

# PROFIT PLANNING: ZERO-BASED BUDGETING

By Tom Cronin

As we begin our new year hopefully you have developed your business profit plan and budget for this year. If you have not, you are not alone. I have found that less than 10% of all businesses have a proper business plan and less than 3% have a PR plan to accentuate their business plan. These are scary statistics, because if you fail to plan, then you plan to fail. Opening a business and shooting from the hip is a sure way to doomed failure. You would never build a home without approved architectural plans. You would never put the roof on your building first; of course not, you would first have a set of plans then start your structure with a firm concrete foundation. The same must hold true for starting a new business venture. So how do we prepare for our successful business future?

Profit planning creates the steps taken to achieve the desired level of profit accomplished through the preparation of a number of budgets. This communicates management's plan so that all parts of the organization are working together toward the same goals. To be completely effective, a good budgeting system must provide for both planning and control. The process involves the creation and implementation of the broad objectives of your organization, the detailed objectives, and a short-term and long-term financial plan. Budgets force owners to think about and plan for the future. In the absence of a budget, many owners would spend all of their time dealing with daily emergencies and putting out fires.

When I was in the corporate operations world, most firms used the traditional approach to budgeting; the managers start with last year's budget and expenses then add to it according to anticipated needs. This is an incremental approach to budgeting in which the previous year's budget is taken for granted as a baseline. This approach is called incremental budgeting or rolling budgets. This technique is easy but antiquated. It never allowed for new projects or for new innovative thinking. This old method only allowed for last year's numbers, without thinking toward a new horizon or future goal. I introduced a new concept that changed the whole approach to their marketing,



PR, sales, and productivity. I introduced zero-based budgeting. It revolutionized the company and we brought them from five years of deficits to profitability in one year.

Zero-based budgeting is a technique that helps enhance good planning and decision-making for your business. In other words, it reverses the working process of the traditional forecasting methods you may have been accustomed to. In traditional incremental budgeting, business owners justify only increases over the previous year's budget and what has been already spent is automatically approved. By contrast, in zero-based budgeting, every division's purpose is reviewed comprehensively and all expenditures must be approved, rather than only increases. No reference is made to the previous level of expenditure. The zero-base is indifferent to whether the total budget is increasing or decreasing.

Zero-based budgeting also refers to the identification of a project or new PR or advertising campaign, and then funding resources to complete the task independent of current resourcing. For example, if you have been using newspaper print advertising for the last twenty-five years and you had a budget of \$50,000 for that last year, but it is no longer producing the results you have

come to expect, you must make a change immediately and decide where those funds should be spent. Television and radio are dying and not giving you the new sales they used to and that expenditure was \$25,000 last year. So do you just throw it into the coffers and hope for the best, or do you develop a new plan from a zero-base to determine what monies should be expensed and where they should be spent. The correct method of the zero-based budget demands that you lay out a sales plan and budget what you need to achieve a profit. In order to create a zero-based budget you must complete the following:

1. Determine your fixed costs (mortgage, rent, utilities, fixed salaries, mandatory supplies, and services).

2. Attempt to cut these expense items to the base needed, not just what you spent last year, then implement a savings and expense control plan (make the tough decisions).

3. Ascertain your variable costs. These costs should fluctuate on a needs basis depending on your projects, sales plan, and new market or PR plan.

4. Develop your sales plan based upon:
  - a. Minimum sales to cover your fixed and variable costs (this will be your minimum or base plan. Once you have developed this base plan you will know what your minimum break even point is yearly, monthly, and daily to break even and make a profit).

- b. Product sales plan: develop a plan for each of your divisions, each profit center, and each product line.

- c. Project sales plan: develop a sales plan for each new initiative, and then allocate the costs necessary to each project to determine if the project will be profitable and when its break even point will be achieved.

5. Allocate sales plans vs. cost plans to show break even and profit centers for each project.