

Zero-Base Budgeting

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17.1 INTRODUCTION

The use of Zero-Base Budgeting (ZBB) as a managerial tool has become, increasingly, popular since the early 1970s. ZBB has been gaining acceptance in the business world as a tool in integrating the managerial functions of planning and control. Initially, the former President of America, Jimmy Carter, has developed this technique, when he was working as the Governor of Gorgia, for controlling state expenditure.

17.2 MEANING

Zero Base Budgeting is the latest technique of budgeting. A budget is a representation of quantification of the firm's objectives. An accurate budget can be framed, when a relationship between the inputs and outputs can be established. In all the activities, such relationship cannot be established. In such areas, it is difficult to develop standard costs. Where it is difficult to compare the resources allocation with the output, ZBB is more appropriate in controlling.

The term 'Zero Base Budgeting' means starting from the scratch.

In Zero Base budgeting, justification of expenditure is to be made for the past as well as new projects. In the traditional budgeting, the figures of the previous years are taken as base and additions are made for the current year. But, in Zero Base Budgeting, even the running projects are to be justified for continuation. If the past projects were allowed to continue, without justification, the past inefficiencies would continue, automatically. So, the manager has to justify, why he wants to continue to spend.

In ZBB, the manager has to justify the essentiality of the new projects for their starting and continuation of previous projects, every year. Equally, the concerned manager has to justify the amount of spending, thereon, is reasonable.

17.3 DIFFERENCES BETWEEN TRADITIONAL BUDGETING AND ZERO BASE BUDGETING

The differences between the two are as under:

Traditional Budgeting Vs Zero Base Budgeting		
	Traditional Budgeting	Zero Base Budgeting
1. Emphasis	Lays emphasis on 'How much'	Lays emphasis on 'Why'
2. Focus	Focus is on increase or decrease in expenditure.	Focus is on 'cost benefit analysis'.
3. Communication	Communication is, usually, vertical.	Communication is, usually, both vertical and horizontal.
4. Approach	Past is taken for granted and never questioned for continuation.	Past is questioned and justification needed for continuation and fund allocation.

Zero Base Budgeting can be applied successfully in State Government spending.

17.4 STEPS FOR PREPARATION OF ZERO BASE BUDGETING

The following steps are involved in Zero-Base Budgeting:

- (A) **Determining the Objectives:** Determination of the objectives is the first step. The objective can be cost reduction in staff overheads or dropping those projects that do not fit in the organisational objectives or focus.
- (B) **Extent of Coverage:** It relates to the decision whether Zero-Base Budgeting is to be introduced in all areas or certain select areas on trial basis.
- (C) **Developing Decision Units:** Decision Unit can be a functional department, a programme, a product-line or sub-line. Each decision unit must be independent. Then only, they come under consideration. Cost benefit analysis is to be done to the decision units. Decision is to be taken, whether the units are to be continued or dropped. If the cost benefit analysis is favourable, the decision unit can be implemented, otherwise can be dropped.

Benefit should be more compared to the cost. Cost benefit analysis is the foundation of ZBB, which helps in ranking the projects.

If the decision unit is dropped, no further thinking is needed about those activities.

- (D) **Developing Decision Packages:** This is the most important step involved in the ZBB process. After decision for selection of the units, the concerned manager of the activity is given the freedom to come out with the alternatives to achieve. He does the cost-benefit analysis and selects the best course of alternative. He summarises the plans and resources required to achieve.
- (E) **Preparation of Budgets:** This is the last stage involved in ZBB process. Once the top management has ranked the various decision packages keeping in view of the cost benefit analysis and availability of funds, a cut-off point is established. All packages (programmes, products etc), which come within the cut-off point are accepted and others rejected. The resources are then allocated to the different decision units and budgets relating to units are approved.

Zero Base Budgeting is an extension of the cost benefit analysis method to the area of corporate budgeting.

17.5 BENEFITS OF ZERO BASE BUDGETING

ZBB is a revolutionary concept. The benefits are as under:

1. **Proper Allocation of Funds:** Funds are scarce. Priority in allocation of funds is made on cost-benefit analysis.
2. **Systematic Evaluation:** Manager has to justify the demand for resources, every year. So, it provides the organisation a systematic way to evaluate different programmes and operations

undertaken. So, for the ongoing projects too, review is made, every year. Funds allocation for the ongoing projects is made, if there is justification to continue, further.

