# Zero-Based Budgeting

Most budgets start from last year's numbers and simply add a few percent. Zero-based budgeting, or ZBB, takes a different path: every budget starts from zero, and every cost must be justified again. The idea was developed by Peter Pyhrr at Texas Instruments, which used it for its 1970 budget. Pyhrr described it in the Harvard Business Review in the same year, and Jimmy Carter later used it as governor of Georgia. ZBB helps organisations spend on what matters now, not on what was there before.

## 1. Start from Zero

In traditional, or incremental, budgeting, last year's budget is the starting point. Old costs stay in the budget, even when they no longer serve a purpose. Zero-based budgeting removes this automatic starting point. Every activity has to earn its place, as if it were new.

**Example:** A family starts its monthly budget from zero instead of copying last month. It finds three streaming services that nobody watches, and it cancels two of them.

**At work:** Lubna, a finance manager at a training company, asks every department to start from zero. The events team can no longer just add five percent to last year's budget.

## 2. Identify Decision Units

The next step is to divide the organisation into decision units. A decision unit is any activity, team or project that spends money and can be managed separately. Examples are a sales office, a training programme or an IT service. Each unit has a manager who knows its work and can explain its costs.

**Example:** The family identifies its decision units: food, transport, housing, leisure and savings. Each family member now takes care of one area.

**At work:** Lubna's team identifies the decision units in the events department: conferences, webinars and printed brochures. Each one now has a manager who must explain its costs.

## 3. Build Decision Packages

For each decision unit, the manager prepares a decision package. It describes what the activity does, what it costs, and what would happen without it. Pyhrr also asked for different levels of effort: a minimum level, the current level, and sometimes a higher level. This shows what each extra amount of money would buy.

**Example:** For leisure, the family builds a decision package with three levels: one outing a month, two outings, or a holiday trip. Each level shows its cost clearly.



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**At work:** The events manager builds a decision package for printed brochures. The minimum level costs five thousand dollars and the current level costs twenty thousand, but it brings very few new customers.

## 4. Rank and Fund

Then managers rank all the decision packages from the most important to the least important. The ranking is based on goals, value and risk, not on habit. Money goes to the packages from the top of the list down, until the budget is used up. Packages below the line are cut, postponed or done in a cheaper way.

**Example:** The family ranks its packages: food and housing first, then savings, then leisure. The holiday trip falls below the line this year, but the monthly outing stays.

**At work:** Lubna's committee ranks and funds the packages. Webinars rank high because they bring many customers at a low cost, while brochures drop to the minimum level. The money saved goes to a new online course.

## 5. Weigh the Pros and Cons

ZBB has clear strengths: it removes waste, questions old habits and links spending to current goals. It also has real costs. It takes much more time and paperwork than incremental budgeting, and activities whose benefits are hard to measure, such as training, can be cut unfairly. For this reason, many organisations use ZBB every few years, or only for selected areas.

**Example:** The family weighs the pros and cons and decides to repeat the full exercise only once a year. In the other months, it simply checks the budget.

**At work:** Lubna weighs the pros and cons with the directors. They agree to use ZBB fully every three years, and every year only for marketing and travel costs.

## Conclusion

In summary, the method is to start from zero, identify decision units, build decision packages, and rank and fund them, and we weigh the pros and cons before deciding how widely to use it. Instead of asking how much to add to last year, it asks what each activity is worth today. Used wisely, it frees money from old habits for new priorities.

### Sources


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