A Blueprint for Application of Zero Base Budgeting to Indian Banking

Mohinder N Kaura

Zero base budgeting is an approach to budget formulation. It seeks to evaluate afresh the budgeted activity levels and related expenditure. Resources are released from projects and tasks that have outlived their utility. Zero base budgeting can serve as an effective tool for redeploying resources.

The budget settlement process in banks is an exercise in distribution of targets rather than a plan based on the business potential of individual branches.

Zero base review would eliminate the incrementation tendency of carrying forward the previous year's inefficiencies.

Kaura outlines a blueprint for application of zero base budgeting to Indian banks.

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Should the banking sector adopt zero base budgeting? If yes, what activities/sections should be taken up for application first? What process should be followed?

Based on interactions with a large number of executives of different banks and indepth semi-structured interactions with the chief officers and the zonal managers of two leading public sector commercial banks, I have identified the specific area suitable for application of zero base budgeting. I am convinced that zero base reviews will help overcome the shortcomings in the performance budgeting system currently in use in Indian banks and enable them to achieve more effective resource allocation. I discuss below the concept of zero base budgeting and a blueprint for its implementation in Indian banks.

What is Zero Base Budgeting?

Zero base budgeting is a planning, resource allocation and control tool which requires a manager to justify his budget request for projected results starting from scratch.

The unique feature of zero base budgeting is the zero base review. It is a structured, systematic, and analytical process of questioning what we do and why we do and deciding what we should be doing and how we should be doing (Kaura, 1987).

The budget is formulated de novo involving reconsideration and a fresh evaluation of each programme, project, and activity and every item of expenditure on it as if it were a new one. It is done without any reference to performance and resource utilization.

The first step in this exercise is the reprioritization of programmes, projects, and tasks. Unwanted activities and projects are dropped. Desirable projects/activities/tasks are included. Resources released from low priority projects/tasks are shifted to those with high priority.
A manager has to identify the minimum/basic requirements of resources to perform the functions of his unit. Expenditures above this minimum are identified as increments that must be justified before they are funded (Dudick, 1978). Zero base review of departments, projects, and activities can be made once every year as part of the annual budget exercise called zero base budgeting. If carried out once in three or four years, it is called a zero base review. Anthony (1978) favoured the zero base review and wanted that "each agency should be examined about once every five years" as zero base budgeting is a time consuming and traumatic process.

Zero base budgeting is especially useful for planning and controlling the operations of sections/departments providing supportive services. Many of these sections are of the discretionary expense type and it is difficult to clearly discern the relationship between their level of performance and the performance of the organization (Kaura, 1983 c).

Planning and Control in Banks

Formal management planning and control systems were initiated in the Indian commercial banks in the seventies to orient banking to the demands of national planning, including such objectives as development of backward regions and weaker sections of society. The public sector commercial banks have adopted the performance budgeting system from 1971. Although the basic objectives of the performance budgeting system are widely appreciated in banks, the implementation of the system has not been effective. The budget settlement process is full of imperfections (Kaura, 1983 a).

The budget exercise is not carried out in a spirit of participation and understanding. In most cases, it is reduced to a distribution of targets. The business potential of the branch and the aspirations of the bank do not become a part of the budgeting process for want of methods to draw meaningful lessons from environmental data.

The monitoring and review of actual performance against the budget is even more defective than the budget settlement process (Kaura, 1983 b). Branch performance is often not jointly reviewed by the unit manager and the controlling manager. The coordinating managers tend to regard budgeted levels as a commitment or a contract irrespective of changes in the operating conditions and non-provision of support in manpower and other resources. Preparation and processing of various performance reports are delayed. Besides, suitable rewards and encouragement systems for motivating the managers of the performing units are absent. Some commercial banks have introduced strategic planning and control systems in the eighties. They are, however, yet to take firm root. The banking industry, of late, has shown interest in introducing zero base budgeting to improve the budgetary process.

