



Zero-Based Budgeting Represents a Revolutionary Approach to Planning Future Activities

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<p>Received: 15th July 2022 Revised: 23rd Aug 2022 Accepted: 15th Sept 2022</p> <p>CC License CC-BY-NC-SA 4.0</p>	<p style="text-align: center;">Abstract</p> <p>Zero-based budgeting is a structured method of budgeting for enterprise activities as if each were initiated from scratch, or "zero base." Under this approach, multiple alternatives for each activity are identified, costed, and assessed based on their potential benefits. The fundamental principle is that every unit of expenditure must be justified. This methodology contrasts with traditional budgeting practices, as it does not rely on prior expenditure levels and instead evaluates costs anew. In contemporary times, zero-based budgeting is increasingly recognized as a groundbreaking approach to planning future activities.</p> <p>Keywords: <i>decision packages, de novo budgeting, incremental budgeting, traditional budgeting, zero-based budgeting</i></p>
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Introduction

Zero-Based Budgeting (ZBB) is a budgeting method where all activities undergo reevaluation with each budget formulation. This approach necessitates managers to justify requested resources for all activities and projects, both ongoing and new, in a prioritized manner. Functional budgets begin with the assumption that the function has no existing cost (i.e., zero cost). Costs are then incrementally compared against benefits, leading to the determination of the maximum benefit for a given budgeted cost. ZBB represents a revolutionary departure from conventional budgeting practices. It could aptly be termed as 'De novo budgeting,' where budgets are formulated from scratch without reference to past budgets or actual expenditures. ZBB can be described as a planning and budgeting process wherein each manager is required to justify their entire budget request in detail, starting from zero base, thereby shifting the burden of proof to each manager to justify any expenditure. This approach entails analyzing all activities into decision packages, which are then systematically evaluated and ranked based on importance.

The basic requirements for application of ZBB are:

1. There must have a budgeting system within the organisation.
2. It requires managers to develop qualitative measures for use in performance evaluation.

ZBB is based on the premise that every rupee of expenditure requires justification.

The traditional budgeting approach include expenditure of previous year which are automatically incorporated in new budget proposals and only increments are subjected to debate. ZBB assumes that responsibility centre manager has had no previous expenditure. Importance features of ZBB are:

- Concentration of efforts is not simply of ‘*how much*’ a unit will spend but ‘*why*’ it needs to spend.
- Choices are made on the basis of what each unit can offer for a specific cost.
- Individual unit objects are linked to corporate targets.
- Quick budget adjustments can be made if, during the operating year costs are required to maintain expenditure level.
- Alternative ways are considered.
- Participation of all levels in decision-making.

Requisites for Implementation of ZBB

The steps involved in successful implementation of ZBB are as follows:

- Corporate objectives should be established and laid down in detail.
- Decision units are identified by dividing the organization according to functions or departments.
- The activity of each function or department is described, analyzed and documented.
- The targets and objectives of each activity are clearly determined ignoring existing budget.
- The performance assessment and measurement criteria for each activity is clearly defined.
- Each separate activity of the organisation is described in a decision package.
- In performance of an activity, the alternative methods and costs are evolved.
- Each activity or decision package is evaluated and ranked by cost benefit analysis.
- The benefits achieved at different levels of funding are analyzed.
- The consequences of not funding the activity are to be estimated.
- Resources in the budget are then allocated according to the resources available and the evaluation and ranking of the competing packages.
- Available resources are directed towards alternatives in order of priority to ensure optimum results.

ZBB and Traditional Budgeting

ZBB reverses the working process of traditional budgeting. Traditional budgeting starts with previous year expenditure level as a base and then discussion is focused to determine the ‘*cut*’ and ‘*additions*’ to be made in previous year spending. In ZBB no reference is made to previous level of expenditure. A convincing case is made for each decision unit to justify the budget allotment of resources for that activity during the period under consideration and the available resources are allocated to different activities in order of its importance to optimize results. The points of difference between traditional budgeting and ZBB are as follows:

- Traditional budgeting is accounting-oriented. Main stress happens to be on previous level of expenditure. ZBB makes a decision-oriented approach.
- In Traditional budgeting, first reference is made to past level of spending and then demand is made for inflation and new program. In ZBB a decision unit is broken into understandable decision packages which are ranked according to importance to enable top management to focus attention, only on decision packages which enjoy priority to others.
- In Traditional budgeting, some managers deliberately inflate their budget request so that after the cuts they still get what they want. In ZBB, a rational analysis of budget proposal is attempted.
- Traditional budgeting is not as clear and responsive as ZBB
- In traditional budgeting, it is for top management to decide why particular amount should be spent on a particular decision unit. In ZBB their responsibility is shifted from top management to the manager of decision unit.
- Traditional budgeting makes a routing approach, while ZBB makes a very straightforward approach and immediately spotlights the decision package enjoying priority over others.

ZBB and Incremental Budgeting

The Zero-Based Budgeting (ZBB) approach and another incremental budgeting method both consider incremental changes in costs and benefits, but they differ in their focus and presentation.

In ZBB, the budgeting process starts from a zero-cost baseline, evaluating each activity based on its incremental costs and benefits. Conversely, the alternative incremental budgeting approach assesses the effects of changing the level or nature of operations from the current state. For instance, a company may analyze the impact of increasing or decreasing production volume on costs and benefits.

