

# ZERO BASED BUDGETTING

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## TOPICS TO BE DISCUSSED:

- What is zero-based budgeting?
- Difference between traditional budgeting and zero-base budgeting.
- Process involved in zero-base budgeting.
- Advantages and disadvantages .

## What is Zero-Base Budgeting?

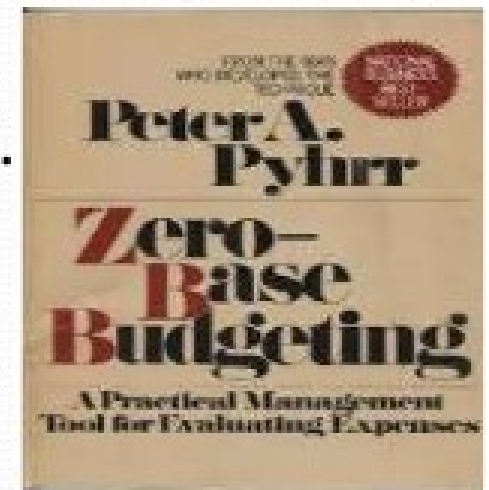
- A method of budgeting in which all expenses must be justified for each new period. Zero-based budgeting starts from a "zero base" and every function within an organization is analyzed for its needs and costs. Budgets are then built around what is needed for the upcoming period, regardless of whether the budget is higher or lower than the previous one.

# Definition...

- The Objective of Zero Based Budgeting is to “reset the clock” each year.
- The Traditional incremental budgeting assumes that there is a guaranteed budgetary base-‘the previous year’.
- Zero Based Budgeting implies that managers need to build a budget from the ground up, starting at zero.
- Resources are not necessarily allocated in accordance with previous patterns and consequently each existing item of expenditure has to be annually re-justified.
- Purpose - ZBB is to reevaluate and reexamine all programs and expenditures for each budgeting cycle by analyzing workload and efficiency measures to determine priorities or alternative levels of funding for each program or expenditure.
- Through this system, each program is justified in its entirety each time a new budget is developed

# Historical Development - ZBB

- Zero-base budgeting (ZBB) became popular in the 1970s but the concept has been around since as early as 1924 when British budget authority E. Hilton Young advocated complete justification of every item requested in a budget.
- Peter Pyhrr, who created and developed a ZBB system for Texas Instruments as part of his responsibilities as control administrator in 1962 is called "**Father of ZBB technique**".
- In 1962 the U.S. Department of Agriculture adopted a ground-up system of budgeting which is considered to be the first formal use of ZBB in the U.S. government.



# Historical Development - ZBB- India

- In India, ZBB was implemented in Science & Technology in the year 1983
- It was adopted by Govt India in 1986 as a technique for determining expenditure budgets. The Ministry of Finance made it mandatory for all the administrative ministries to review their respective programs and activities in order to prepare expenditure budget estimates based on the principles of zero-base budgeting.
- In 1986, Rajiv Gandhi eager to take India into the 21st century, wished to adopt zero-based budgeting (ZBB) & tried to implement ZBB in Defense Ministry also.
- ZBB was later emphasized in the Seventh Five year Plan(1988-93) – Transportation sector.
- The Maharashtra government renamed and used it as development based budget.
- However not much progress in this regard has happened on this area since.



## Differences:

### ○ TRADITIONAL

- It is more accounting oriented.
- Its approach is monitoring towards expenditure.

### ○ ZERO-BASE

- It is decision oriented.
- Its approach is towards achievement of objectives.

- Its focus is on increase or decrease of expenditure over the past.
- In traditional budgeting, communication is very vertical.
- It focus is on cost benefit analysis.
- It encourages communication both vertical and horizontally.



## Steps involved in ZBB

1. Identification of decision units.
2. Analysis of each decision unit through development of decision packages.
3. Evaluation and ranking of decision packages to develop the budget.
4. Preparing the budget including those decision packages which have been approved.



## Process :

- The objective of budgeting should be determined. When the objective is clear, then efforts will be made to achieve that objective.
- Next is to decide which operational areas should be used or applied.
- The next step in zero based budgeting is developing of 'decision packages'.

- Cost and benefit analysis should be undertaken.
- The final step involved in zero-based budgeting is concerned with selected, approving decision packages and finalizing the budget

# Advantages Of Zero Base Budgeting

- Out of date inefficient operations are identified.
- Allow managers to quickly respond to changes in external environment.
- It Promotes questioning and challenging attitudes.
- It ensures efficient use of limited resources by allocating them according to the relative importance of the programs.
- The annual review of the programs indicates the relative worth of the programs and thus ensures no programs continues beyond its productive life.
- It helps the management to design and develop cost-effective techniques for improving operations.
- The corporate objectives can be achieved more successfully under zero-base budgeting.
- The establishment of decision units makes the performance evaluation system more effective.



# Limitations of Zero Base Budgeting

- Increased paper work.
- Cost of preparing many packages.
- Subjective ranking.
- More emphasis on short term benefits and Qualitative benefits are ignored.
- Small organization cannot afford it.
- The identification of decision units and decision packages creates number of problems for the organization(Decentralized).
- The process of zero base budgeting requires experiences, intelligence, expertise, and continuous training on the part of executives. Thus , it is not suitable for an ordinary organization.