



TOOLKIT 40 – ZERO BASED BUDGETING

- ❖ **Ensure your costs are in line with sales in order to achieve desired profit levels.**
- ❖ **Cut out flab and unnecessary costs.**
- ❖ **Re-focus resources on the things that add real value.**

Zero Based Budgeting is a radical approach to delivering required profit levels. Very often costs steadily build up over years and are never really challenged – they become a fixed cost.

Zero Based Budgeting strips out all unnecessary costs and helps your business get back to basics.

ZERO BASED BUDGETING

Most businesses when budgeting take a guestimate at future sales (1), add in the existing costs (2) and what's left is profit or loss (3).

(1) Sales estimate	£50m
(2) Costs as before or slightly amended	£49m
(3) Profit	£1m

In Zero Based Budgeting you do it in a different order. Sales guestimate (1), profits required (2), what we can afford to spend to achieve profit required (3)

(1) Sales estimate	£50m
(2) Profits required	£5m
(3) What we can afford to spend	£45m

The management challenge then is to decide what they need to spend the £45m on in order to hit the profit target. This forces tough decisions on resources and strips out non-essentials. It is quite a brutal process which is best done by considering 'what-ifs' and different options.

Zero Based Budgeting can be done at a number of levels; business overall, department or business unit.

Here is the process:

STEP 1

Decide what level you are going to work at; business, department or business unit.

STEP 2

Determine next 12 months sales estimate.

STEP 3

Decide what net profit is required.

STEP 4

Subtract Step 3 from Step 4 and this is the level of cost that can be afforded.

STEP 5

Determine which costs are fundamental and cannot be scrapped or reduced. Interestingly, there are usually very few!

STEP 6

Decide what to spend the costs left on after completing Step 5.

STEP 7

Construct a budget based in the **** and monitor it carefully?