Under incremental budgeting, managers typically present total funds required for the upcoming period, with minimal detail about specific activities covered. However, ZBB provides a detailed breakdown of both current funding levels and proposed increases, shifting the focus towards activities and outputs rather than just the required monetary input.

By scrutinizing activities and outputs in detail, ZBB enables a more comprehensive analysis of a unit's total operations in alignment with organizational objectives. This approach facilitates consideration of alternative methods for delivering required services in the upcoming budget period.

ZBB and Decision Packages

ZBB requires that decision packages are developed and ranked. The first step of preparing the decision package is very critical as the final budget is developed on the basis of these packages which prioritized. The final budget is produced by taking packages that are approved for funding, sorting them into their appropriate budget units and adding up the costs identified on each package to produce the budget for each unit. As the process of ZBB depends on prioritizing of decision package it is very crucial that decision package are prepared very carefully after a thorough understanding of their contribution to goals and objectives of organisation, resources required (inputs), and expected outputs. The concept of minimum level funding, and the preparation of different decision packages for incremental levels of funding and performance make the preparation of these package a complicated exercise.

Determining the activities around which decision packages should be prepared is the most important step in ZBB. It is necessary to prepare decision packages at the beginning of each organisation to promote detailed identification of activities and alternatives. In order to avoid complications and to give a yardstick or benchmark for control purpose it is necessary to develop norms by identifying the basic requirements (inputs/resources for minimum level) to run the program and the expected outputs at this minimum level funding. Minimum level is that performance or funding level below which it is not feasible to continue a program as it cannot fulfil its objectives. Just as over-allocation and wasteful expenditure should be curtailed, it is necessary to avoid under-allocation and non-availability of funds for proper implementation of programs. Determination of minimum level is a difficult task and it is always much below the current level of expenditure in any government organization. They can either reduce spending and adhere to current level of activity or enhance the level of activity and performance for the same amount of spending. For this purpose also, development of norms is necessary, so that we are able to define how much of the same activity is feasible at the minimum level of funding or what are the extra activities to be included at current higher level of funding. Then performance measures for each level are necessary to develop proper information and control systems.

The decision package are of two types:

1. Mutually Exclusive Packages- Each of these contains an alternative method of getting the same job done. The best option among the packages must be selected by cost-benefit analysis and the other packages are then discarded.
2. Incremental Packages- These divide an aspect of work or activity into different levels of effort. Base package will describe the minimum amount of work that must be done to carry out the activity.

ZBB is Beneficial

The arguments in favour of implementation of ZBB are:

- In course of ZBB process, inefficient and obsolete operations are identified and removed.
- It adds psychological impetus to employees to avoid wasteful expenditure.
- It help in close monitoring of cost behaviour patterns in order to decide the effect of alternative course of action.
- It is a planning tool for management which helps in identification of wasteful and obsolescent items of expenditure.
- The documentation required enables a coordinated in-depth knowledge of an organization's operations to be available to all management.
- The scarce resources will be allocated more efficiently to activities and departments of the organization according to priority of programs. This system weeds out inefficiency and reduces the cost of production because every budget proposal is evaluated on the basis of cost-benefit analysis.
- ZBB is not based on incremental approach, so it promote operational efficiency because it requires manager to review and justify their activities or funds requested.
- Since this system requires participation of all managers in preparation of budgets, responsibility of all level of management is successful execution of budgetary system can be ensured.

Criticism Levelled Too

The criticism levelled against ZBB for the following reasons:

- ZBB will lead to an enormous increase in paper work created by the decision packages. The assumptions about costs and benefits in each package must be continually updated, and new packages developed as soon as new activities emerge.
- ZBB is criticized for emphasis of short-term benefits to the detriment of long-term benefits.
- ZBB may encourage the false idea that all decisions have to be made in the budget. Management must be able to meet unforeseen opportunities and threats in all times and must not be restricted from carrying out new ideas simply because they were not approved by a decision package cost benefit and ranking analysis.
- Where objectives are very difficult to quantify as in research and development or general administration, ZBB does not offer any significant control advantage.
- Defining the decision units and decision package is the difficulty encountered by companies introducing ZBB.
- ZBB requires a lot of training for managers. If managers do not understand correctly the idea at the back of ZBB, it cannot be introduced successfully.
- ZBB might call for management skills in decision analysis to construct decision packages which the organisation does not possess.
- Another problem with ZBB is the difficulty of the ranking process. Managers face the following three common problems.
 1. The large number of packages they have to rank.
 2. There is often a conceptual difficulty in having to rank packages which they regard as being equally vital, for legal or operational reasons.
 3. It is difficult to rank completely different types of activity, especially where activities have qualitative rather than quantitative benefits, such as spending on staff welfare and working conditions, where ranking must equally be entirely subjective.

Conclusion

In summary, Zero-Based Budgeting represents a formalized approach to budgeting for enterprise activities, treating each activity as if it were initiated anew, or "from zero base." Unlike traditional budgeting methods which rely on historical trends or adjusted figures, ZBB begins with the premise that the budget for the upcoming period is zero, requiring every process or expenditure to be fully justified for inclusion. This approach shifts the burden of proof to managers, compelling them to justify why expenditures should occur and to outline the consequences if proposed activities are not undertaken. ZBB involves identifying, costing, and evaluating multiple alternatives for each activity based on the benefits they offer. Existing activities are then compared with alternative resource allocations during the budgetary planning phase to ensure optimal allocation of resources.

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