

# *Chapter 7*

## ZERO-BASE BUDGETING (ZBB)

# INTRODUCTION

- The need for an effective budgeting technique is increasingly felt in the constantly changing environment of modern time. The traditional budgeting has not measured upto this expectation. The traditional budgeting process takes up the previous allocation for various activities as the base in formulating the new budget.
- On this basis, the new allocations are made with a few changes here and there, e.g., ₹ 50,000 were spent during the previous year on advertisement. On this basis, the fresh allocation may be made at, say, ₹ 60,000 for next year and this may be included in the new budget.
- The Zero-base budgeting does not take any previous allocation as the base. It rather, subjects all activities and expenditures, current as well as new, to fresh scrutiny. This shows that the allocation to any activity during the previous year is not accepted as the base. The allocation for all activities is treated as zero.

- Thus ZBB removes the following defects of traditional budgeting.

- The unnecessary and insufficient expenses of previous years are carried forward, as they are not recognized and removed.
- Managers never try to identify the wasteful expenditure nor think of alternatives means of achieving the targets.
- As no analysis of proposals included in the budget are made, the main issues are not highlighted. Hence, the allocation of funds become irrational.
- In traditional budgeting, the managers simply add some amount to the previous allocation to various projects. Thus, they ask for more and more funds without thinking whether it will benefit the business.
- As funds are blocked in unnecessary and wasteful proposals, new projects do not get the priority that they deserve, as enough funds are not available for them.
- Progressive atmosphere does not prevail in the enterprise as managers are not progressive and do not want to come out of old traditions.

# MEANING AND DEFINITION OF ZBB

- Zero base budgeting is used for strict analysis of costs and benefits of any new projects before they are included in the budget.
- In simple words, “Zero-base budgeting is a process of reviewing, analyzing and evaluating each demand to be incorporated into the budget, so that its justification for including it in or excluding it from the budget can be determined.”
- According to David Lieninger, “ ZBB is a management tool, which provides a systematic method for evaluating all operations and programmes, current or new, allows for budget reductions and expansions in a rational manner and allows re-allocation of sources from low to high priority programmes.

- From the above definitions, it is clear that –
  - ZBB is a method of evaluating each proposal, programme and operation before it is included in budget.
  - Each proposal put forward by any manager has to be justified.
  - Alongwith the new proposals and programmes, even old ones are put to strict scrutiny.
  - Funds are diverted from low-priority proposals to high priority proposals.

## **STEPS IN ZERO BASED BUDGETING**

Identifying the Decision Units



Making Decision Packages



Ranking Decision Packages



Allocating Available Resources



Controlling and Monitoring

# Traditional Budgeting

Vs.

# Zero Base Budgeting

Basic Difference	Traditional Budgeting	Zero Base Budgeting
<b><u>Emphasis</u></b>	It is accounting oriented; emphasis on “How Much”	It is more decision oriented; emphasis on “Why”
<b><u>Approach</u></b>	It is monitoring towards the expenditures	It is towards the achievement of objectives
<b><u>Focus</u></b>	To study the changes in the expenditures	To study the cost benefit analysis
<b><u>Communication</u></b>	It operates only Vertical communication	It operates in both directions horizontally and vertically
<b><u>Method</u></b>	It is based on the extrapolation i.e. from the yester figures future projections are carried out	Its decision package is totally based on the cost benefit analysis.

## **Advantages of ZBB**

- (1) Inefficient or obsolete operations can be identified and discontinued
- (2) ZBB leads to increased staff involvement at all levels since a lot more information and work is required to complete the budget
- (3) It responds to changes in the business environment
- (4) Knowledge and understanding of the cost behaviour patterns of the organisation will be enhanced
- (5) Resources should be allocated efficiently and economically

## **Disadvantages of ZBB**

- (1) It emphasises short-term benefits to the detriment of long-term goals.
- (2) The budgeting process may become too rigid and the organisation may not be able to react to unforeseen opportunities or threats
- (3) The management skills required may not be present
- (4) Managers may feel demotivated due to the large amount of time spent on the budgeting process
- (5) Ranking can be difficult for different types of activities or where the benefits are qualitative in nature



# ZERO BASED BUDGETING - ZBB

**Definition:-** ZBB in management accounting involves preparing the budget from the scratch with a zero-base.

## **Steps in Zero Based Budgeting**

- 1) Identification of a task.
- 2) Finding ways and means of accomplishing the task.
- 3) Evaluating these solutions and also evaluating alternatives of sources of funds.
- 4) Setting the budgeted numbers and priorities.

**ZBB Example:-** Say a manufacturing dept. spent \$10 million last year. So in current year, it can either increase or decrease the requirement to \$11 million or \$9 million respectively. ZBB involves calculating all the expenses of the dept. and justifying each of them. This reflects the actual requirement which may be \$10.6 million.

**How Zero Based Budgeting is different from Other Methods?**

**Accuracy and Efficiency**

**Coordination and Communication**

**Time-Consuming**

**May be Expensive**

### **ADVANTAGES**

### **DISADVANTAGES**

**Reduction in redundant activities**

**Budget Inflation**

**High Manpower Requirement**

**Lack of Expertise**