

ZERO BASED BUDGETING IN INDIA-ITS RELEVANCE TO PUBLIC ENTERPRISES

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ABSTRACT

The need for an effective budget procedure is increasingly apparent in business enterprises, so as to face the appareling operating costs and declining growth rates. In the present era of hectic competition, world wide inflation, technological advancement, soaring costs of production and distribution & depleting resources, no organization can survive and thrive unless it adopts a pragmatic and effective approach to budgeting system. ZBB is an important technique in which unnecessary expenditures are eliminated from the proposed budget. In this paper, we have discussed about the concept, definitions, budgeting process, decision units, decision packages, benefits and lacunas of ZBB. If this technique is adopted by the public enterprises the expenditure can be controlled.

1.0 INTRODUCTION

In the present era of hectic competition, world wide inflation, technological advancement, soaring costs of production and distribution & depleting resources, no organization can survive and thrive unless it adopts a pragmatic and effective approach to budgeting system. Developing and adopting a budget is perhaps the single most important and time- consuming activity of an organization whether in a Government, PSUs or Private Sector Company. However, developing countries, like India, have been facing severe fiscal constraints due to rising demands for more and better public services. Over the years, the governments at every level have been discussing, experimenting with, and implementing new ways of budgeting. The budget is increasingly being talked about as a tool to promote accountability and effectiveness, rather than simply as a vehicle for allocating resources and controlling expenditures. Similarly, since the ‘liberalization’ of urban economy, the environment of

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PSUs has undergone substantial changes. PSUs have also been trying to respond to these changes in some manner specially by reforming their budgetary practices. Performance Budgeting (PB) and Zero Base Budgeting (ZBB) are special budgeting techniques used by government departments and companies.

The need for an effective budget procedure is increasingly apparent in business enterprise in the face of appareling operating costs and declining growth rates. All enterprises therefore are compelled to an environment in which the allocation of resources is constantly exposed to challenges with corporations facing decreasing profits and increasing pressures to hold down prices and with government striving against increasing demand and cost of services.

Zero base budgeting is a strategy that is often employed by the businesses, non-profit organizations, and even individuals in planning an operating budget for an upcoming calendar year. Many companies and organizations prefer to utilize the zero base budgeting technique, even if there are a number of resources in hand to handle a significant number of expenditures in the budget for the upcoming year. This approach creates a situation where the company is prepared to deal with a shortfall of revenue by drawing on resources that were in place, but considered to be outside of the budget. Since unanticipated downturns in sales, as well as increase in operational costs can occur in any business, zero base budgeting is certainly prudent approach to the budgeting efforts.

II.0 EVALUATION OF BUDGETING PROCESS

The budgeting process is an essential component of management control systems and has been an effective system by which management can successfully plan, coordinate, and control. The process involves the creation and implementation of the broad objectives of an organization, and a short-term & long-term financial plan. The philosophy and procedures used to implement zero-base budgeting in industry and government settings are quite similar, only slightly differing with the mechanics to fit the specific needs of each organization.

This approach is different than traditional budgeting techniques due to the analysis of alternatives. Managers must identify alternative methods of performing each activity first, such as evaluating the costs and benefits of making a project or outsourcing it, or centralizing

versus decentralizing operations. In addition, managers must identify different levels for performing each alternative method of the proposed activity. This means establishing a minimum level of spending, often 75 percent of the current operating level, and then developing separate decision packages that include the costs and benefits of additional levels of spending for that particular activity. The different levels allow managers to consider and evaluate a level of spending lower than the current operating level, giving decision-makers the choice of eliminating an activity or the ability to choose from a selection of levels of effort including tradeoffs and shifts in expenditure levels among organizational units.

The zero-based budgeting system puts the burden of proof on the manager, and demands that each manager justifies the entire budget in detail and prove why he or she should spend the organization's money in the manner proposed. A "decision package" must be developed by each manager for every project or activity, which includes an analysis of cost, purpose, alternative courses of action, measures of performance, consequences of not performing the activity, and the benefits.

