The fall and rise of zero basing

Realizing value series

Rapidly changing business models demand increasingly agile responses, as resources shift to support strategic objectives. The true value of zero based cost management lies in driving trade-offs between risk and value, thereby facilitating this need to constantly direct resource to the point of greatest strategic worth.

The volume of articles published in 2017-18 alone stands as evidence of the resurgence of zero basing. Commentators point to the various forces at work which have propelled it back into the collective consciousness of business leaders:

— a drive for more radical and creative approaches to delivering value and unlocking the status quo

— changing attitudes to operational risk management

— smarter, more agile organizations needing to redeploy resources quickly.

However, references to the approach as being a form of 'dark art' or an unknown 'secret sauce' in the process of cost reduction only serve to mystify, as do the limitless efforts to re-brand and conceptualize what is in fact a straightforward technical process.

There is no doubting its potential value. Done well, zero basing can help to drive the most granular level of cost transparency, introduce new levels of cost conscious behavior and aggressively reallocate both funds and capacity towards those areas where they can deliver the greatest value. Clear and proven techniques used regularly in both the private and public sector help to demonstrate its effectiveness in cost optimization, particularly where a clear understanding of the activities, unit costs and productivity levers are made transparent and constantly challenged.

However, it fell out of favor following its introduction over 40 years ago, with some executives at the time increasingly seeing it as unwieldy, labor intensive, highly disruptive and ultimately not delivering to the bottom line. A potentially powerful process was falling foul, it seemed, of basic failings in application.

KPMG professionals see some early and disconcerting signs of what we regard as similar mistakes being repeated which, if not countered, could likely result in a comparable fall from grace.

Specifically five core shortcomings are at risk of being repeated across multiple organizations:

- over-emphasis on zero basing as a technical process rather than a human process
- unwillingness to change attitudes to risk
- poor focus on materiality and value
- failure to create constructive tension by initiating difficult data-led debates on priority choices, value and risk
- lack of attention on driving long-term value from zero basing.

A new approach is required, one that builds on the principles of how private equity organizations create value. They apply a relentless focus on engaging with leadership to own and drive results, testing historical attitudes to risk and prioritizing resources to activities that create the most value. Put simply, getting leadership to re-think their organization through the eyes of an external investor.

Hardwired into this approach are a set of core principles which can help drive a compelling and differentiated approach:

- a focus on evidence-based decision-making to build consensus
- deal quality analytics to remove emotion in politically charged board rooms
- the highest standards of rigor in governance to drive pace and cadence.

These same principles we contend must also be placed at the heart of zero based cost optimization if the process is to succeed this time around.

Doing this well helps to drive a fundamentally different conversation and perspective on how the work gets done in an organization. Focusing on the following, can create the conditions required for zero based success:

Prioritizing human factors over a technical process

Getting people to challenge established protocols and ways of working whilst taking bold decisions on value trade-offs demands authentic engagement of 'hearts and minds'. Zero basing is an emotional and often difficult journey for leaders and staff; plan to provide coaching and support in the process, timely decision-making and effective resource reallocation. Private equity firms are skilled at embedding experienced operators alongside existing leadership to provide the challenge and support; zero basing requires the same.

Focusing ruthlessly on value creation

The scale of the challenge often makes it difficult to know where to start. Effective zero basing must begin with a laser-like focus on where the material value opportunity sits; avoid attempting to zero base everything and risk delivering nothing. Prioritizing processes and activities based on a combination of materiality, the level of discretionary activity, risk and business criticality delivers a bigger 'bang for the buck'.

Injecting tension into the system

At the heart of the process is the tension of balancing what to give up, set against the risk of stopping or changing the activity. The highest standards of objectivity are required to make these trade-offs, supported by process and governance to ensure decisions are unencumbered by established politics, historical decisions and cultural constraints that frustrate effective zero basing. Zero basing means zero basing; start with the legal and regulatory minimum and work from there, then you create the right tension rather than negotiated compromises away from today's position.

Tackling attitudes to risk head on

Managing shifting risk profiles is at the heart of effective zero basing. Embedding governance, process and a data-led methodology is essential to avoid value-creative ideas being blocked lower down the organization. This is particularly important to manage the shifting risk profiles created by changes in service levels or the removal of certain activities. Private equity firms manage away the 'gold-plating' by having a clear separation between creating options and making decisions, with decisions only being taken at a leadership level where risk trade-offs are better understood.

Focusing attention on driving long-term value from zero basing

Many business leaders have been attracted by value/risk trade-offs and affordability thresholds as a way of injecting a one-off 'shot in the arm' to their businesses, but few appear to be casting their gaze further out to acknowledge its longer term value. Continuous, staggered 'waves' of zero basing focused on 'hot spot' areas minimize disruption but create a constantly refreshed portfolio of cost initiatives. Furthermore, structured training anchors a more commercial culture in a set of newly learned behaviors, and an eye towards enabling processes, systems and incentives 'locks in' these ways of working, to encourage teams to think like an external investor every day.

This long-term perspective is the most difficult to crack, yet the most important. The pace at which long-established business models are now changing demands far greater agility, not only in predicting these shifts, but in rapidly reallocating resources in response. Furthermore, the frequency of these changes creates a state of more constant disruption as executives seek to realign, and realign again, the pillars of their operating model with their forever changing customer needs, market dynamics and unique proposition selling points.

This is where the future positioning of zero basing becomes so crucial. Gone are the times when an annual cycle of budgeting using zero basing was adequate to reboot the internal cost management machine. The requirement for new levels of commercial and organizational agility put an ongoing, long-term, continuous process of challenging resource allocation at the heart of true competitive advantage.

So, when that old friend zero basing does make a house visit, it's vitally important in the interests of better enabling organizational agility, that business leaders hear the bell, open the door and acknowledge the core pre-conditions set out here. By doing so, in KPMG's view, they have the potential to be greatly increasing the likelihood of successfully applying it in today's business environment.

Xavier Gabriëls
Partner
E: xgabriels@kpmg.com
T: +32 (0)3 821 17 63

Elena Donckerwolcke
Director
E: edonckerwolcke@kpmg.com
T: +32 (0)2 708 38 72

Johan Jansen
Sr Manager Advisor
E: johanjansen@kpmg.com
T: +32 (0)3 821 18 25

Sandy Kik
Sr Advisor
E: skik@kpmg.com
T: +32 (0)3 821 17 95

Designed by **CREATE.** | CRT092990A | February 2018