB), basing resource demand on the now instead of last year's performance, frees up capital which can then be used on activities that ultimately boost growth.

LOWERING OVERHEAD TO **FUEL GROWTH**

More and more companies are looking for ways to lower overhead. For starters, many are confronting increased complexity as they operate across many different markets, in terms of both regulation and customer demands. Tackling this complexity tends to raise overhead. And they are seeking to balance developed and emerging market opportunities. Developed markets are returning to growth, but there is no easy path to success and competition is fierce. At the same time, multinationals are also trying to increase market-share in fast growing emerging countries—even if doing so is not that profitable at first.

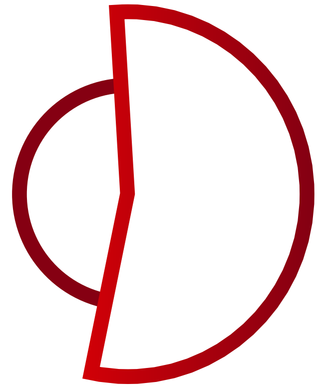
Another thing to consider: businesses need to ward off the threat of takeover. Industry consolidation is under way in sectors including consumer packaged goods and pharmaceuticals. And there are internal challenges that have to be considered. In an environment where cost pressures remain fierce, it is vital to be able to focus resources on driving growth. But where companies are managing to generate savings from cutting unproductive expenses, there is still the challenge of capturing the money generated for redeployment purposes. Too often, funds that are freed up are not subsequently used to promote growth elsewhere.

What exactly is “zero-based budgeting”?

Today’s definition of zero-based budgeting is different from the traditional budgeting technique introduced by the US government over 50 years ago. ZBB requires justifying each budget item’s need or cost, while respecting strict policies and top-down targets set by the cost category owners. This level of detail allows for useful internal and external benchmarking. ZBB is an open and transparent way of creating a budget, resulting in important insights into consumption. Budgeting from zero each year helps to remove unnecessary cost and create a detailed forecast. Savings can be earmarked and assigned to activities that ultimately boost growth.

FROM **A** TO **ZBB**

ZBB can fuel growth by removing waste and freeing up capital that can then be turned to more lucrative activities. At its core, ZBB is about agility—and getting companies to run in a more cost-efficient way to make them more competitive. A common mistake that occurs with cost-cutting is a piece meal approach focused mainly on overhead and cost of goods sold. These efforts only scratch the surface and risk causing the company to lose valuable, differentiating capabilities. Companies need to focus on their core goals. Funds that are not working towards those goals should be shifted into activities that drive growth.



According to Accenture research, only

about half

of companies (51 percent) are able to sustain their cost savings for one to two years.[1]

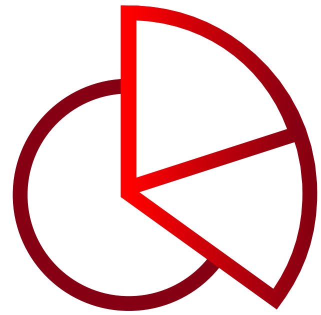
ZBB can help performance: it is a way to assist with driving growth. Indeed, without ZBB, it's likely the money needed to grow just wouldn't be there. But to make ZBB move the dial on performance it's critical to:

- Create forensic visibility into costs and eliminate waste from the organization.
- Make cost savings sustainable.
- Create a corporate culture where cost-cutting is part of the company's DNA and individuals are accountable.
- Identify areas where the freed-up cash can be reinvested into growth and innovation.

FORENSIC **VISIBILITY**

One of the challenges executives face when trying to manage costs is getting visibility at the line-item level. Visibility is more than just a mapping exercise; it's a real analysis. With improved cost management, usually 20 to 35 percent of costs can be reallocated, which means that either people are not using the chart of accounts properly, or the accounts are simply not granular enough.[2]

ZBB can create significant spend visibility at a granular level. It also helps align procurement and finance, ensuring consistent data. A matrix with all cost packages on one dimension and structure on another allows an integrated view of how much is spent, by whom, and on what. Then it can be possible to identify tangible cost reduction opportunities, through better price negotiations, more competitive consumption policies and better operational efficiency. Budgeting from zero each year helps to remove unnecessary cost and create a detailed forecast. Savings can be ring-fenced and assigned to activities that will boost growth.



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SUSTAIN **SAVINGS**

One key to sustaining cost benefits is to improve accountability such that people treat the company's money as their own. Accountability is more than just a leadership idea; it is a way to alter behavior at all levels, with everybody contributing, from the lowest levels of the organization to the highest.

For example, those responsible negotiate with business units to set up a "smart consumption" policy, monitor compliance and remedy problems so accountability is embedded in the structure and cost management becomes a continuous process. This creates a positive tension that can be difficult to manage, but at the same time stimulates teamwork around budgetary goals.

CHANGING THE DNA

Strategic cost management can only be successful if new mindsets are adopted across the entire company. The aim should be to change the company culture so that sustainable cost management becomes part of the company's DNA. Employees should constantly question the need for spending. Good techniques for organization and cultural change will be essential. Employees must understand the need for transformation and what is in it for them. Senior executives need to support the change every day and not just through words; they should lead by example. Good communication planning is also essential, using a variety of channels and materials to create awareness and encourage adoption of effective cost-reduction techniques by the entire organization.

All of that requires ambition—it is not an easy process, but it is necessary in order to permanently reduce cost and drive growth. However, a top-down, prescriptive company culture is not a requirement: ZBB can work in many different cultures.

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REINVEST FOR GROWTH

Strategic cost reduction can only be successful if the savings are reinvested in areas of the company to drive growth, innovation, improved productivity, better customer experiences and so on. Programs to drive cost savings need to be planned such that related growth strategies are designed simultaneously. Consider how effective strategic cost management helped drive expansion for a leading telecoms company serving Africa and the Middle East. Faced with rising competition and declining margins in their core business, the company, using zero-based budgeting, reset operating budgets and within six months realized a $550 million annual cost reduction; $250 million derived from new SG&A initiatives and $300 million achieved in core spend areas. Ultimately, improved margins helped the company step up its investments in areas of strategic importance, and fueled growth initiatives.

Another ZBB case in point: One global healthcare company sold a piece of its business, diminishing overall revenue, and leaving it saddled with a legacy cost structure. Through ZBB, they targeted $1 billion of indirect spend annually and $1.5 billion of personnel costs. Now the company is positioned to save $1 billion in the next three years. Thanks to the savings generated through ZBB efforts, the company was able to acquire a new high-profit business, bringing with it an enhanced portfolio of products to the market and stronger overall sales.

SPEND LESS, GET MORE

Achieving profitable and sustainable growth through zero-based budgeting hinges on a few things: having an effective blend of cultural change, business process improvement and technology deployment—all underpinned by a deep understanding of the industry dynamics at hand.

Companies need to create better forensic visibility into spending, and then make savings sustainable through better accountability, process improvements and culture change. And most important, organizations should closely link spending reduction with their strategic growth plans—spending less to get more, driving competitiveness in the long term.

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[1] Accenture Strategy Strategic Cost Reduction research, 2014.

[2] Accenture analysis.

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