The decision packages must be ranked in order of importance once they have been created. This allows each manager to identify priorities, combine decision packages for old and new projects into one ranking, and allows top management to evaluate and compare the needs of individual units or divisions to make funding allocations. In this respect, zero-based budgeting is quite different than traditional rolling budgets. Rolling budgets often appeal to people who prepare budgets because they make budget development much easier. Managers can add an inflation factor to the previous year's budget and then include any adjustments for major changes. Rolling budgets also give management a concrete number to help make comparisons from year to year. However, traditional rolling budgets have a tendency to create conflict; they can create an incentive to spend money carelessly in order to justify the next year's budget. They can also create inefficient operations due to the fact that individual departments or units do not have to justify expenditures based on operations, but only on the prior year's expenditures.

III.0 THE CONCEPT

ZBB is a management concept linking planning, budgeting, review and operational decision-making into a single process. Basic premises of ZBB in the private sector are that the budgets

be justified from its “base upward” and that new or existing programmes and activities compete for resources annually by justifying current relevance, efficiency and effectiveness.

ZBB is a flexible approach to budget formulation by which budget analysis and justification shifts away from increments above the baseline represented by existing programmes, to systematic requirement for both new and existing programmes and activities justified and analyzed by the decision makers. The theme of Zero-based budgeting is:

- That it deals practically with all elements of budget.
- That it examines the on-going activities closely which are proposed.
- That it provides a range of choice to the managers in setting priorities and funding levels.

IV.0 DEFINITIONS

Zero Base Budgeting has been defined as a planning and budgeting process required by each manager to: i) Establish objectives for his function; ii) Define alternative ways of achieving the objectives; iii) Selecting the best alternative so as to achieve these objectives; iv) Break that alternatives into incremental levels of efforts; v) Costs and benefits of each incremental levels; vi) Describe the consequences of disapproval.

Zero Base Budgeting is a method of budgeting in which all expenses must be justified for each new period. Zero base 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.

ZBB is a technique which complements and links the existing planning, budgeting and review processes. It identifies alternative and efficient methods of utilizing limited resources in the effective attainment of selected benefits. It is a flexible management approach which

provides a credible rationale for reallocating resources by focusing on the systematic review and justification of the funding and performance levels of current programmes or activities.

V.0 CHARACTERISTICS

- ZBB involves managers (who have discretion over direction) at all levels in the budget and operational process.
- Justifies the resources requirements for various levels of existing activities as well as for new activities.
- Forms the justification on the evaluation of discreet programmes and activities or other functions of each decision unit.
- Establishes an agency for all managerial levels and objectives which can be identified and measured.
- Assesses alternative methods of accomplishing objectives.
- Analyze the probable effects of different budget amounts or performance levels on the achievement of objectives.
- Uses “decision packages” as the major tool for the budgetary review analysis and decision making.
- Ranks the programmes, activities, funding levels and reallocates resources in order of priority.

VI.0 THE PROCESS

Taking recent developments in account it can be seen that different authors have evolved different ways for the working of ZBB. But the available literature leaves out important information when the approach of ZBB is used in both private and public sectors. Hence a uniform procedure of ZBB as workable in any environment whether private or public sector is as follows: Internal Zero-Based Budgeting procedures are to be developed within an agency/organizational using the following steps in the process:

VI.1 IDENTIFICATION OR REDEFINING THE MISSION AND GOALS OF THE ORGANISATION: The first step in the identification of ZBB is the identification of inter-related hierarchical parts of the enterprise. The next step is to determine whether any reorganisation is necessary for the implementation of ZBB. This can be accomplished by preparing a new organisation chart and this information is to be communicated up and down to the various management levels.

VI.2 IDENTIFICATION OF THE ORGANISATIONS DECISION UNITS AND DECISION PACKAGES: A ZBB decision unit is an activity/programme or department for which decision packages are to be developed and analysed. It can be described as a cost or a budget centre. Managers of each decision units are responsible for developing a description of each programme to be operated in the next fiscal year. In ZBB, these programmes are referred to as decision packages and each decision package usually will have three or more alternative ways of achieving the decisions packages objectives. Thus a decision package provides necessary information to the management for selecting the right course of action based on the ranking of various competing proposals.

VI.3 RANKING OF DECISION PACKAGES BASED ON COST-BENEFIT OR QUALITATIVE CRITERIA: Once the decision packages are developed, they are to be ranked in order of priority of management. The ranking decision packages, in order of priority allows managers at each level of the organization to determine which specific goals and objectives are more important than the others and to allocate limited resources to the important objectives. Although the ranking of various decision packages will be done by the top management, this step splits up into three different integrated phases:

- Preliminary review and ranking will be done by the operation managers preparing the different decision packages.
- The concerned supervisory authority will review all the proposals submitted by different operational managers working under it. It may be empowered to accord final approval to the budget proposals involving expenditure up to pre-determined limits.