In other words, there is no difference between the new projects and ongoing projects from the view-point of allocation of funds.

3. **Links Budgets with Goals of Enterprise:** Those projects that do not fit within the overall goals of the enterprise are not continued, even if they were commenced. Goal oriented approach of the enterprise would be developed.
4. **Zero Base Approach:** Zero is taken as the base, every time. Only those activities and programmes that are essential are undertaken, which improves the overall efficiency of the enterprise. Alternative courses of action are always studied. Economies are achieved, eliminating wastage. The focus of the management is on analysis and decision-making
5. **Optimum use of Resources:** As cost-benefit analysis is the guiding principle in fixing priorities, resources are used to the optimum advantage of the organisation.
6. **No Incremental Approach:** Normally, budgets are based on incremental approach. The usual feature of functional heads is to seek information from the accounts department for the previous year's expenditure, add 'something' for the current year and try to justify the increase. This incremental approach is not possible with Zero-Base Budgeting. Manager has to justify their activities and the funds requested.
7. **Most Appropriate for Non-Manufacturing Areas:** Zero-Base Budgeting is very appropriate for the staff and support areas (Non-Manufacturing Areas). In these areas, the output of these areas is not, directly, related with the final output of the organisation.

Within the business world, ZBB can be applied to research and development, data processing, quality control, marketing and transportation, legal staff and personnel office.

Example: A separate training department may remain in an organisation. The utility of the continuation of the department may be studied, in comparison to conducting training outside the organisation. Training is a non-manufacturing area and its discontinuation within the organisation and providing diverse types of training to staff, outside the firm, may be more ideally suitable, while reducing the costs to the enterprise.

17.6 LIMITATIONS OF ZERO BASE BUDGETING

In spite of the many advantages, it suffers from the following limitations:

1. Computation of cost-benefit analysis is essential for ZBB. This is not possible in respect of non-financial matters.
2. The system of ZBB has no scope to adjust for changes. So, ZBB has no scope in flexible budgeting.

3. ZBB involves lot of time and cost of operating is also high.
4. Formulation of decision package is a difficult process and all the managers may not have the necessary expertise.

17.7 CONCLUSION

To conclude, Zero-Base Budgeting is not a panacea for all evils. But, it can certainly overcome the weaknesses of the conventional budgets and improves the usefulness of budgeting process.

Check Your Understanding

(A) State whether the following Statements are True or False

1. Zero-Base Budgeting is the latest technique of budgeting.
2. In Zero-Base Budgeting, the focus of management is on analysis and decision-making.
3. There is no difference between the conventional budgeting and Zero-Base Budgeting.
4. In Zero-Base Budgeting, zero is taken as base.
5. Zero-Base Budgeting allows the continuation of ongoing projects, without any review and justification.
6. Non-manufacturing areas are suitable for implementation of Zero-Base Budgeting.
7. Cost benefit analysis is the foundation for Zero-Base Budgeting.
8. Zero-Base Budgeting cannot be applied in Government departmental budgets.

Answers

1. True 2. True 3. False 4. True 5. False 6. True 7. True 8. False

Fill in the Blanks

1. Zero-Base Budgeting overcomes the weaknesses of
2. Zero-Base Budgeting is ideal for implementation in

Answers

1. conventional budgeting. 2. non-manufacturing areas/Government budgets.

Descriptive Questions

1. What is meant by Zero-Base Budgeting? What are the different steps involved in it and how is it useful to the business? Explain its limitations. **(17.1 to 17.6)**
2. Justify Zero-Base Budgeting is superior to conventional budgeting. **(17.1, 17.2, 17.3 and 17.5)**
3. What do you mean Zero-Base Budgeting? How does it overcome the weaknesses of the conventional budgeting? **(17.1, 17.2, 17.3 and 17.5)**

Interview Questions

Q.1. What is 'Zero-Base Budgeting'? State its utility.

Ans. 'Zero-Base Budgeting' is the latest technique of budgeting. This is a managerial tool, where every manager has to justify each rupee of expenditure on the basis of cost-benefit analysis. This is applicable to the new as well as on-going projects/activities. This is more applicable in non-manufacturing areas such as research and development, training, legal, staff and support areas. This type of budgeting is ideal in Governmental activities.

