

Accelerated Zero Based Budgeting: Immunizing against the Downturn



Roland
Berger





Accelerated Zero Based Budgeting: Immunizing against the Downturn

After ten years of continuous growth, the positive economic cycle has come to an end and the first of Europe's economies are heading into recession. Besides grappling with the external circumstances, companies commonly face the fact that the investments they have made in digitalization and operational excellence initiatives may not have been reflected in the balance sheet yet. The transformation feels more like a marathon than a sprint. As business leaders acknowledge the need to take the long view as they

strive to see strategic projects through to the end, smart cost management becomes crucial to bridge the gap between ensuring viability today and securing future fitness for companies.

So what is the key to efficient cost management under the altered conditions in which businesses now find themselves?

The zero based budgeting (ZBB) approach proved useful for many decades. At the core of ZBB is budget allocation based on the goals and market conditions of the future and not on last year's figures. The approach helped many companies to become more efficient, to cut unnecessary costs and to focus resources on growth.

However, classic ZBB is no longer sufficient to meet the challenges of digitalization, acceleration and rising complexity facing almost all industries. Especially not when the global economy's growth engine is faltering.

Roland Berger's "Accelerated Zero Based Budgeting" (AZBB) approach is a powerful update to a proven methodology. AZBB enables companies to rapidly adapt to the changing economic conditions and is a highly efficient lever that directly addresses cost structures. This paper describes the way AZBB can be helpful in preparing for the coming storm.

Adaptive Operations – The flexibility to face the new future

Inevitably, the digitalization, integration and inter-connectivity of value chains and business ecosystems also mean that knowledge and innovation cycles are constantly accelerating. This is evident both on the technology level and in the very high rate of change we now see in previously stable consumer needs, fashions, beliefs and cultural certainties.

Faced with an economy built on speed, key business processes and traditional organizational structures as well as the way companies build teams or cooperate with partners, customers, suppliers and external experts must radically change. A company's operational system must adapt to the conditions it finds itself in, namely faster change and an increasingly harsh economic climate. We call this Adaptive Operations.

The basic prerequisites to achieve a state of Adaptive Operations are a high degree of flexibility, lean and agile organizational and decision-making structures, excellent talent and a strong ecosystem that generates opportunities and innovations and limits risks. Above all, however, companies must be able to control their cost structures and adapt them quickly and effectively to changes in the market. This is the only way for firms to create the scope for strategic initiatives and to increase their resilience to exogenous shocks in an increasingly unpredictable and volatile world.

Cost management, deconstructed

The challenge in striving for fast and adaptive cost management and flexible budget planning lies in the fact that established processes, realities and responsibilities need to be reviewed – and then deconstructed as necessary. It is essential to take a very critical look at evolved structures and to ask what value they add to the overall success of the organization.

Probably the most significant cost management premise that needs to be challenged today is the practice of budgeting on the basis of prior year figures. This approach is unsuited to the demands of a constantly changing world. The budget structures of past years cannot simply be rolled forward and used as the budgeting basis for future years. Operational excellence is not achieved by deducing the new from the old. The question to be asked instead is, "Which measures and resources do I now need to successfully keep pace with extreme market developments?" Yesterday's norms must not determine tomorrow's standards.

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The art of gentle disruption

This insight is the starting point for zero based budgeting (ZBB). The core of the management accounting method developed more than 50 years ago by Peter A. Pyhrr consists in determining each individual budget allocation based on the specific goals of the upcoming planning period. In other words, deriving the budget from the future and not from the past.

Targets that are prioritized according to their importance, alongside cost caps and policies set by the owner of the respective cost category, form the framework for ZBB. It results in the consideration of internal and external benchmarks, the rationalization of planning, the clear allocation of cost items to results and a correspondingly high level of transparency for individual cost items. Because sacred cows can only survive in the shadows where no one looks too closely for years. And that is precisely what is systematically ruled out by ZBB, a process that is initiated anew every single year. With the help of ZBB, companies can determine exactly which budgeted activities have made a particularly effective contribution to their growth.

At the same time, ZBB has the potential to bring considerable unrest into the organization. Changing established routines and well-rehearsed communication and negotiation processes can cause tensions and conflicts on both the professional and the emotional level.

