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M. Frank Barton Jr.

Darryl G. Waldron

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Zero - Based Budgeting: Is it New, Or Unique?

by M. Frank Barton, Jr. and Darryl G. Waldron

Zero-based budgeting is attractive conceptually and provides many avenues for implementing imaginative approaches to managerial decision making. It is not a new or unique approach to budgeting, as many have tried to suggest, but a practical approach that has been used by good managers since the early days of the commercial revolution.¹ In applying zero-based budgeting one is forced to consider each function performed, the expected benefits of each alternative, and the cost of those benefits. Budgeting systems labeled as traditional are, upon closer examination, contemporary in nature. They were devised for use in organizational settings which often encourage suboptimization and "empire building" by managers who are accountable to a diverse set of constituents having significantly different information requirements, to say nothing of investment objectives. True budgeting is really zero-based budgeting, found, perhaps, in its purest form, among small businesses unable to afford the more popular incremental approach.²

Commonly accepted budgeting processes are still a part of zero-based budgeting with one important qualification; all items at all levels are questioned. Management is encouraged to search actively for business opportunities, to forecast business environments, and to establish measurable business objectives and develop long-range plans. The development of annual or short-range plans and profit objectives integrates capital rationing and cost-benefit analysis with line item

budgeting. Based on guidelines provided by management, for a budget line item to survive, the function must be justified at a selected level of operation and cost corresponding to that level of activity when measured through cost/benefit and performance analysis. Support necessary to operate at different levels is subjected to incremental analysis and scarce resources are allocated to those activities promising the greatest incremental gain. Prior years' budgets may be useful in an historical sense for identifying work trends and relationships among critical performance variables; however, no item is considered above question, and every activity must be cost justified at forecasted operating levels. Here, for example, "same as last year" sufficient cost justification under the incremental approach used by at least one leading multinational firm with which the writers are familiar would be clearly insufficient justification under a zero-based system.

Zero-based budgeting should not be viewed solely as a means of cutting cost, but rather as a method of gaining more effective control of an organization and its cost generating activities. In both government and industry we continually hear the comment, "if we had the funds and adequate staffing, that service would be provided" while undertaking projects in other areas that are neither required nor of equal benefit to owners, clients, or the public. The zero-based approach provides for the identification of these less productive functions and promotes the redirection of scarce

resources to activities which promise the greatest incremental gain for the operation as a whole.³

Implementing a zero-based budgeting system can, and often does, represent a threat for many employees, particularly where it constitutes a radical departure from established budgeting practices. The employee's job security is often perceived as being threatened and, in many cases, individuals are ill-equipped to actively participate in the zero-base process. Management can, to some extent, offset such problems through training sessions involving top, middle, and lower levels of management as well as operating personnel who will ultimately determine the success of any changes in the budgeting process. Such training must precede installation of a zero-base system. Emphasis should be placed on the potential of zero-base budgeting for generating improvements in services, identifying and supporting essential functions not adequately funded under existing budgeting procedures, for improving management's ability to exercise control within their functional areas, and the specific benefits that will accrue directly to management and operating employees as a consequence of more efficient resource utilization.

The chances of successfully implementing a zero-base budgeting system can be enhanced by first developing a strategy for initiating the necessary changes:⁴

1. Conduct a series of meetings to discuss zero-based budgeting, educating those expected to use it—exploring what it is and what it is not and what it can and cannot realistically accomplish.
2. Discuss the application of zero-based budgeting to "our" situation and the importance of optimizing system-wide performance.
3. Develop a manual of operation with guidelines for identifying decision work units, minimum increments and ranking of decision units.
4. Conduct training programs for unit managers during which emphasis is placed on similarities as well as differences in existing and planned systems.
5. Establish a timetable for each project, using, to the extent possible, a participatory approach.
6. Provide guidance to unit managers as budgeting processes are conducted and refined.



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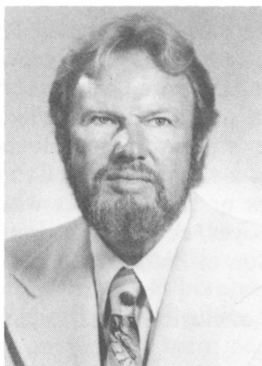
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7. Assist top management in their evaluation of functional rankings and work increments.
8. Emphasize the integration of functional units and related decision packages to achieve a "systems affect".
9. Prepare and assemble the budget on a system-wide basis.
10. Emphasize participation and open communication throughout the budgeting process.

