Why Zero-Based Budgeting Goes Wrong

Four common pitfalls can keep companies from achieving lasting results.

By Jason Heinrich, Andrew Carleton and Tracy Thurkow

BAIN & COMPANY

Jason Heinrich is a Bain & Company partner based in Chicago. Andrew Carleton is a Bain partner based in London, and Tracy Thurkow is a partner in Atlanta.

Executive Summary

- More executives than ever are considering zero-based budgeting as a cost-cutting tool. But many will be disappointed, because they view it only as a cost-cutting tool and not as a big shift in cost management philosophy.
- When ZBB fails, it's usually because leadership is neither engaged nor aligned, cost-cutting is indiscriminate, cost control is the primary message, and execution is inadequate, prioritizing pace, tools and benchmarking over capability building.
- A fundamental change in mindset can make the difference between wasted hopes and winning the ZBB trifecta of boosting revenues, margins and employee engagement.

Few management tools can match zero-based budgeting (ZBB) as a way to overhaul the practices that keep a company from reaching its full potential. That is why so many business leaders see it as a no-brainer to manage costs better and drive strategic thinking at all levels of the organization. They are aiming to win the ZBB trifecta of growing both revenues and profits while boosting employee engagement. When Bain & Company recently surveyed nearly 1,300 executives across industries and throughout the world about their views on 25 different management tools, we learned that zero-based budgeting is increasingly top of mind. Across all regions, more than 50% of respondents surveyed in 2017 indicated an intention to use ZBB in 2018.

Companies that view ZBB as a mere tool—as opposed to a transformational approach to cost management—may achieve savings in their first year but then revert to old spending patterns. It is the difference between going on a crash diet to shed a few pounds and committing to lifestyle changes that improve your overall health, losing weight in the process.

However, if our past follow-on survey results are any measure, the number of companies deploying this solution—as opposed to intending to deploy it—will be substantially lower. While executives like ZBB in theory, when faced with the reality of what it takes to do it right, many opt to postpone or abort. They start out with the view that zero-based budgeting is a simple matter of ignoring last year's budget when developing this year's budget. But they often become intimidated when they discover that it is far more complex, representing a fundamental shift in the company's overall approach to cost management. Moreover, companies that view ZBB as a mere tool—as opposed to a transformational approach to cost management—may achieve savings in their first year but then revert to old spending patterns. It is the difference between going on a crash diet to shed a few pounds and committing to lifestyle changes that improve your overall health, losing weight in the process.

Just how daunted are executives by zero-based budgeting? Users gave it the lowest satisfaction rating of all 25 management tools in our survey.

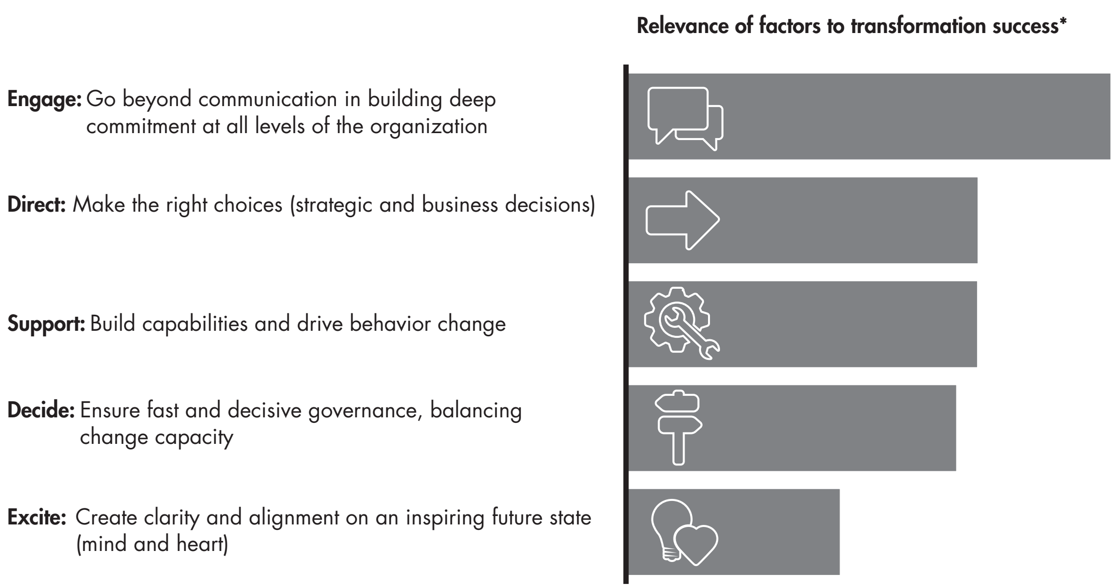
> Zero-basing cannot be a mechanical, finance-only effort. Instead, it is a chance to rethink all activity in the organization.

