



Implementation of zero base budgeting system to commercial banks in India: Need of the hour

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Abstract

Zero Based Budgeting (ZBB) is an operating, planning and budgeting process which requires each manager to justify his entire budget request in detail from scratch and shifts the burden of proof to each manager to justify the proposed spending. ZBB is not based on last year's budget but rather on ground zero. ZBB is a powerful managerial tool that will help the bank management in judicious allocation of resources, minimization of cost of operation and in deriving the optimum benefits out of the current deployment funds. By permitting constant review and appraisal of on-going programmes, it enables the management to spotlight redundant and relatively less deserving schemes and staves-off their perpetuation and thereby safeguards the organisation from suffering on account of them. Since ZBB requires justification of each budget request, it permits trade-offs within and across departments and relates costs and benefits of programmes and managers will be very careful in selection of projects in the very beginning. They will always be cost conscious and objective during the operation of the projects. Thus, the ZBB will foster a culture of efficiency and cost consciousness among the bank executives which is very much in demand in the present Indian banking scenario.

Keywords: Commercial banks, cost-benefit analysis, decision packages, decision units, zero-based budgeting

Introduction

Commercial banks in India have come to be recognized as vital catalytic agent engaged in the herculean task of stoking the engine of economic development and uplifting the teeming helpless and neglected masses of the country. Post nationalisation period has witnessed unparalleled expansion of branch network, growth in deposits and dimensional, functional and geographical increase in lending operations of the commercial banks. Today, they constitute one of the pillars of the Indian economy and control the commanding heights the economy. To ensure the uninterrupted growth at a rapid pace, it is necessary that these banks function efficiently.

However, it is intriguing to observe that until recently there has been a steady erosion of bank's profitability. While social orientation alone is not responsible for profit erosion as it is widely made out to be, the fact remains that bank's future march on the road to social banking will depend only on how effectively the resources are being carved. Among the various factors that contributed to the deplorable profitability performance of the banks, lack of proper utilisation of financial resources has been the major one. This is mainly due to ineffective planning and monitoring system. Although they have launched formal planning and performance budgeting system more than a decade back to plan and control their operations, these have not fructified for the fact that the existing planning and monitoring system do not provide any mechanism for constant evaluation of efficacy and effectiveness of the current operations. The existing systems review only a fraction of total activity because detailed analysis of only those expenditure items which are likely to increase (or decrease) is made. The reasonableness of the previous year's level performance is not critically reviewed; it is taken for granted. This leads to entire planning system to be based on incremental growth. Certain percentage growth is indicated as a corporate objective vis- a-vis the previous year's performance. As a result, if the past performance has been unsatisfactory, the

incremental results achieved in the subsequent year are higher than the average of the banking industry and this is applauded as meritorious, while the fact remains that the bank may have provided more than necessary resources by way of manpower, equipment, etc., in the previous year and goes on providing more resources for the current year for achieving the incremental growth of outputs.

Zero Based Budgeting: Relevance for Indian Banking Sector

The present budgeting system does not pay any attention to cost factor which is very important for a banking enterprise facing the problem of deteriorating profitability. The existing level of cost, which is generally based on a traditional "business as usual" position is hardly winnowed and the "unit cost" is presumed to be valid perpetually. It has become fancy for bank managers to place entire blame on the Government for the continued decline in their profitability rate because the social responsibility function imposed on banks is generally not as remunerative as their traditional commercial activities. Although there is some truth in it, but to what extent social obligations adversely affect profitability of the bank has not been precisely determined because the costs involved in undertaking both traditional and non-traditional activities are not examined at every managerial level. In the existing budgeting system, where expenses are budgeted, the basis is the permissible extent of incremental growth depending on the activities undertaken by a branch. This leaves the individual activities undertaken by the branch totally out of focus and a "branch position" (which is after all, only a composite entity) is relied upon.

