



Plugged In: Zero Basing

What it is and why you need to do it—now

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In this edition of KPMG's Global Energy Institutes *Plugged In* we asked Chris Young, Graeme Young and Fergus Woodward to discuss what "zero basing" is and how it works, why power and utility (P&U) companies need to be taking a hard look at it, and how it's turned around the fortunes of many organizations.

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

Traditional power and utility (P&U) companies have been under growing pressure these past two decades to make significant changes in the way they operate. This pressure has come on multiple fronts; from regulators, from the public, and as result of increased competition.

Regulators have been pressing P&U organizations to lower costs to customers while, at the same, requiring them to meet increasingly stringent performance and customer satisfaction standards. This also includes pushing the industry to adopt more environmentally friendly, renewable energy alternatives.

And thanks to deregulation efforts by the government to break up monopolies and encourage competition to reduce customer costs, traditional P&U players are also facing challenges from new, lower-cost competitors. These companies are often digitally enabled, technologically advanced, and more agile.

Finally, P&U organizations are finding that their formerly "captive" customer base has more freedom to choose a provider, is less loyal, more knowledgeable and ready and willing to switch companies. This is particularly the situation confronting P&U organizations that held regional monopolies.

Some organizations have responded to this multi-headed attack primarily through classic cost cutting – laying off workers, cutting down on the use of contractors or freelancers, squeezing suppliers, and so on.

But the industry is coming to understand that it needs to take more radical, fundamental measures in order to change the dynamic (while still providing a solid return to their shareholders). When done correctly, zero basing allows P&U organizations to reduce complexity, gain agility, and better target their resources and efforts to overcome the regulatory, customer and competitive obstacles they're facing and position themselves for success in the future.

Zero basing is 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.

This leads to better informed concrete choices on how to reallocate resources so that spending levels are "right"—not just lower—and where they should be targeted to have the greatest strategic impact.

The prize for getting zero basing right can be significant: We have helped many P&U organizations achieve savings of 10–30 percent in spending.

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.

Focus on big value areas

Focus on the areas with the potential to generate significant returns or results to justify the considerable effort required. This means understanding your current costs and what's driving them, 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—and may be applied in both back office and front office environments

In addition, many organizations have enormously complex and costly legacy systems that may need to be overhauled to improve efficiency. They also tend to have large technical engineering field forces tasked with maintaining the networks, but that operate in a suboptimal way.

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Prioritize human factors over technical process

It's critical to engage the "hearts and minds" of your personnel at all levels to operate a successful zero basing program. This includes senior management as well as the workforce. In KPMG firms experience, a key reason for zero basing not working out as planned is that the business failed to adequately address the human factor in its design and deployment.

This is particularly critical in the P&U industry, where companies often had a monopoly over their respective regions. They weren't subject to the fierce competition that many other industries faced. So, they haven't been confronted with the same type of cost-cutting and customer retention pressures that other sectors have had to deal with simply to survive.

What's more, as a heavily regulated, heavily unionized industry, many organizations suffer from an ingrained culture that has historically been inflexible and resistant to change. As a result, its management tends to be more set in their ways in terms of how they run their business.

Balancing what's needed with what's being done

Once target areas have been identified for zero basing, all associated activities need to be scrutinized to determine whether they're necessary and if alternate options exist.

Now let's not kid ourselves. There is a legitimate cause for concern about changing how things are done. P&U organizations are subject to public and regulatory scrutiny, and if a new approach doesn't work—say power isn't restored on a timely basis or a gas leak isn't fixed quickly and a dangerous situation is exacerbated—the consequences can be significant for all involved.

But if zero basing is done correctly, and you make the right choices, your organization should be able to deliver the same or better services without sacrificing the bottom line.

Tackle attitudes to risk head on

KPMG professionals have found that some of the most effective zero basing programs help ensure the "right" people—the ones who know the business best—are involved in evaluating the risks of any proposed changes and developing options and alternatives. Only major decisions with high potential risks or high profiles are escalated to the board and decided at the most senior levels; lower level risks are addressed by those lower down in the organization.

Organizations that take this approach not only benefit from better, more effective decision making, they experience a clear cultural shift that elevates morale, drives empowerment and ownership, and motivates teams 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.

Drive long term value for zero basing

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

A key factor in zero basing is reviewing and understanding the incentives that regulators build into their cost and reward structure. These incentives essentially provide that if an organization meets or exceeds certain performance levels (e.g., timeliness of repairs or how long it takes to answer customer calls) it can charge more or receive some other type of reward from the government. A rigorous integrated zero basing approach can show you how spending or investing more in the right areas can help you achieve better performance levels, entitling you to additional incentives that enable you to attain greater revenues.

Final thoughts

P&U organizations need to be constantly reinventing themselves to become simpler, leaner, more flexible and agile. Zero basing is a powerful tool to help them do that. It's not just about cutting costs; it's about making clear, informed, strategic choices on where to allocate resources and what strategies to implement.

Keep in mind that doing zero basing across the entire enterprise can be a very time and labor intensive process. This is one reason why many organizations opt to apply it only to certain areas of the business initially. This approach lets you achieve quick wins and build trust and support for extending zero basing more widely.

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