***Zero based budgeting***

The budget setting process often begins with the question “How much did the cost centre spend last year?” That then becomes the baseline for this year’s budget. the process may be refined by adding a percentage for inflation, or deducting a percentage for expected efficiencies.

It’s a very easy process, but flawed. Flawed for a number of reasons:

* it assumes nothing will change. Because what we spend depends on how we do things, the assumption is that we’ll do things in the same way every year
* there’s no scope for growth. As the business grows, the demands it places on all its departments will grow, and that will need more budget

**What do I need to do next year?**

This is the question zero-based budgeting starts from, rather than “How much did I spend last year?” so the focus is always on what will be different next year, rather than assuming everything will be the same as last year.

That’s quite a good start point for modern businesses that work in a constantly changing environment!

**The bottom line**

There are two bottom lines.

The bottom line for the zero based budgetholder is that they must understand how they will achieve their objectives within the budget. Otherwise they’ll either end up overspending against budget, or not achieving their objectives: either of which may damage the business.

The bottom line for the business is that it must have enough income to cover all the zero based budgets, and still have an adequate profit. Failing to ensure this will damage the business.

So there will be times when the directors say “We can’t afford these budgets, they’ll have to be cut.” But if we spend less, we can achieve less, so this will have an impact on budgetholders’ objectives. There may need to be a discussion about changing objectives if budgets are cut in this way.