The art of ZBB lies in maintaining the optimal balance between the positive effects of the changes introduced and the conflicts within the organization that may

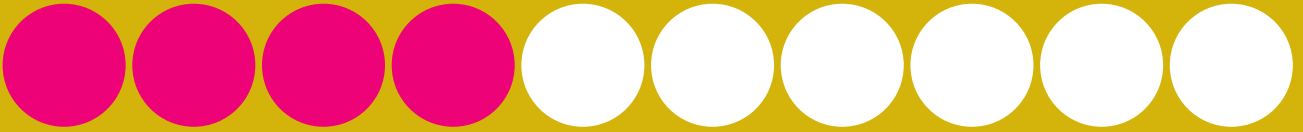
be associated with them. If too many compromises are made, the benefits of the approach will be disproportionate to the costs of the deep disruption. An excessively radical approach can have a dysfunctional effect if it destroys the basis for smooth-running processes and valuable long-term growth opportunities just because they appear questionable from a short-term perspective. This is a risk that must be taken seriously, especially in the innovation and transformation context.

Successful zero based budgeting is not, therefore, a matter of slashing budgets across the board. It's about applying the art of gentle disruption. It requires from the outset the full involvement of the organization's top decision-makers alongside regular, systematic monitoring of the process and intensive, cross-departmental communication between process participants at all levels of the company. Only then will it be possible to bring active cost management geared to short cycles into harmony with a strategy that looks to the long term.

The consumer goods industry is a good example of the fact that zero based budgeting works. Leading companies in the sector use it to keep their SG&A costs down.

ZERO BASED BUDGETING

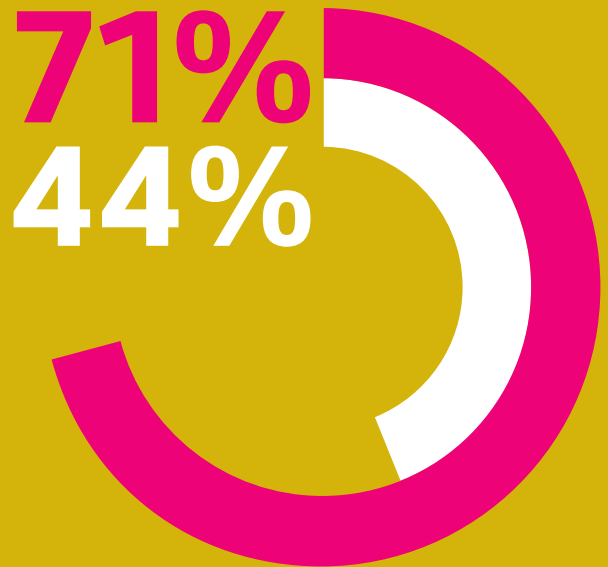
An example from the
consumer goods industry



4 of the global top 10

Unilever, Coca-Cola, Anheuser-Busch InBev and Mondelez
apply this powerful cost management tool.

71% of companies applying ZBB
keep SG&A cost growth
below revenue growth, while
only **44%** of companies without
ZBB achieve such ratios.



The potential savings amount to **USD 108 bn** if the entire
consumer goods sector used ZBB (on average 17% of SG&A
costs per company).

AZBB METHODOLOGY OVERVIEW

The AZBB approach relies on 3 key types of levers:
renunciation, productivity and resource levers

RENUNCIATION LEVERS

Are we doing the right thing?

Do we need this activity?

What is the right "service level"?

PRODUCTIVITY LEVERS

Are we doing things right?

Who should do it?

Can it be simplified?

Can it be automated?

RESOURCE LEVERS

Are we using the right resources?

Is the activity non-core and delivered by an external service?

Are resources over/under-qualified?



15 to 25 percent cost savings: Accelerated ZBB as a new efficiency lever

ZBB has already helped many successful companies to become more powerful and efficient, to cut unnecessary costs and to invest the newly available resources in growth segments. Experience shows, however, that the "classic" form of ZBB is no longer sufficient to meet the challenges of digitalization and the disruption facing almost all industries. Especially not when the global economy's growth engine is faltering.

The extreme speed of change and the complexity of transformative processes call for an update to ZBB. Roland Berger has developed a proprietary new approach, "Accelerated Zero Based Budgeting", which creates financial leeway for the transformation of business models and enables companies to rapidly adapt to the changing economic circumstances they find themselves in. As an efficiency lever that directly addresses companies' cost structures, it is an ideal complement to lean initiatives that focus on process efficiency.

A special feature of AZBB is that this approach – unlike many other optimization programs such as Lean or Six Sigma – does not originate from within production and then has to be adapted to other areas of the company with varying degrees of success. AZBB is designed as a tailored cost management solution for companies that need to quickly identify and realize concrete savings potentials in addition to lean and efficient processes in order to invest the redirected resources in growth initiatives.

In contrast to traditional cost management methods, AZBB shifts cost responsibility to the line managers. This means that decisions on which costs to reduce are based on experience and knowledge that only those on the front line of the business (in sales/distribution, production, etc.) can have. And they are based on a broad organizational consensus without which uncompromising cost discipline is impossible and cost initiatives cannot be successful in the long run.