So as to arrest the deteriorating profitability performance of Indian commercial banks, the top management has to install such a planning and control system as could force the executive to identify and analyse what they are going to do in total the 'cost' involved in performing the activities, set objectives and goals, make requisite operating decisions and

evaluate changing responsibilities and work load as an integral part of the monitoring system. This is done only under "Zero-Base Budgeting" (ZBB).

The Government of India, decided to introduce ZBB in its various department from the financial year 1987-88 and directed all the State Government and Public Undertakings to install this control system.

With a view to ensuring optimal utilisation of resources and economising costs it is high time for the bank managers to launch this approach. However, success of ZBB approach lies in its proper implementation by the functionaries who require thorough understanding of the concept of ZBB as also the sequence of activities that have to be performed under this approach.

Re-evaluation of Activities in terms of Cost-benefits

According to Peter A. Phyr, who first introduced this system in a U.S. based firm, Texas Instrument in 1970, ZBB is an operating, planning and budgeting process which requires each manager to justify his entire budget request in detail from scratch and shifts the burden of proof to each manager to justify why he should spend any money at all. ZBB implies constructing a budget without any reference to what has gone before, based on a fundamental reappraisal of purposes, methods and resources. It attempts to re-evaluate all programmes and activities in terms of cost-benefit. ZBB is not based on last year's budget but rather on ground zero, thus avoiding the common tendency in budgeting to look at changes from the previous period. Under this approach the entire banking business programme is divided into goals and activities and cost of each activity is then calculated from the ground up. Each expenditure is reconsidered from the very beginning. It is like assuming that a zero expenditure has been defrayed on an activity at the time of its review, although the activity is being performed for a long period and may have already involved some expenditure.

In ZBB, a bank is required to justify not only the new programme and the funds therefor but also the on-going activities and the funds for them. Thus, provisions for existing programmes are also required to be justified in the budget rather than adding them in the budget as a matter of routine. As such, the existing programmes will not be treated as immutable but will be examined afresh as to their continued utility and effectiveness, thereby freeing resources for new programmes. The basic idea underlying this approach is not just to cut expenditure but to make the entire programmes more effective by a more purposive allocation of resources to various programmes.

ZBB thus differs markedly from the traditional budgeting as also from performance budgeting. In their traditional budgeting the current expenditure levels are used as an established base from which an analysis in detail of only those items that involve increases or decreases is made. In contrast, ZBB requires evaluation of the whole project so as to establish its need, and not just the additional requirements. In performance budgeting, evaluation of the entire programme expenditures takes place and at the same time the expenditures continue almost as in the routine budgeting practice. But, in ZBB entire expenditures are reconsidered to justify their continuation.

Implementation of ZBB

Budget making exercise under ZBB involves the following:

1. Identification of "Decision Units";

2. Formulation and development of "Decision Packages";
3. Review and rank of the "Decision Packages"; and
4. Allocation of Resources.

▪ Identification of "Decision Units"

Preparation of ZBB begins with identification of decision units. A decision unit is a full description of each individual activity which a manager undertakes and the decisions made by him in respect thereof. These decisions pertain to the level of expenditure and the scope, direction or quality of work to be performed. The decision units are ultimately the modules which will be assessed for their achievements under ZBB. Identification of decision units calls for breaking down the conglomeration of operations at each managerial desk into the relevant-elementary activities (which are, of course, inter-related to other activities). This can be done effectively if organisation structure, management and objectives of the enterprise are known.

The benefit of this sort of analysis is that the relevance of each activity to the total role of that manager as well as to the corporate objective is focused sharply. It also helps the manager to realise why he is performing a particular activity and also what resources, by way of manpower and other facilities like transport etc. (which all involve expenditure) are necessary and whether there are alternative methods of performing the same activity at a lower cost. For instance, a branch manager has to undertake a number of activities, such as appraisal of agricultural loan applications the objective of which is to ensure that over dues are reduced, inspection of small-scale industrial units so as to detect the incidence of sickness or incipient sickness, and organising deposit mobilisation weeks/fortnights/months so as to attract more and more savings of the community. All these involve cost. ZBB insists that the manager conceives of the alternative strategies of carrying out the above activities at lower cost. Even activities like O & M, organisational planning, economic research etc., which are relatively more difficult to plan and control can be subjected to the system of ZBB and performed at a most economical cost. In sum, all those activities which are amendable to a cost-benefit analysis are within the orbit of ZBB.

