
Reconsidering Budgeting after the COVID-19 Outbreak

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Abstract

The financial field is experiencing unprecedented changes, as the effects of the COVID-19 outbreak are unraveling. One of the main challenges the managers have to face is the elaboration and implementation of the budgets. During 2020, companies worldwide had to continuously adjust the budgets which were already approved before the pandemic. But, as everyone understood that the world is not facing just a temporary situation, executive leaders had to also reconsider their budgeting process, taking into consideration the uncertainties of the future. It was clear that the traditional way of developing a budget, based on historical information, was no longer relevant and a new process should be implemented. Therefore, the aim of this paper is to put into discussion which would be the best alternative to the traditional budgeting process. Based on the thorough analysis of the reports published by relevant organisms and firms, the authors concluded that the best alternative would be the zero-based budgeting technique. The paper presents the benefits of this method, but also a guideline regarding the implementation of this process.

Key words: COVID-19; budgeting; accounting;
Zero-Based Budgeting (ZBB);

JEL Classification: M40, M41

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1. Introduction

Crisis have always produced significant changes in the fields they affect, but COVID-19 is now causing a worldwide critical situation, where its impact can affect a wide range of companies and functions. In response to the uncertainty generated by this crisis, leaders worldwide are forced to rethink and redesign the whole budgeting process. Starting from 2020, the preparation of an annual budget has been a major challenge, as the future predictions are constantly changing. After continuously adapting previous approved budgets and improvising new forecast, executives worldwide must find a solution in developing a relevant budget during the pandemic context.

The aim of this paper is to bring clarifications regarding the budgeting process in the era of COVID-19. As it is a new topic, the research was based on reports published by several consultancy firms or well-known organisms in the financial field, such as: Deloitte, PricewaterhouseCoopers, World Health Organization, Gartner, Accountancy Europe or International Monetary Fund. In the first part of the paper, the authors analyze the basic principles of the Zero-Based Budgeting technique, which appears to be a promising solution for the budgeting process worldwide. Secondly, it is analyzed how the main companies can benefit from adopting this method during and after the COVID-19 pandemic. Moreover, it was presented a guideline on how executive leaders can put into practice the activities which are specific to Zero-Based Budgeting.

The contribution of this paper resides in bringing clarifications regarding the budgeting process during this worldwide crisis. Furthermore, the content of this paper should be relevant both to the scientific literature, but also to the financial field, as it presents a structured overview of the benefits of adopting the Zero-Based Budgeting, but also a guideline regarding its implementation.

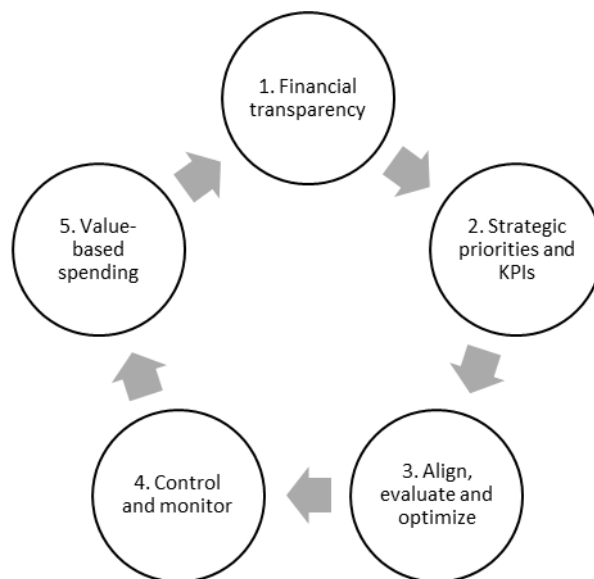
2. Is Zero-Based Budgeting the appropriate instrument to make predictions during COVID-19?

