

THE INTERNATIONAL JOURNAL OF BUSINESS & MANAGEMENT

A Revisit to Zero Based Budgeting

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Abstract:

Zero based budgeting was a popular cost management tool in the early 1970s and currently it seems to be a lacklustre budgeting method. While this article does not attempt to hearken back to the yesteryears of popularity, this mini article endeavours to deliberate on the fundamental concepts of zero based budgeting and discusses on the benefits and drawbacks of implementing zero based budgeting in organisations. In addition, a brief recommendation on how zero based budgeting can be pragmatically useful is also touched on.

Keywords: Zero based budgeting, accountability, savings

1. Introduction

Zero-based budgeting requires managers to disregard previous year's budget and to take forthcoming year's planning from scratch (Dyson, 2017). As a result, managers are engendered to assess every budgeting item afresh and to decide which item deserves funding or cut. Using decision packages, as introduced by Pyhrr (1977) to be the types of activities that the management can identify and describes, the management is then required to evaluate and rank these activities in relation to their functional or operational needs (Shelby, 2013). Kavanagh (2012) suggested three bases for consideration; namely, packages of basic, current service and enhanced. On this note, while basic package takes care of the minimum level of funding required for the organisation to stay viable, current service package looks at the needs to continue the current processes, and enhanced package delves into the needs to augment current service level to a higher level. In this way, the organisation is able to stay competitive and possesses the agility for better financial deployment in the environment of increased uncertainty.

2. Benefits of the Zero Based Budgeting

As zero-based budgeting aims to rectify the budgetary slack problem of incremental budgeting, informed decisions on the line item provide the mean to allocate financial resources to the one that creates the most value. On this note, benefits of zero-based budgeting are notable, which include:

- Purposeful spending following prioritization of functions (Ross, 2018), which help in scrapping non-essential organization activities
- Identification of duplication of activities and centralizing these activities for efficient operation (Minmier & Hermanson, 1976; Ross, 2018).
- Identification and elimination of redundant activities after alignment of business strategy (Deloitte, 2015)
- Sustainable cost saving due to avoidance of automatic budget increases (Deloitte, 2015)
- Ensure accountability and ownership mind-set (Agarwal & Amte, 2016)
- Increased involvement of frontline managers in the budgeting process (Pyhrr, 1977)

Interestingly, Rehffuss (1977) notes that the decision-making process in zero-based budgeting offers the managers the opportunity to develop their managerial skills especially in terms of the establishment of minimal levels of organizational performance and to be highly informed of their operational needs and priorities. This way managers are in greater familiarity with the organisational processes and budgetary spending.

3. Drawbacks of the Zero Based Budgeting

The zero based budgeting is not without drawbacks. While the zero based budgeting can provide prudent spending, the drawbacks have been described, as follows:

- Costly and time consuming process, since zero based budgeting is conducted annually (Ross, 2018) and manpower is required for detailed deliberation.
- Implementation could be resisted by staff, especially when the scope of responsibility is under the scrutiny of zero based budgeting (Atrill & McLaney, 2015) and the fear of being replacement or elimination.
- Top management may not fully support this as it may expose organisational weaknesses such as organisational atrophy (Pearson, Henley, & Michael, 1981).

Unfavourable information may also be not forthcoming if a higher budget is requested or the budget preparation time is too short (Rehffuss, 1977). As the decision-making process involves effective administration, communications, and

training of managers who will be involved in identifying and ranking the decision packages, analysis may not be comprehensive if the collected data is incomplete (Pyhrr, 1977).

Clearly, the crafting of decision packages requires meticulous data collection and organisational preparation. Similarly, the methodical evaluation of these decision packages (Suver & Brown, 1977) is time-consuming and requires an overarching perspective of the organisation. A rigorous process to examine each budget proposal with its inclusion justification is consequently needed. Thus, a short period of budget cycle would dwarf the good effect of zero based budgeting as the preparatory process may be hastened, or, at its worse, cannot accommodate the good intent of zero based budgeting (Ahmad, 2007). Nevertheless, Duane (1982) argues that organizational digitization may ameliorate the time-consuming process of data collection.

Interestingly, zero based budgeting can be gamed for the ultimate benefit of funding. Savvy managers can manipulate intelligently for vested interest in short-term financial projects or in favour of senior management priorities. In this way, departments become more competitive for departmental survival or progression and this may result in deteriorating esprit de corps in the organisation.

As annual zero based budgeting requires substantial time commitment for financial analysis, training is needed for effective implementation. Consequently, trained staff are recruited in the review process. Organisation needs to address these new costs in view of the training requirement and time commitment to budget reviews (McNally, 2017).

4. Circumstances that Would Make Zero Based Budgeting the Most Appropriate Method

Suver and Brown (1977) claims that zero based budgeting is most applicable to overhead expenses activities, of which services, support and travel expenses (Hartung, 2013) are usually not efficiently managed. On the other hand, Duffy (1989) points out that zero-based budgeting is "best applied to administrative, technical and commercial portions of a budget". For instances, overhead that revolving on administration, marketing and sales, and R & D as well as production support services which deals with maintenance, supervision, and engineering and design are the applicable areas (Ross, 2018). In fact, Atrill and McLaney (2015) point out that zero based budgeting is most appropriate for discretionary budget and Ross (2018) adds on that the usefulness is more direct in non-profit and governmental organizations.

Mergers could leverage on zero based budgeting for better allocation of resources and to fund critical business initiatives for enhanced sustainability (Block, 2009). While mergers and acquisitions can lead to successful organisational expansion, poor financial budgeting can dismayingly affect the firm's profits and stock prices negatively (Stunda, 2014). Discerning use of financial advices is therefore critical as the managers need to create value strategically with insightful market outlook (Chuang, 2017).

5. Conclusion

As zero based budgeting requires prudent justification of each expenditure proposal in terms of efficiency, effectiveness, and organizational priorities (Dirsmith & Jablonsky, 1979), this brings upon a saving of unnecessary cost and alignment to current business strategy. With a discerning use of zero based budgeting, it can provide a mean to organisational value creation while eliminating unnecessary spending and prioritizing strategic imperatives.

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