▪ Formulation and Development of "Decision Packages"

Another vital exercise involved in ZBB is development of decision packages. A decision package is a budget request which lists the function or activity of the decision unit, goals and objectives of the activity, benefits to be derived from undertaking the activity/programme, financial consequences of not undertaking the activity, the estimated cost of the package and alternative ways of performing the same activity or achieving the same objectives. In addition, manager is expected to identify alternative levels of efforts and spending to perform a specific activity. A minimum level of effort package, which is actually the grass root's funding level necessary to keep an activity/programme alive (usually 70-75% of the current operating level) must be established and additional levels of efforts with its costs and benefits must be identified in separate decision packages have different performance output and separate funding requirements. This analysis forces every manager to consider and evaluate a level of spending lower than his current operating level, gives management the alternative of eliminating an activity or choosing from several levels of

efforts and allows tremendous trade-offs and shifts in expenditure levels among organisational units.

▪ **Review and Rank of "Decision Packages"**

Once the decision packages are developed, they are reviewed and ranked in order of decreasing benefit. This stage, thus, entails prioritisation of the various activities undertaken by each manager as well as by the managers. The ranking has to be done at various levels starting from the lowest level of the managers who identify decision units and prepare decision packages. The ranking of decision packages requires to be done in the light of the corporate priorities laid down for the ensuing budget period, and cut-off point on the total permissible cost to be incurred in the next year. Each concerned manager will rank his own decision packages. These are then sent upward through the management hierarchy where the decision packages are once again reviewed and ranked along with the other decision unit packages at selected levels and a single, consolidated ranking for all the packages is produced.

In the process of ranking, the "Volume Problem" will emerge particularly at the highest levels where thousands of packages are to be reviewed and ranked. In a large banking organisation the problem of ranking a large number of decision packages can be handled by a committee at each of the higher levels. Use of computer in this regard will be extremely useful in shuffling and reshuffling the numerous decision packages on the basis of the objectives and corporate priorities and cost considerations. In arriving at a progressive total of the costs involved and deciding upon the ultimate cut-off point the manager can make use of a computer. Thus, the decision packages falling below the cut-off point would have to be discontinued.

▪ **Allocation of Resources**

Once the decision packages have been finalised, resources are allocated as among various functions and sub-functions for the ensuing year.

Utility of ZBB Approach

ZBB is a powerful managerial tool that will help the bank management in judicious allocation of resources, minimization of cost of operation and in deriving the optimum benefits out of the current deployment funds. By permitting constant review and appraisal of on-going programmes, it enables the management to spotlight redundant and relatively less deserving schemes and staves-off their perpetuation and thereby safeguards the organisation from suffering on account of them. Since ZBB requires justification of each budget request, it permits trade-offs within and across departments and relates costs and benefits of programmes and managers will be very careful in selection of projects in the very beginning. They will always be cost conscious and objective during the operation of the projects. Thus, the ZBB will foster a culture of efficiency and cost consciousness among the bank executives which is very much in demand in the present Indian banking scenario.

ZBB can also be employed as a very effective means of control system that establishes clear cut objectives and goals, measures progress towards these goals, indicates positive action required if the actual performance deviates from the plan and budget and displays potential for further improvement.

The management's efforts in directing and motivating employees are facilitated by ZBB because most managers have to work together in developing and finalising the decision packages and operating plans. It provides ample opportunity to the branch managers to identify problems that are likely to be faced by them in achieving the goals. It also commits the managers to a set of defined objectives and goals, performance standards and accomplishments that they will be held accountable for. This is because each branch manager is involved in decision-making.