2.1. Theoretical framework regarding Zero-Based Budgeting

Nowadays, the business environment is constrained by various factors, such as sales uncertainty, social distancing or e-commerce development over the traditional selling channels (IMF, 2020; Crucean & Hategan, 2021). But, probably the most important factor that should be taken into consideration while discussing about a budget, are the constrains regarding costs. Executive leaders worldwide should have an approach which allows them to assess their spending in connection with the value it is generating within the companies (Accountancy-Europe, 2020). After conducting their business in the pandemic context for more than a year now, more and more managers are starting to notice the advantages which Zero-Based Budgeting offers (Wiles, 2020; Gartner, 2020). But, in order to be able to successfully apply this technique, one must understand what Zero Based Budgeting is and its principles. The Zero-Based Budgeting method is in total disagreement with the traditional budgeting, which takes the costs from previous periods and apply different increase or decrease rates in order to obtain values which will guide the whole company in the next year. But, in the current context, companies should choose wiser how to allocate their resources (Mondaq, 2021).

The Zero-Based Budgeting technique should be understood starting from its name. In theory, the zero comes from the fact that the budget will start from a completely empty canvas, not taking into consideration what were the previous expenses (Callaghan, Hawke & Mignerey, 2014). In practice, one cannot simply remove all the previous costs that were made. But the idea is not to rely on previous costs and to deliberately choose how to allocate all the resources taking into consideration the operational and strategical objectives. In order to successfully apply this method, there are a few steps which are recommended to be followed, presented in

Figure no. 1.

Figure no. 1. Steps in Zero-Based Budgeting implementation


Source: Adapted from Wiles (2020)

The first step, ensuring financial transparency, is necessary in order to understand the relationships between cost drivers and costs, which will emphasize the value added by each activity in a company. Also, by clearly understanding different types of cost (fixed or variable), managers can understand the impact these expenses have. This high level of financial transparency should bring to surface inefficiencies that have not been taken into consideration before.

Secondly, in the pandemic context it is of paramount importance to clearly define which are the strategic objectives of the company, in order to ensure their prioritisation while developing the budget. The higher management should clearly and openly communicate their strategical priorities across all the functions in order to maintain a tight collaboration towards a common objective (WHO, 2020). After this step, the strategic objectives should be translated into appropriate KPIs, which should be able to capture the effectiveness and efficiency of the results of these objectives.

In order to have an efficient budgeting process, there should be an alignment of the objectives, with the KPIs and with the spending made in order to achieve these indicators. After a thorough evaluation of these expenses, companies can have a better understanding whether they can be shifted to another activity or if they should not be included in the budget at all. But, the cost reduction