- The top management will review all the decision packages so forwarded.

VI.4 PREPARATION OF BUDGET AND ALLOCATION OF RESOURCES: Once the decision packages sets are accumulated from all the programmes or activities consolidated and ranked at highest possible organizational level, the preparation of the detailed budget begins. Some of the information for the budget estimates and justifications to be submitted to the budget committee are initially provided by the decision packages. After preparation of budget estimates and supporting data for the budget year, the management will submit these documents to budget committee. The top management will also submit a ranking sheet that lists, in priority order, the decision packages that comprises the organizations budget request.

VI.5 IMPLEMENTATION: There are two types of factors which are to be considered before installing the Zero Base Budget. The first types of factors are: Top management policy, Organizational size and location, Management capabilities, Adequate time and ZBB formats. The other types of factors that are to be considered before designing and implementing ZBB are: Principal users of the generated information, Objectives & Expectations of ZBB and linkage to existing organizational system. The following are the steps involved in the implementation of ZBB:

- Selection of advisory implementation team
- Training to the ZBB managers
- Preparation of calendar of events
- Development of ZBB manual.

VII.0 WHAT ZERO BASED BUDGETING CONSISTS OF?

ZBB deals with a total budget request not just a increase or decrease over previous year. The Zero-base approach requires each organization to evaluate and review all its programmes and existing activities systematically as closely as any proposed new activities. It is necessary to perform the following steps prior to the use of ZBB-a statement of the overall purpose of the organization , specification of long range goals and strategic plans, objectives and

development of division and department. The following are the more important elements of any ZBB programme:

1. Top management support
2. Identify “decision units”
3. Analyze each decision unit as a “decision package”
4. Formulate decision packages by cost benefit analysis to develop the budget request.
5. Rank Decision packages
6. clear and realistic goals
7. Allocation of funds
8. Assignment of authority and responsibility
9. Creation of responsible centers
10. Flexibility

VII.1 A DECISION UNIT:

The decision unit may correspond to the budget unit in those organizations with a budget unit or cost centre structure. Decision units can also be defined as major projects or capital projects. In each case, the decision unit should have an identifiable manager. It is necessary to consider the size of the decision unit. If too small a decision unit is selected then considerable detail is required with little payoff in the budget process. If too large a decision unit is derived, then alternative may not be properly evaluated.

Decision Unit =Project manager + Project team or Activity manager and his team.

VII.2 THE DECISION PACKAGE CONCEPT

A decision package is defined as one incremental level in decision unit. Thus there may be several decision packages for one decision unit. The concept of decision package has revolutionized the whole process of budgeting. It is the building block of the ZBB concept. It is a document that identifies and describes each decision unit so that management can

evaluate it and rank it. In formulating decision package it is necessary to assume that each decision unit budget request is made up of a sum of a series of decision packages. Furthermore, each decision package specifies a discrete set of services, activities and resources. The first package, the one that is given the higher priority, represents a minimum level of fund; usually substantially less than the current level say 10 to 20 percent less. The number of decision package is a summary of all aspects of an activity that helps management to take decision. The aspects included are: purpose of activity, various proposed methods of its performance, alternative levels of performance, cost of its performance, benefits that would accrue to the organization by its performance and the consequences of it non-performance. (As shown in Table 1)

Table1: DECISION PACKAGES

PROGRAMME ‘A’			
REVIEW			
D E C I S I O N P A C K A G E S	LEVEL 4 of 4	Improvement level-2	
	LEVEL 3 of 4	Improvement level-1	
	LEVEL 2 of 4	Up to Improvement	
	LEVEL 1 of 4	Minimum level	

VII.3 REVIEW AND REMARK

Following the compilation of decision packages, the next step is to rank all decision packages for a decision unit in descending priority. The ranking may be performed by individual manager. Reviewing and ranking basically eliminate from “How much to spend and where to spend?” There are three different questions for ranking:

- 1) What goals/objectives?
- 2) How much resources, and
- 3) How many major goals.

Thus it is to rank all decision packages for a decision unit in descending priority. The ranking may be performed by individual manager or a committee. Firms have developed extensive techniques for conducting the ranking procedure. At successfully higher organizational levels, a series of ranking may be required. It is necessary to consolidate the decision packages for review at each higher level of the organization order to reduce the date handling problem.

