KPMG

Zero basing – tackling attitudes to risk head-on

Realizing value series

Global Strategy Group

Zero basing is an intrinsically radical approach involving new and challenging ways of rethinking the cost base. But how can companies manage the attendant risks while avoiding blocking good ideas?

In the recent KPMG International publication on the resurgence of zero basing, we highlighted five key conditions for making it work. In this article – the second in a series of articles on these five conditions – we discuss how to balance risk and value.

Resetting the cost base, and adding back only those activities that drive clear business value, involves a significant break from past ways of working. Not surprisingly, ingrained attitudes to risk can lead to opposition lower down the organization, which could hold back ideas that may be established practice in other companies.

This presents a dilemma for those implementing zero basing programs: how do they ensure an objective assessment of the true risk of decisions, to reduce the likelihood of opportunities missed (typically due to innate conservatism), whilst avoiding unintended consequences that damage the business?

These challenges are particularly important for asset-intensive businesses, like oil and gas or infrastructure. Managing risks, either of major health, safety and environmental (HSE) incidents, or of commercial losses running into millions of dollars, is a core part of day-to-day business in such organizations. Long-established protocols for dealing with risk are central to day-to-day decision-making, and zero basing demands an approach that recognizes these realities.

When done properly, such an approach directly confronts existing mindsets and procedures, which may no longer be relevant. Through KPMG member firms' zero basing experience across multiple industries, we have observed three key risk management challenges and recommend appropriate responses to address the challenges head-on.

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Establish a simple, consistent framework for classifying and rating risks

Many large companies have robust ways of identifying and tracking enterprise-wide risk, as well as specific approaches for guiding capital projects through 'stage gates' and assurance processes. By its nature, a zero basing project raises many opportunities to optimize costs. These range from simple decisions like redesigning the travel policy or reducing non-essential training, to more fundamental changes involving revising IT support service levels or cutting back on discretionary maintenance.

Leaders need a standard way of assessing risks associated with each identified opportunity, challenging them to debate the scale of benefit versus the associated risk, to decide which opportunities to proceed with.

Case study

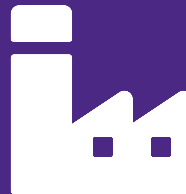
A utility infrastructure company adapted its corporate risk framework for use in a zero based review. This enabled the company to quantitively compare different risks associated with individual opportunities across the portfolio. Armed with this information, management could choose between opportunities where the benefit was similar but the risk profile was very different. For example, transferring non-core activities from a front office team to a call center, versus reducing the level of detail in certain reports provided by finance business partners. Such an approach should be tailored to the needs and practices of the organization, for instance, by re-purposing a pre-existing risk assessment framework. It should also address the different dimensions of risk like HSE, commercial, regulatory, reputational, etc.

Quantify the risk-value trade-offs

Teams steeped in a culture of risk registers, audits and technical evaluations often tend to assess improvement opportunity risks solely in terms of potential downsides. This means they fail to fully recognize the commercial context and do not take sufficient time to explore possible ways of reducing the risk.

Case study

The downside risk of an opportunity to reduce engineering activity in a world where a barrel of oil costs US$100 may be materially different where a barrel costs US$30. Likewise, a manufacturing plant's assessment of the potential to reduce production of non-profitable products may be very different in a world of rising prices and high capacity utilization, as opposed to a world where the opposite is true.



The answer is to quantify risk-value trade-offs, using a data-led approach to directly compare risks with potential benefits. This should take into consideration the specific commercial and operational needs of each asset and/or business unit. By insisting that teams identify potential mitigating actions for each risk rating, management can unlock the 'art of the possible' and prevent more radical options being stopped in their tracks.

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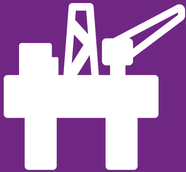
Make decisions at the right level in the organization

As discussed in our previous article *Zero basing – charting the human journey*, a successful zero basing program seeks to build ownership throughout the organization, by putting people at the heart of the process and empowering them to take key decisions wherever practical. However, the approach of middle management is often to make a full risk evaluation, and only recommend to senior leadership those opportunities they personally feel to be of limited or zero risk – on the grounds that 'no-one gets rewarded for raising risk levels'.

Case study

One energy client a KPMG member firm worked with had a clear and compelling opportunity to reduce the number of marine supply vessels serving its offshore installations, as evidenced by consistently low utilization across peaks and troughs of activity. The logistics manager was rewarded on the basis of on time in full equipment delivery offshore, but without accountability for unit cost performance. Based on past experience of unpredictable demand from these assets, he only saw the downside risk that future demand might at some point increase, leaving him unable to meet his performance metrics.



The key to unblocking this natural conservatism is to separate accountability for generation and selection of options. By agreeing early on who deals with individual opportunities as they emerge, with more complex risk/value trade-offs made by senior leaders, middle management is freed from the fear of being held responsible for the associated risks. Such a tactic helps keep value 'on the table' and allows a more balanced assessment of downside risk.

A successful zero basing program is highly dependent on effective risk management. It is not about sweeping legitimate concerns under the carpet and pretending the risk is not there; it is about tackling these challenges head-on with a simple, consistent and transparent approach. This takes emotion out of the discussion, and helps management make well-informed, well-balanced decisions that maximize value to the organization whilst dealing properly with the implications.

Here are five questions executives leading zero basing programs should ask themselves, to ensure their approach to managing risk/value trade-offs is keeping value 'on the table':

1. Where is your organization on a scale from 'risk-averse' to 'risk-taker'?
2. How have current commercial pressures shaped your risk appetite?
3. Do you understand the full risk/value trade-off associated with each cost-saving opportunity?
4. How would you decide between an opportunity to reduce HR service levels, versus an opportunity to reduce low value-adding activities in operations, if the value of both opportunities was the same?
5. Have you empowered your teams to come up with radical options and unconstrained thinking? Who will take the key decisions regarding cost and investment opportunities?

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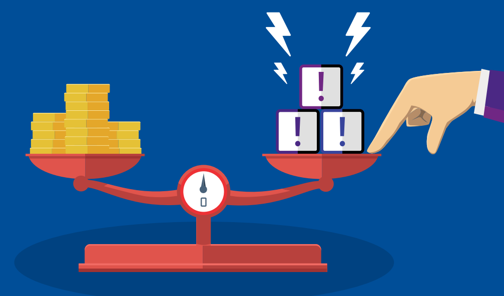

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Designed by **CREATE.** | CRT104423A | November 2018