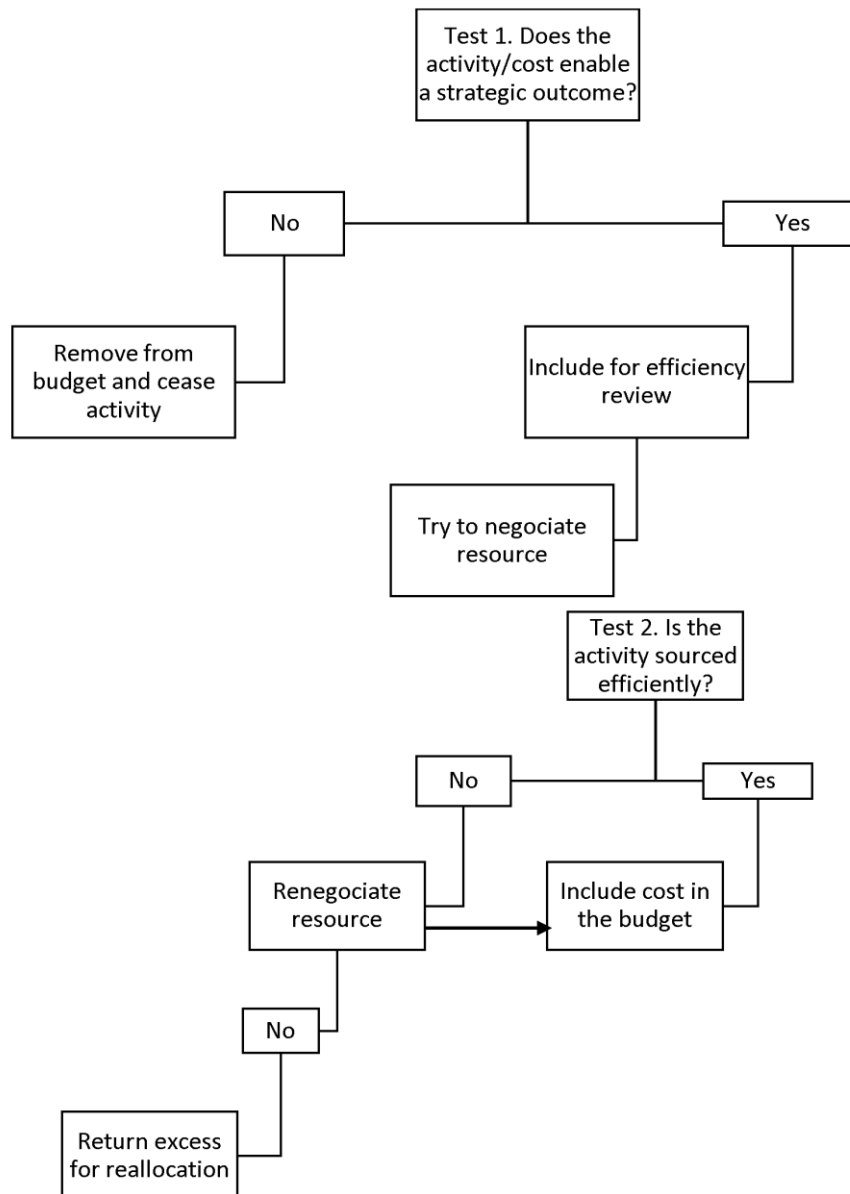
should be taken into consideration only when there are no other value-adding activities to which expenses could be shifted or if the company needs the resources in order to survive (Wiles, 2020; Callaghan, Hawke & Mignerey, 2014; Deloitte, 2018; Mondaq, 2021).

Furthermore, the budget and its implementation should be constantly monitored and reviewed in order to ensure that the company is still focused on the strategic objectives that were initially formulated. Finally, zero based budgeting should be operationalized taking into consideration the principle of value-based spending. All the expenses should be made only after ensuring that they are generating value for the company, but often this require a thorough analysis and some difficult choices in order to decide if a certain spending can be included in the budget or not.

Gartner (2020) developed a Zero-Based Budgeting Tree, a tool which should be used in order to decide which expenses should be included in the budget, shown in *Figure no. 2*. The first test should be applied to remove all the unnecessary activities or costs. For the remaining activities or costs, the second test should be applied, remaining in the end only with the relevant costs. Using this map should ensure that:

- All activities are evaluated in a fairly manner
- The decision process is free of bias

Figure no. 2. Zero-Based Budgeting decision tree



Source: Adapted from Gartner (2020)

The Zero-Based Budgeting can often become a tedious and time-consuming method, but research shows (Callaghan, Hawke, & Mignerey 2014; Deloitte, 2018; Gartner, 2020; Wiles, 2020) that if it is implemented in a correctly manner, it takes only a few more days to develop it in comparison with the traditional budgets, but the results are exceeding expectations.