The ranking process establishes priorities among the functions described in the decision packages. The ranking would be made by top management to analyze the trade-off among profit centers and specifically to compare the marginal benefits of funding additional decision-packages against the organization's profit needs. With the decision packages ranked in order of priority, management can continually revise budget by revising the cut-off level on any or all ranking (Table 2 shows).

Table 2: Review & Rank-All Decision Packages

Area	Projects	Decision packages	Decision units	Decision U manager	Rank Review of Decision units	Top manager	Rank in descending priority
I	A	A1 A2 A3	A1 B1 A2	L1	A1 Q1 X1	L1	I
	B	B1 B2 B3	C1 C2 B2	L2	B1 A2 C1	M1	II
	C	C1 C2 C3	B3 C3 A3	L3	Q2 P1 X2	N1	III
II	P	P1 P2 P3	Q1 Q2 P1	M1	X3 Z1 Z2	N2	IV
	Q	Q1 Q2 Q3	R1 R2 R3	M2	Y1 Z3 Y2	L2	V

	R	R1 R2 R3	P2 P3 Q3	M3	Y3 R1 R2	M2	VI
III	X	X1 X2 X3	X1 X2 X3	N1	P2 R3 P3	N3	VII
	Y	Y1 Y2 Y3	Z1 Z2 Y1	N2	C2 C3 B2	M3	VIII
	Z	Z1 Z2 Z3	Z3 Y2 Y3	N3	B3 A3 Q3	L3	IX

Decision Packages : A1 Q1 X1 for decision units have been ranked in descending priority basis at ‘first’ and thus B1 A2 C1 for ‘second’ priority so on...

VIII.0 BENEFITS OF ZBB:

This new system can provide significant benefits at all levels throughout. These benefits include focusing the budget process, a comprehensive analysis of objectives and development of plan to accomplish those objectives. Combining planning, evaluate management particularly in planning, evaluation and budgeting, causing managers at all levels to evaluate in detail the cost effectiveness of their operation and specific activities both new and old-all of which are clearly identified. The various benefits of ZBB are as follows:

1. Requiring that alternative ways to meet the objectives are identified.
2. Identifying trade off between and within programmes.
3. Providing managers at all levels with better information on the relative priority associated with budget request and decision.
4. It may eliminate duplicative and overlapping programmes.
5. It would permit agency to better establish its priorities and allocate scarce resources.
6. Budgets need not be recycled when expenditure levels change instead of the decision packages to be added or deleted to implement the budget change.
7. The ZBB results in undertaking only essential and high priority scheme in the organization.
8. The ZBB process forces management to look ahead and become more effective and efficient in administrating the business operations. It insists administrating the

- business operations. It instills into managers the habit of evaluating carefully their problems and related variables before making any decisions.
9. The ZBB helps to co-ordinate, integrate and balance the efforts of various departments in the light of the overall objectives. This results in goal congruency and harmony among the department.
 10. It improves the quality of communication which results in better understanding and harmonious relations among managers and subordinates.
 11. It has made the budgeting exercise itself more rational & systematic and less political and arbitrary.

IX.0 DISADVANTAGES OF ZBB

ZBB is a systematic approach to the solution of problems. But it is not foolproof; it suffers from certain problems and limitation as given below:

- 1) An increase in time and effort required for budget preparation.
- 2) A contention that the new system has not significantly affected the allocation of funds.
- 3) An effective view of the decision packages, ranking approach to meet challenge in the level of-funding.
- 4) ZBB is not an exact science, its success hinges upon the precision of estimates that are based on facts and managerial judgment. Managerial judgment can suffer from subjectivism and personal biases. Thus, the adequacy of ZBB depends upon the adequacy of managerial judgment.

X.0 CONCLUSION

The need for an effective budget procedure is increasingly apparent in business enterprise in the face of appareling operating costs and declining growth rates. All enterprises therefore are compelled to an environment in which the allocation of resources is constantly exposed to challenges with corporations facing decreasing profits and increasing pressures to hold down prices and with government striving against increasing demand and cost of services. The ZBB

is a strong and effective tool of the management with the help of which a firm base for sound planning, operational, review and control system for each and every phase of organisations activities can be evolved to achieve objectives result.

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