These executives likely would have changed their view if they had been armed with knowledge about what typically goes wrong with ZBB. When we surveyed more than 400 business leaders about their experiences with such transformational change efforts, they cited the need to build deep commitment at all levels of the organization, beyond communication; to make the right strategic and business choices; and to garner widespread support *(see Figure 1)*. Indeed, zero-basing cannot be a mechanical, finance-only effort. Instead, it is a chance to rethink all activity in the organization. Installing the nuts and bolts of a program is just the beginning. ZBB is a capability that both requires and enables culture change. When it goes sour, it's usually because leadership fails to energize the organization, win hearts and minds, and thoughtfully address the failure points.

Based on our work with hundreds of companies across industries, we have identified four common pitfalls. Here is why, despite their faith in ZBB's potential, some companies have so much trouble achieving results that stick over time.

Figure 1

Managing delivery risks is critical to success in transformational change efforts



*Based on responses from leaders who achieved 100% or more of their ambition
Source: Bain risk history survey, 2018 (n>400)

Pitfall #1: The insidious problem of public agreement but private dissent

Even the most ambitious ZBB initiative is doomed to deliver unsatisfying results unless leaders vocally endorse it from day one, striving to generate buy-in from the executive team and throughout the organization during the program's design and implementation. It needs to be a top-five priority on the CEO's agenda.

A new cost management capability represents a serious redirection for a company. ZBB is not a typical cost-cutting program that can be "unveiled," with minimal organizational involvement in its creation and minimal employee rewards for its success. That type of approach will only foster resentment and resistance.

Pitfall #2: Inflicting the same pain everywhere

Many associate ZBB with across-the-board cost-cutting. That is a misconception—and the wrong starting point. As a sophisticated cost management capability, zero-based budgeting helps a company clearly distinguish between strategic and nonstrategic costs—the first step toward rebalancing how every dollar should be spent to prioritize high-return investments.

As part of ZBB, companies evaluate their investment posture to understand where to devote resources and where to make deep cuts, based on their strategic priorities. They determine the capabilities in which they should invest to become best in class and those that they can deprioritize to become best in cost.

Pitfall #3: Making cost control the primary message

Too often, companies view ZBB as just another cost initiative instead of focusing on its other dimensions, such as the strategic reinvestments that fuel growth and the ownership mindset that kindles employee engagement. For example, ZBB helps eliminate the clutter that makes it hard for employees to do their jobs, simplifying the organization and the practices that frustrate results-oriented high performers.

Zero-based budgeting needs ongoing care and nurturing to deliver its full potential. Leaders need to make a fundamental mindset shift, moving from the posture of "We're going to roll out ZBB in the organization" to "ZBB will only work if we help the organization adopt and leverage it."

Pitfall #4: Not recognizing that execution is a people issue

Even when companies strive to craft an effective ZBB program, they may find themselves falling short with inadequate execution that prioritizes pace, tools and benchmarking over capability building. Many companies spend too little time and energy on the human aspect of teaching and training a new set of behaviors. It is one thing to install a new set of tools and processes to improve financial visibility and cost management. It is something else to fully integrate those tools into how employees work, introducing a new way of managing costs.