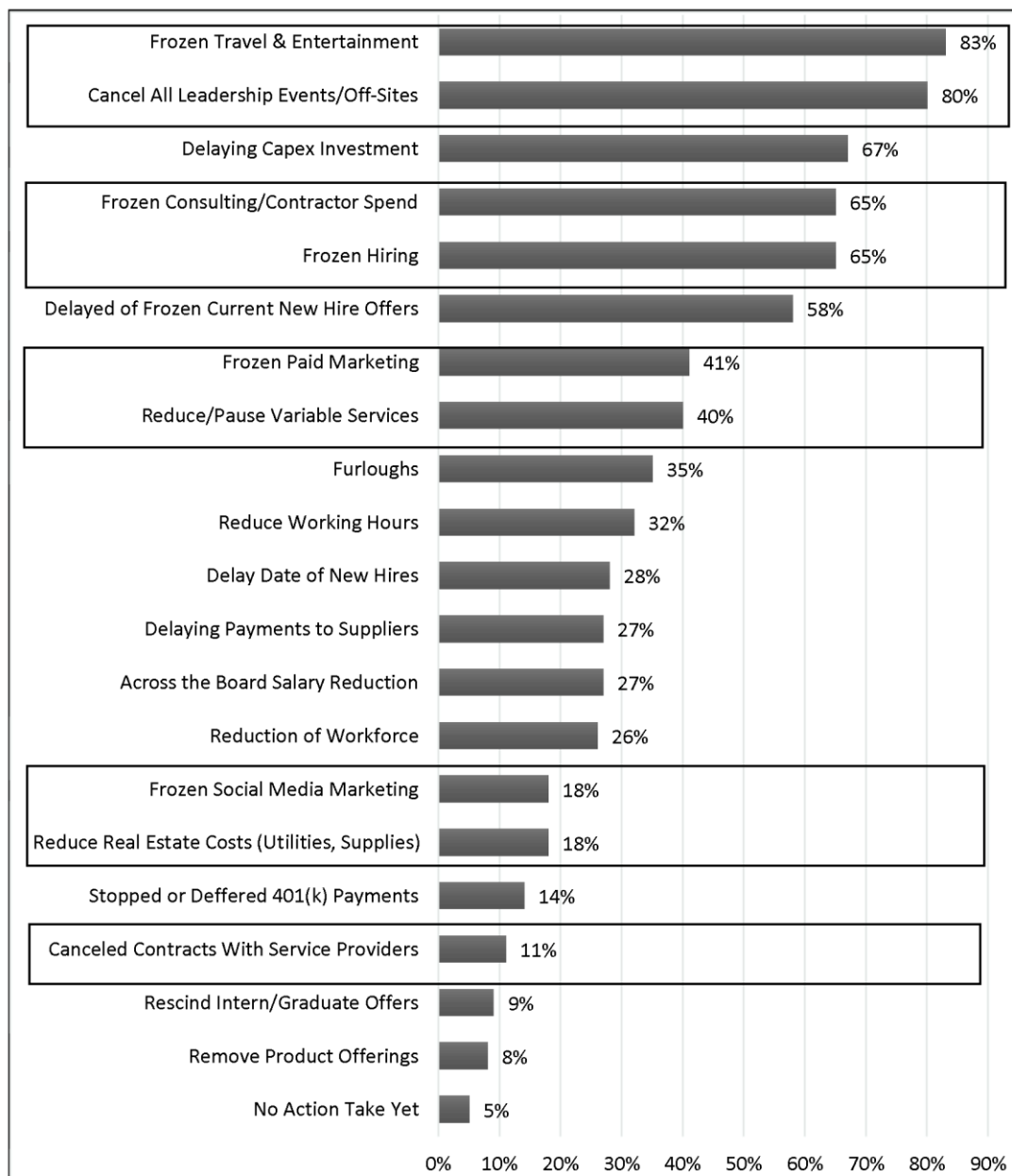
2.2. Guidance regarding budgeting in the context of COVID-19

Taking into consideration the uncertainty of the business environment which was caused by the COVID-19, financial managers worldwide are redesigning their budgeting process in order to survive (Mondaq, 2021;

WHO, 2020). This new approach represents an opportunity to put into practice all the lessons which can be learned from this critical period. The budget pressures from 2020 demanded serious cost reduction in order to increase short-term efficiency and the survival of the companies. According to a study (Gartner, 2020), in April

2020, 26% of the participants in the study anticipated that they would be using the Zero-Based Budgeting technique in order to overcome the pandemic situation. The main advantage these executives have seen in the Zero-Based Budgeting is that it presents a safe and structured approach to identify cost reduction policies.