However, the bank managers have to face several problems in formulation and execution of this technique. The most important problem experienced by the management is in the area of formulation of decision packages. Determining activities, functions or operations to develop decision packages for establishing the minimum level of effort and identifying work measures and evaluation of each activity involve lot of subjective judgement on the part of each activity manager and are, therefore, subject to question.

In ranking and reviewing the decision packages, the management faces problems of determining who will do the ranking, to what level within each organisation packages will be ranked and what method or procedure will be used to review and rank the packages.

There are certain fears and administrative problems which top management of a bank have to face particularly in the initial years of the implementation of ZBB. Branch Managers as well as regional managers may often be apprehensive of any process that forces decision-making and requires detailed scrutiny of their function for all to see. Administration and communication of ZBB process are likely to pose serious problems because more managers become involved in this process than in most budgeting and planning procedures.

Adoption of ZBB in a Commercial Bank

In view of the above, it is advisable to the bank management in India to select a pilot area where to implement it first and learn from it the difficulties experienced before extending it to all activities, areas, and branches. Thus, to start with, the top management may introduce ZBB in respect of certain vulnerable activities and regions where either the performance is not up to the desired level or the cost is suspected to be excessive. Even before the pilot implementation is taken in hand, the management will have to ensure that extensive leg-work has been undertaken so that there is intellectual and emotional acceptance of the system at all managerial levels.

In the light of the experience, this system should be extended to other areas and activities so that ultimately the entire banking organisation is covered in course of time.

It is further advisable that the entire work of implementation of ZBB system is monitored by a centralised staff department under the supervision of the chairman/managing director of the bank. Such a staff department will serve the purpose of keeping the top management informed of progress and also help to establish credibility lower down. In a large commercial bank having decentralised administrative set-up, each administrative office should have a staff department on the above pattern.

Another decision which top management of a bank will have to take in regard to implementation of ZBB system is as to what should be the appropriate level of managers who will be asked to identifying decision units and prepare

decision packages. In a bank, it will be in fitness of things to restrict these tasks up to the level of branch managers and departmental heads at the administrative office. At branch level, each significant manager's desk will be subjected to prescribed scrutiny.

Time requirement is also an important factor to be considered while implementing ZBB approach. At present, annual performance budgeting exercise in a bank takes 14 and 16 weeks' time. It will be possible to adopt a similar time-frame for ZBB. Another moot question to be taken into account is how frequently ZBB exercise should be undertaken. Since ZBB exercise involves lot of cost, time and efforts and there may be radical changes in the decision units or the decision package from year to year, the management is advised to undertake this exercise once in three years. In the intervening two years, if necessary, the decision packages may be updated. The ranking exercise may be undertaken every year.

Whatever be the frequency of implementation of ZBB system that may be decided upon, it would be in the interest of a bank to make a critical analysis of the first year's ZBB process upon completion, and then identify the problem prone areas and the remedial measures. Appropriate changes should be incorporated when the exercise is repeated. Soon after this, the bank management will be in a position to draw up a ZBB manual for use by branch managers, regional managers and administrative heads at the corporate level of the organisation.

What is most important for effective implementation of ZBB approach in a bank is that the managers should be exposed to the basics of ZBB and imparted adequate training. It would be useful to repeat capsular training programmes on location so that even potential managers may be appropriately oriented.

Conclusion

ZBB is an operating, planning and budgeting process which requires each manager to justify his entire budget request in detail from scratch and shifts the burden of proof to each manager to justify the proposed spending. ZBB is not based on last year's budget but rather on ground zero.

- In ZBB, budget making process involves the following steps:
- Identification of Decision units;
- Formulation and development of Decision packages;
- Review and rank of the Decision Packages; and
- Allocation of Resources.

ZBB is an invaluable managerial tool which helps the bank management in judicious allocation of resources, minimisation of cost of operations and in deriving the optimum benefits out of the current deployment of funds.

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