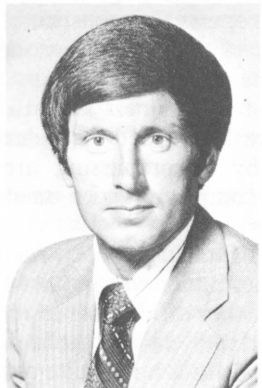
The adoption of zero-base budgeting since Texas Instruments, Inc., popularized the concept in 1970 has been widespread. Well over one hundred companies have embraced the zero-base concept including Allied Van Lines, Westinghouse, Xerox and such public entities as the State of Georgia, and the State of Texas. Refinements in the process have come with the broader acceptance and a more realistic appreciation of what zero-base budgeting can and cannot accomplish. Among the proven advantages accruing to users of zero-based budgeting are:

1. A more efficient allocation of financial resources.
2. A more formalized structure for budgeting discretionary costs.
3. Early initiation of strategic planning well in advance of the budgeting process.
4. Increased participation by lower and middle management in the budget process.
5. Improved quality and quantity of information at all levels of management.
6. Greater availability of data necessary for measuring effectiveness and, to a lesser degree, efficiency for discretionary cost centers⁵

The term "zero-based" budgeting may be new, although the concept is not. It has, however, caught the imagination of many managers in the public and private sectors. Its adoption can result in the improved use of resources, better products and services, and increased profit for investors, particularly in those situations where abuses of incremental budgeting are tolerated or even provided for. Zero-based budgeting offers a theoretically sound basis for identifying essential work functions, reallocating resources, improving planning, and better controlling operations. Used correctly, the zero-base approach to



M. Frank Barton, Jr. CPA, Ph.D., is Assistant Professor of Accountancy at Memphis State University. His recent publications include an article in the Fall 1978 issue of Government Accountant Journal, and The Bottom Line: Your Career in Accounting published in 1977 by Horton and Daughters.



Darryl G. Waldron, Ph.D., is Assistant Professor of Management at Memphis State University. His research interests include capital structure and its relationship to the cost of capital, and he is a contributor to various professional marketing and management journals.

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budgeting can complement the development of an integrated organizational system. However, as is so often the case, the level of acceptance is at least as important as the technology involved in converting planned to actual performance. ■

Notes

¹Actually, the first evidence of the implementation of a formalized zero-base system occurred within the United States Department of Agriculture during preparation of their 1964 fiscal year budget. Secretary Orville Freeman who, as governor of Minnesota, had developed a keen interest in budgetary problems stated as early as 1961: "I think we should in a real sense reconsider the basic funding for each program — justify them from zero in the budgetary phase." Letter from Orville Freeman, United States Secretary of Agriculture, to David Bell, United States Director of the Budget, Washington, DC, August 16, 1961.

²The "incremental approach" as it applies to budgeting, suggests that attention is focused on only the changes or marginal differences that occur between existing appropriations and proposed expenditures. Such a process accepts the existing base and examines only the increments which extend the current budgeting program into the future. Such an approach encourages the curve of expenditure activities to be continuous and upwards. For a more comprehensive discussion of incrementalism applied to budgeting refer to: Charles E. Lindblom, "Decision-Making in Taxation and Expenditures", *Public Finances: Needs, Sources, and Utilization*, (Princeton, N.J.: Princeton University Press, 1961), pp. 287-93.

³While it represents a separate area of study, the reader may find it worthwhile to review the concept of "management from a systems point of view". One objective of an effective budgeting system should be the integration, through more efficient control, of organizational sub-systems into a functioning whole. This concept is carefully examined in: Robert J. Mockler, "The Systems Approach to Business Organization and Decision Making", *California Management Review*, Vol. 11, No. 2, pp. 53-58.

⁴In this article, zero-base budgeting is defined as: An operation, planning, and budgeting process, which requires each manager to justify his entire budget request in detail, and shifts the burden of proof to each manager to justify why he should spend any money. This procedure requires that all activities and operations be identified in decision packages which will be evaluated and ranked in order of importance by systematic analysis. For a more detailed presentation refer to: Peter A. Phyr, "Zero-Base Budgeting", *Harvard Business Review*, Volume 48, Number 6, November-December, 1970, pp. 111-21.

⁵George S. Minmier, "Zero-Base Budgeting: A New Budgeting Technique for Discretionary Costs", *Mid-South Quarterly Business Review*, Volume XIV, No. 3, October, 1976, pp. 3-8.

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