Figure no. 3. Cost reduction measures taken during the COVID-19 pandemic



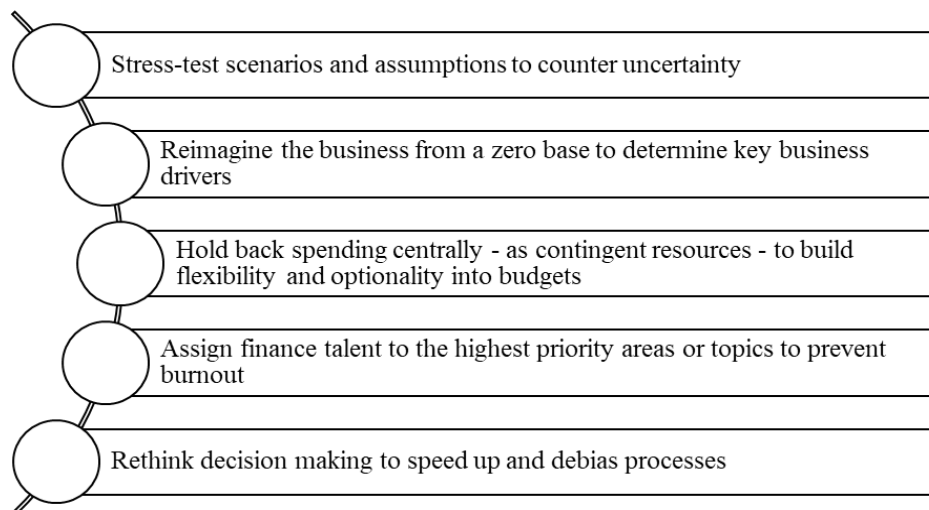
Source: Adapted from Gartner (2020)

Executives have used some of the Zero-Based Budgeting tools even before officially implementing it. (Agraval, Birshan, Grube, Maloney & Seth, 2020; Gartner, 2020). Starting with March 2020, most organizations embraced a cost-cutting exercise, based on the principles of the Zero-Based Budgeting. “However, a Zero-Based Budgeting approach to budgeting is more than just a cost-cutting exercise; it eliminates extraneous expenses that are not aligned with the strategy and instead shifts funds into activities that drive sustainable growth” (Gartner, 2020). In **Figure no. 3**, there are presented the first actions which were taken by executive leaders worldwide in order to survive the pandemic effects. The ones highlighted in a square are usually measures related to the Zero-Based Budgeting. As it can be easily observed, the top measures taken by executives in order to overcome the effects of the pandemic, are in direct connection with the Zero-Based Budgeting.

Moreover, taking into consideration the complex economic environment, a perfect budgeting process may not be achievable, but there might be a better version of it. The common budgeting process can be unnecessarily prolonged by negotiations and may not always be in direct connection with the strategy of the company. In opposition, a completely new budgeting process can address different topics which may generate added value for the company and suggest actions which are the translation of the strategical objectives of the company (Mondaq, 2021; IMF, 2020). In order to achieve the benefits of the Zero-Based Budgeting in the current pandemic context, Agraval, Birshan, Grube, Maloney, & Seth (2020) suggest that there might be five steps that CFOs can take in order to rethink and redesign their budgeting process.

The five steps are presented in **Figure no. 4**.

Figure no. 4. Steps that CFOs can take in order to redesign the budgeting process



Source: Adapted from Agraval, Birshan, Grube, Maloney, & Seth (2020)

I. Stress-test scenarios and assumptions to counter uncertainty

This first step refers to analysing the assumptions and decisions that were previously made in order to determine their relevance in the current context. The result of this analysis should be an alignment of all departments and functions regarding the next steps. This stress-test scenario should also be taken into consideration by the senior management in order to

determine whether there is a need of a bold initiative that can only be done at the higher levels.

II. Reimagine the business from a zero base to determine key business drivers

“Business leaders’ mindsets were changed when they were forced to move resources from areas that were once considered untouchable and saw that those moves

resulted in a better prioritization of the projects, an improved understanding of fixed versus variable costs, and a clearer overview of risks and opportunities” (Agraval, Birshan, Grube, Maloney & Seth, 2020). As shown above, most of the business leaders have already implemented zero based budgeting measures during 2020 in order to keep alive their companies. When preparing the budgets during or after the pandemic, executives should keep the same principles, meaning that in some areas they have to start from zero and not base their resource allocation on previous dimensions.