Relevance of Zero Base Budgeting to Banking

As discussed earlier, the unique feature of zero base review is its philosophy of questioning. This philosophy can be incorporated into the branch performance budget settlement meetings through a deliberate effort. It will promote settlement of the budgeted targets in a spirit of participation and encourage efforts to draw meaningful lessons from the branch environmental data. Besides, it will help to inculcate a high level of motivation and zeal to attain the targets by making the branch manager own up the targets. I am convinced that zero base review will strengthen the performance budgeting exercises in banks by minimizing the effects of the shortcomings now present in the performance budget settlement meetings.

Activities to be Reappraised

However, a structured reappraisal and examination of the activities of the coordinating departments and supportive service sections at the head office-, zonal, and divisional offices is needed.

Under the performance budgeting system, the budget for the division is obtained by consolidating the settled budgets for various branches and the items of expenditure and other data for the divisional manager's office. In practice, what is commonly done is to make marginal adjustments to existing levels of activity, resource consumption, and expenditure. The reason for this is the inability to see clearly the link between the levels of activity of the supportive services and coordinating sections and the business performance of the bank. The desirable level of activity and expenditure for these sections cannot, therefore, be determined with adequate justification. The zero base review will enable a complete justification of the administrative and other expenditures of the coordinating sections in the divisional manager's office. Likewise, performance budgets for the
zones can be developed after a zero base review of the different coordinating/supportive sections of the zonal office. Similarly, the performance budget for the bank as a whole will be the result of the settlement meetings incorporating the philosophy of zero base review for business parameters and the activities of various coordinating/supportive departments and sections.

At the head office of a typical commercial bank, a zero base review is needed for each of the following sections: credit sections for financing agriculture, small scale industry, other priority sectors, industry and trade, rehabilitation of sick units, deposit mobilization, merchant banking, foreign exchange, customer service, branch expansion, central accounting, inspection and audit, funds and investment management, planning, personnel, legal, premises maintenance, security, and EDP.

As the zonal offices in many banks are almost miniature replicas of central offices controlling the operations of a region of the country, the zero base review should also be made for each one of the coordinating sections or supportive service units located at the zonal office, e.g. credit to small scale industry, agriculture, industrial finance, business development, inspection and audit, accounts and finance, merchant banking, foreign exchange, premises, legal, and security.

The central purpose of applying zero base review to budgeting is to seek complete justification for the budgeted activity levels and related expenditures. The same is expected of a perfect performance budget settlement. Hence, what is needed is the removal of imperfections in the actual operation of the performance budget settlement process rather than replacing it by zero base budgeting, particularly for the branch level budgets.

**Introducing Zero Base Review**

Introducing zero base review in a bank can be visualized as a four-step process:

- identification of decision units or discrete activities
- construction of decision packages
- priority ranking of decision packages or alternative performance methods
- allocation of organizational resources to decision units and the formulation of the budget for the organization.

**Identification of Decision Units**

A decision unit or centre is a programme, project, or a segment of the organization for which separate budgets are prepared. It is a segment for which a manager makes decisions on expenditure, scope, direction, and quality of the task to be performed. The decision unit is analogous to the responsibility centre concept.

Zero base review should not be applied to the departments as a whole but to individual segments within the department. The zonal office cannot be considered as a decision centre. Its sections dealing with credit to small scale industry, large scale industry, agricultural sector, rehabilitation of sick units, and trade can be treated as separate decision units. It may sometimes be necessary to merge a couple of activities or sections together to form a decision unit or to split up a section into a couple of decision units.

**Constructing Decision Packages**

A decision package is a self-contained document for a decision unit. It questions its utility and appraises its level of activity and tasks. The document helps in deciding the minimum desirable level of activity and tasks vis-a-vis alternative methods of achieving them employing a different type and quantum of resources. Sometimes, several decision packages are prepared for the same decision unit, or a separate decision package for every alternative way of performing the minimum level of activity or for each one of the activity levels. The team constituted for preparing a decision package must document all information after thorough discussion and justification.

**Sample Illustration.** For understanding the process of constructing a decision package, I have developed the example of the Agricultural Credit Section in the Credit Department, with the assistance of executives from different banks.