It takes the participation of all employees who hold operational responsibility for cost efficiency to guarantee the sustainability and success of the measures agreed upon. Project analyses show that the use of AZBB can save an average of 15 to 25 percent of the addressed costs. In addition, the knowledge generated through AZBB is systematically collected and made available as a resource for the next program. This ensures a continuous increase in "AZBB Excellence".

Roland Berger's AZBB approach offers several advantages over classic ZBB

1. Fast identification of potential savings

The basis for the AZBB projects is an extensive database of sector-wide benchmarks and best practices. This allows areas with particularly high savings potential to be identified quickly. In addition, data-assisted performance scans ensure that initiatives are calibrated as efficiently and accurately as possible.

2. Cross-functional perspective

In contrast to classic ZBB methods, the focus of AZBB is not limited to general overheads such as personnel, finance or IT costs. As a cross-functional approach with an end-to-end perspective, AZBB also integrates central corporate functions such as marketing, sales, procurement and supply chain management.

3. Variety of instruments

Through consistent and early involvement and commitment of line managers in cost reduction initiatives, AZBB can activate levers that are not available in purely top-down projects. This guarantees better results and a wider project reach.

4. Sustainability

ZBB initiatives often end with lists of cost reductions being handed over to the line managers with operational responsibility. By contrast, AZBB not only ensures that cost reduction potential is identified but also helps to implement it and safeguard the changes long term. At the same time, the consensus-based, integrative approach prevents people attacking costs unilaterally and prematurely. This ensures that structures and projects that are problematic from a purely cost perspective but of long-term strategic importance can be protected.

AZBB at Roland Berger – From zero to cost excellence in three months

AZBB is intended to enable companies to adapt their cost structures quickly and comprehensively to changes in the market and competitive situation as they emerge. The AZBB projects carried out by Roland Berger are therefore designed for extremely fast implementation. As a rule, an AZBB project lasts three months, with a multi-stage approach proving to be particularly effective:

STEP 1

The program begins with a preparatory phase, in which the starting points and cost reduction targets are defined based on benchmarks and best practices from Roland Berger's project experience. The combination of quantitative facts and qualitative potentials produces significantly higher savings. In addition, it ensures stakeholder acceptance, as discussions are held with everyone as equals (e.g. the combination of commercial and technological expertise, or precise knowledge of the procurement markets in areas like marketing/media buying).

STEP 2

In the next step, the company's current cost structures and activities are subjected to a comprehensive diagnostic analysis to identify the areas with the highest savings potential. These areas are then

analyzed in detail on the basis of three clusters of questions:

- Should we be doing this? Do we really need this activity and, if so, do we need to be doing it at this level of quality and frequency?
- Are we doing whatever we're doing right? Can the activity be consolidated, decentralized or outsourced? How can we make the processes simpler and faster or even automated?
- Are we allocating the right resources to the right activity, done right? Can we use any offshoring or nearshoring solutions? Are the dedicated resources proportionate to the complexity of the activity?

STEP 3

On the basis of this analysis, a list of prioritized short-term optimization levers is created, which can be refined and validated in several further steps.

ROLAND BERGER'S AZBB APPROACH

AZBB is based on a systematic 3-step approach.
Results can be generated in ~3 months

1

Launch and mobilization

- Communication
- Scoping
- Ambition

Ambitions, issues and priorities

2

Activity-based cost base diagnosis

- Activity transparency
- Cost structure analysis
- Identification of areas with potential

Activity analysis by Decision Units (DU)

Quantification of short-term optimization levers

- Optimization lever identification
- Quantification of potential
- Ambition

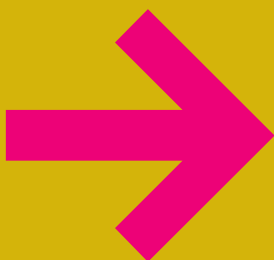
Preliminary list of quantified cost optimization levers

3

Validation of targeted short-term savings

- Detailing of levers
- Risk evaluation
- Creation of link to budget
- Implementation preparation

**Targeted cost base estimation
Action plans and reviewed budgets**



Expected results:

**15–25% reduction of
addressed cost base**

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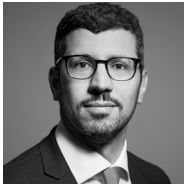


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Companies worldwide are faced with an economy transformed by acceleration, a harsh political climate, digitalization and changing cultural patterns. Keeping up with radical change requires new perspectives on corporate operations structures and the way companies build supply networks, control risks, respond to customer needs and attract talent.

Adaptive Operations is Roland Berger's approach to help businesses adjust to these challenges by achieving a high degree of flexibility, resilience, elasticity, cost effectiveness and optimized working capital.

Find out more about the future of operations:

➔ rb.digital/opera_2030_en

#OPERA 2030

by Roland Berger

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