III. Hold back spending centrally – as contingent resources – to build flexibility and optionality into budgets

In most cases, once the budgets are approved, changes are hardly an option or several approvals are needed. But, in the COVID-19 context, companies had to learn how to be more flexible and constantly adapt to the changing conditions. This flexible attitude should be maintained in the next years as well, if companies desire to overcome the negative effects of the pandemic (PwC, 2020; WHO, 2020; Mondaq, 2021). Moreover, they should also adapt their key performance indicators (KPIs), as the old ones are rarely still relevant. The choice of the appropriate KPIs is of high importance as they show how the company is coping with the new conditions, but also, they have a huge role in resource allocation, which is of paramount importance in this situation.

IV. Assign finance talent to the highest priority areas or topics to prevent burnout

The pandemic context has completely changed the dynamics of the finance team in a company. The words “fast” and “change” have become ordinary while the working remotely to support major budget shifts and taking critical decisions (PwC, 2020). The segregation of duties was no longer a priority and everyone was involved in the process, which may have been stressful or tiring for the finance team. Luckily, digital solution became a priority during the pandemic causing taking some pressure of those working in the finance area. But this means that there should be a change in the way of working, while learning to work with the new digital tools which were implemented in 2020. In order to protect their employees from burnout, managers should set

priorities for the next periods, with clear objectives, expected outcomes and defined deadlines. “In all cases, it is important for CFOs to lead with empathy and it is critical to establish clear communication plans” (Agraval, Birshan, Grube, Maloney & Seth, 2020).

V. Rethink decision making to speed up and debias processes

Firstly, managers should define the new budgeting and decision-making process, so the finance team has a clear understanding of how the business will be conducted started from now on. But, in order to make these changes, managers should also reconsider their KPIs and align them with the new strategy, taking into consideration the effects of the COVID-19 on their company. Moreover, both managers and their team should be constantly transparent regarding the relevant KPIs and budgets and should have a smooth communication with everyone in the company. Also, the traditionally incentives given to the employees should also be adapted to the new conditions in order to keep the employees motivated and debias the processes.

In order to remain competitive on the market, organizations worldwide face severe pressures to cut cost while still achieving the desired level of performance (Gartner, 2020; PwC, 2020). By trying to implement some of the specific activities of the Zero-Based Budgeting, executive leaders should have a more structured overview regarding of the cost saving measure that can be taken.

3. Conclusion

During this unprecedented period of uncertainty related to the COVID-19, every sector is affected and there is a need of a general shift in the way things are done within the companies. When referring to the budgeting process, it is critical for the executive leaders to understand the importance of the correct allocation of resources during this worldwide crisis. The traditional budgeting process, which takes the costs from previous periods and apply different increase or decrease rates in order to obtain values which will guide the whole company in the next year, is no longer relevant in the COVID-19 context. As it was presented through the paper, one of the most effective method is the Zero-Based Budgeting. The budget pressures from 2020 demanded serious cost reduction in order to increase short-term efficiency and

the survival of the companies. The main advantage of the Zero-Based Budgeting is that it presents a safe and structured approach to identify cost reduction policies. „However, a Zero-Based Budgeting approach to budgeting is more than just a cost-cutting exercise; it eliminates extraneous expenses that are not aligned with the strategy and instead shifts funds into activities that drive sustainable growth” (Gartner, 2020). By following the steps presented above, companies can firstly align their objectives with the strategy and then translate these

objectives into relevant KPIs. Furthermore, the KPIs will support the management in understanding which activities are generating value to the company and try to reallocate or reduce the resources of the activities which do not bring any added value in the company. By trying to implement some of the specific activities of the Zero-Based Budgeting, executive leaders should have a more structured overview regarding of the cost saving measure that can be taken, and can remain competitive on the market.

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