**Objectives of Decision Unit.** The objectives of the Agricultural Credit Section are:

- get maximum business on agricultural advances
- minimize the amount locked up in overdues through regular monitoring
- prepare proposals for refinancing of loans
• encourage/guide the farmers to take up innovative schemes and prepare the same for submission to the National Bank for Agriculture and Rural Development (NABARD).

**Current Operations and Resources Employed.** The section has to:

- frame guidelines from time to time for decisions on how and whom to give credit
- monitor performance in relation to the targets
- impart training on specific aspects of lending to the agricultural sector
- arrange periodical counseling services to farmers on the latest developments/technology in the field of agriculture.

**Resources.** The section has one chief manager, two deputy chief managers, five other officers, ten clerks, and two peons. Besides, it also has four jeeps, two typewriters, and a micro processor. Table 1 shows the current budgeted resources for the Agricultural Credit Section and two other alternative ways of doing its work.

**Criticality of the Activity.** How critical is the activity of the section? The consequences of not performing the activity are:

- difficulty in coordinating and controlling the achievement of targets for lending and recovery of overdues. In the absence of proper training guidelines, the staff may not take efficient and rational decisions
- without the counseling services, the farmers may not be motivated to adopt latest techniques/developments in agricultural sector, thus impairing agricultural production.

The minimum level of activity that must be performed is:

- 16 per cent of the total advances of the banks should go to agriculture
- individual branch targets have to be fixed keeping in mind the potential
- constant check on overdues to be kept so that the amount locked up in overdues does not increase
- achieve 75 per cent of the recovery level.

What are the alternative ways of accomplishing the minimum level of activity and the objectives of the decision unit?

Three alternative ways, including the current one, were identified as shown in Table 1. These were:

- to carry on with the present level of activity with the existing staff of the department, Zonal offices' cells play a marginal role but head office' agriculture credit section does most of the work
- in addition to the permanent staff in the section, use staff employed in small scale industries and other divisions during the peak season of lending
- almost all the operational aspects of lending to the agriculture sector should be handled by relevant sections at the zonal office. Only a skeleton staff at the head office would be dealing with the NABARD, the government, and the Reserve Bank of India.

Table 1: Resources Budgeted for the Agricultural Credit Section

<table>
<thead>
<tr>
<th>Alternatives</th>
<th>Number of Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture Credit section at the head office as at present with zonal offices playing only a marginal role</td>
<td>1 Chief Officer, 2 Deputy Chief Officers, 5 Officers, 10 Clerks/Stenographers at Zonal Offices, 4 Managers at Zonal Offices, 3 Officers at Zonal Offices, 1 Chief Officer</td>
</tr>
<tr>
<td>Present arrangement at the head office plus staff from other work credit sections during peak work period</td>
<td>Same as above plus four officers during peak period</td>
</tr>
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<thead>
<tr>
<th>Major Job done at the zonal offices' cells with head office only doing liaison for example with RBI and NABARD</th>
<th>At the Head Office</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Chief Officer, 1 Manager, 2 Officers, 4 Clerks</td>
<td>1 Chief Officer, 4 Deputy Chief Officers, 5 Officers, 8 Clerks/Stenographers</td>
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What should be the criteria of performance for agricultural credit task? The following criteria were identified:

- percentage of recovery of the amount locked up under various schemes/activities
- amount of loans granted to the agriculture sector or the chances of achieving prescribed targets
- number of borrowal accounts
- level of suits/filed accounts
- number of schemes prepared for availing refinancing and percentage refinanced to total lending
- rendering counselling services
- periodical inspection of bigger units, proper and timely pre-sanction survey and post-sanction follow-up of larger units/accounts.

Ranking Process

The alternatives and decision packages have to be evaluated and ranked before they are selected for funding and inclusion in the budget for the organization. They have to be evaluated against the key parameters of performance of the department to which the decision unit belongs, and then selected according to the criteria spelt out in the decision package (Cowen, et al 1978). In Table 2, I have provided an evaluation of the three alternative ways of performing the task of the agricultural credit section in the credit department on the criteria identified above.

