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Drilling Down: Zero Basing

What it is and why you need to do it now

In this edition of the KPMG Global Energy Institutes Drilling Down series, we asked Chris Young and Graeme Young to discuss the "zero basing" concept, why energy firms need to be taking a hard look at it, and how it's turned around the fortunes of many firms.

Why is zero basing attracting so much attention from the industry now?

Oil and gas companies have been under tremendous pressure the past few years on several fronts. They've experienced big swings in commodity prices, questions have been raised about their fundamental business practices, and competition has come from new – and sometimes unexpected – entrants into the market.

Many firms have responded primarily by cutting costs – laying off employees, getting rid of contractors or freelancers, squeezing suppliers, and so on. But the industry is beginning to understand that it needs to do more to change the dynamic.

Zero basing is exactly what oil and gas firms need to meet these challenges. Instead of repeating top-down cost reductions, it focuses on simplifying and rationalising *activities*. Rather than trying to do the same work with fewer resources, zero basing gets to the heart of what these firms need to do to prosper in today's challenging environment: reduce complexity, and target resources and efforts on the activities that genuinely create value.

When done correctly, zero basing allows oil and gas companies to do the seemingly impossible task of reducing costs without overwhelming teams that have already been stretched by previous cost reductions.

Is zero basing different than zero based budgeting?

While zero basing and traditional zero based budgeting (ZBB) have common roots, zero basing has evolved a long way from ZBB.

The traditional ZBB process is typically led by finance, which scrutinizes every expenditure to build a bottom up annual budget. Zero basing primarily is driven by business leaders who understand the trade-offs between costs, risk and value of the services and products they provide.

They focus on business activities and drivers (e.g. marketing), creating alternatives, and then translating them into innovative strategies with an eye to cost, budgets and performance. This, in turn, leads to better informed, concrete choices on how to reallocate resources so that spending levels are "right"—not just lower – and have the greatest strategic impact.

The prize for getting zero basing right can be significant: We have helped many organizations achieve savings of 30 percent or more compared to their prior spend, or significantly improve returns with the same level of investment.

How do you implement a successful zero basing program?

There are five key components to consider if you want your zero basing program to be successful.

1. Focus on big value areas

Focus on the areas with the potential to generate significant returns or result to justify the considerable effort required. This means understanding your current costs and what's driving them, or where gaps exist in performance and how to improve it.

Zero basing can be used effectively with many different cost elements – for example, headcount or third-party spend. Regardless of the area, a key to success is to set clear, overall goals from the outset and align your zero basing approach around those goals.

2. Prioritize human factors over technical process

It's critical to engage the "hearts and minds" of your personnel to operate a successful zero basing program. In our experience, a key reason for zero basing not working out as planned is the company failing to adequately address the human factor.

Having clear goals spurs everyone in the organization to pull in the same direction and propels teams to consider radical, outside-the-box options that often result in innovative yet effective solutions. It's also important to have change management, employee communications, and training programs in place help bring people along the zero basing journey.

3. Balancing what's needed with what's being done (instead of "Inject tension into the system/")

Once target areas have been identified, all associated activities need to be scrutinized to determine whether they're actually necessary. Some activities may be mistakenly driven by legal or regulatory requirements and, in addition, don't provide their intended benefits. For example, some financial firms devote tremendous resources in preparing long, detailed reports that exceed what's required. What's more, clients don't find these reports any more useful than simpler, easier-to-prepare ones.

Also, some companies take great pains to customize products and services for individual customers. But a zero basing analysis may reveal that this super customization isn't necessary: their customers would be just as happy with more standardized products or services. For this purpose, it's helpful to bring in internal stakeholders, external subject experts, and customers to participate in the zero basing program and get diverse views that challenge engrained thinking.

4. Tackle attitudes to risk head on

An effective zero basing program places the development of options and alternatives in the hands of the people who know best; those on the front lines and in the business units. Only major decisions with high potential risks are escalated to and evaluated at the most senior levels.

We've found that organizations that take this approach not only benefit from better, more effective decision making, they can experience a clear cultural shift that elevates morale. Managers and teams feel empowered and motivated to come up with innovative ideas. At the same time, leadership has the responsibility of pushing teams to dig deeper and come back with more or better options when appropriate.

5. Drive long term value for zero basing

Zero basing is not a one time shot in the arm to boost business. Because of the rapid pace of change in the business arena, organizations should continually look for "hot spots" that need to be scrutinized and reevaluated for current resource allocation requirements.

This approach also allows the company to remain agile and flexible, targeting zero basing at areas of need. Doing zero basing across the entire enterprise can be a very intensive process and a major challenge unless a company is fully prepared for it.

Has emerging technology played a role in the ascent of zero basing?

Yes. Emerging technology and powerful data and analytics (D&A) tools enable firms to analyze enormous sets of data and do zero basing far more efficiently and quickly than ever before.

In addition, sophisticated visualization tools create vivid, easily understood graphics that let you view multiple outcomes simply by changing certain variables. This lends itself to real-time decision-making based on the most up-to-date data.

Final thoughts

In this new ultra-competitive energy industry environment, firms may need to be simpler, leaner, and more flexible and agile. Zero basing offers a path for doing just that. It's not just about cutting costs; it's about making clear, informed, strategic choices on where to allocate resources and what business strategies to implement.

About the KPMG Global Energy Institute

The KPMG Global Energy Institute (GEI) is a worldwide knowledge-sharing forum on current and emerging industry issues. Launched in 2007, the GEI interacts with over 43,000 members through multiple media channels, including audio and video webcasts, publications and white papers, podcasts, events, and quarterly newsletters. Subscribe today to begin receiving valuable insights covering critical business topics and industry issues by visiting the KPMG Global Energy Institute.

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