Ultimately, zero-based budgeting goes wrong when companies start with incorrect ideas about what it is and what it is not. Viewing it as a program to “install” is bound to disappoint. Instead, ZBB is a new capability that requires and enables culture change. It needs ongoing care and nurturing to deliver its full potential. Leaders need to make a fundamental mindset shift, moving from the posture of “We’re going to roll out ZBB in the organization” to “ZBB will only work if we help the organization adopt and leverage it.” The distinction is huge—and spells the difference between wasted hopes and winning the zero-based budgeting trifecta of boosting revenues, margins and employee engagement.

Shared Ambition, True Results

Bain & Company is the management consulting firm that the world's business leaders come to when they want results.

Bain advises clients on strategy, operations, technology, organization, private equity and mergers and acquisitions. We develop practical, customized insights that clients act on and transfer skills that make change stick. Founded in 1973, Bain has 56 offices in 36 countries, and our deep expertise and client roster cross every industry and economic sector. Our clients have outperformed the stock market 4 to 1.

What sets us apart

We believe a consulting firm should be more than an adviser. So we put ourselves in our clients' shoes, selling outcomes, not projects. We align our incentives with our clients' by linking our fees to their results and collaborate to unlock the full potential of their business. Our Results Delivery® process builds our clients' capabilities, and our True North values mean we do the right thing for our clients, people and communities—always.

Key contacts at Bain & Company

Americas

Jason Heinrich in Chicago *(jason.heinrich@bain.com)*
Tracy Thurkow in Atlanta *(tracy.thurkow@bain.com)*
Bradford Martin in Chicago *(bradford.martin@bain.com)*
Kurt Grichel in Seattle *(kurt.grichel@bain.com)*
Lewis Weinger in Dallas *(lewis.weinger@bain.com)*
Patrick O'Hagan in Boston *(patrick.ohagan@bain.com)*
Caperton Flood in New York *(caperton.flood@bain.com)*
Herbert Blum in Toronto *(herbert.blum@bain.com)*
Ron Kermisch in Boston *(ron.kermisch@bain.com)*
Jed Fallis in Toronto *(jed.fallis@bain.com)*
Peter Hultman in San Francisco *(peter.hultman@bain.com)*

Asia-Pacific

Vinit Bhatia in Hong Kong *(vinit.bhatia@bain.com)*
Kenji Govaers in Tokyo *(kenji.govaers@bain.com)*
Jean-Philippe Biragnet in Tokyo *(jean-philippe.biragnet@bain.com)*
Simon Henderson in Sydney *(simon.henderson@bain.com)*
Deepak Jain in New Delhi *(deepak.jain@bain.com)*

Europe, Middle East and Africa

Andrew Carleton in London *(andrew.carleton@bain.com)*
François Montaville in Paris *(francois.montaville@bain.com)*
Véronique Pauwels in Amsterdam *(veronique.pauwels@bain.com)*
Dominik Thielmann in Munich *(dominik.thielmann@bain.com)*
Christian Fenner in Munich *(christian.fenner@bain.com)*
Alasdair Robbie in London *(alasdair.robbie@bain.com)*

For more information, visit www.bain.com

Amsterdam • Atlanta • Bangkok • Beijing • Bengaluru • Berlin • Boston • Brussels • Buenos Aires • Chicago • Copenhagen • Dallas • Doha • Dubai Düsseldorf • Frankfurt • Helsinki • Hong Kong • Houston • Istanbul • Jakarta • Johannesburg • Kuala Lumpur • Kyiv • Lagos • London • Los Angeles Madrid • Melbourne • Mexico City • Milan • Moscow • Mumbai • Munich • New Delhi • New York • Oslo • Palo Alto • Paris • Perth • Rio de Janeiro Riyadh • Rome • San Francisco • Santiago • São Paulo • Seoul • Shanghai • Singapore • Stockholm • Sydney • Tokyo • Toronto • Warsaw Washington, D.C. • Zurich