Table 2: Evaluation of Costs and Benefits of Alternative Ways of Performing the Agricultural Credit Task

<table>
<thead>
<tr>
<th>Criterion</th>
<th>Alternative</th>
<th>1</th>
<th>2</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recovery Percentage</td>
<td>Low</td>
<td>Good</td>
<td>High</td>
<td></td>
</tr>
<tr>
<td>Chances of Lending Targets Not Met</td>
<td>Good</td>
<td>High</td>
<td>Very High</td>
<td></td>
</tr>
<tr>
<td>Number of Borrowal Accounts</td>
<td>Low</td>
<td>Satisfactory</td>
<td>Very High</td>
<td></td>
</tr>
<tr>
<td>Number of Suit-filed Accounts</td>
<td>Large</td>
<td>Normal</td>
<td>Low</td>
<td></td>
</tr>
<tr>
<td>Refinancing Proposal Scheme</td>
<td>Low</td>
<td>Large</td>
<td>Very High</td>
<td></td>
</tr>
</tbody>
</table>

The ranking of the decision packages and alternatives begins at the level of the decision unit/section where the decision packages are initially constructed.

Exhibit 1 shows the 16 decision units at the zonal office of a typical commercial bank. The ranking process for the decision unit dealing with credit to agriculture would proceed as follows. The agriculture officers and the rural development officers working in the section will first rank the proposed alternatives and packages. Their cumulative rankings are forwarded to the deputy chief officer, agriculture finance department, who will, in turn, review the ranking done by the decision unit officers and assign his own ranks. The consolidated ranks are then sent to the chief officer, credit division, who will repeat the process. The highest level of management for the ranking process is the zonal manager. The final selection of the alternative or decision package is made on the basis of consolidated ranks and the projected availability of funds.

Formulating the Budget for the Zone

A summary of the administrative expenditure and other details to be included in the performance budget for the zone is compiled on the basis of the information contained in the decision package for the alternatives selected for different decision units. Normally, the alternative/decision package with the highest consolidated ranks is selected. Sometimes available organizational resources are not adequate to meet the requirements of the selected alternatives/decision package. In such a situation, the alternative with the second highest rank is selected for inclusion in the budget for the organization. Thus, final funding levels and allocation of resources result from various levels of management review which establish any changes in corporate priorities (Hill, 1977).

Conclusion

The relevance and applicability of zero base budgeting to the banking sector can be summarized as follows:

- the need for subjecting the activities of the coordinating units and sections providing supportive services at the head offices, zonal offices, and regional offices of the banks cannot be denied in the context of the current status of performance budgeting in the banks.
• the questioning philosophy of zero base review could be incorporated to strengthen the settlement meetings for finalizing performance budgets of the branches which form the basic operating units
• zero base budgeting will not replace the performance budgeting system practised in the banks; instead it will help remove the drawbacks in the performance budgeting system and enhance its effectiveness
• zero base budgeting has a very powerful and convincing philosophy as its implementation results in improved planning and deployment of resources besides making the operations cost effective
• zero base budgeting should not be viewed as a reductionist exercise. Its application will lead to either reduction in the expenditure and resources consumed or an increase in the expenditure and resource requirements supported by appropriate justification.

Recommendations

Based on my study of the banks and meetings with executives, I would make the following suggestions for implementing zero base budgeting in banks successfully:

• top management of the banks must be completely committed to the adoption of zero base budgeting
• zero base budgeting should be projected primarily as a resource planning and a re-deployment process rather than simply as a cost reduction and a cost control exercise meant to curb non-essential activities
• adequate thought must be given to the likely human problems by educating the executives and staff about its utility and allaying unnecessary concerns about the possibility of reduction in employment and dislocation of work. As staff appointments and salaries cannot be reduced in Indian banks, it would be better if an assurance is given that no retrenchment will be made
• monitoring cells should be set up at the head office as well as the zonal offices for implementing and resolving problems in implementation
• the deputy chief officers, chief officers, and zonal managers must be trained in the procedures for constructing decision packages and making the ranking decision so that personal biases affecting the benefits of the system are avoided
• finally, it is desirable to select two to three departments every year for making a zero base review so that each department gets appraised once in four to five years.

References


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