

Who needs budgets?

You do.

YOUR BUDGETING
PROCESS CAN TARGET
INFORMATION THAT NEEDS
TO FLOW WITHIN YOUR
ORGANIZATION AND TO
YOUR B2B PARTNERS.

BY PENELOPE SUE GREENBERG AND RALPH H. GREENBERG

BUDGETS AREN'T JUST ABOUT THE NUMBERS. They're about communicating vital information within the organization. And in the very near future, the budgeting function in your organization may be called on to serve as a role model for communicating information in business-to-business (B2B) collaborative planning processes.

Budget bashing has become a popular topic and has even led to the suggestion that budgets are outdated and no longer needed, but don't be too hasty in advocating that your organization dump its budgeting process. Although such a position might make you popular with some colleagues, it isn't in your organization's best interests. The reason? The most important aspect of your budgeting

process soon may be as a communication model for reducing information asymmetries and uncertainties between your organization and its B2B partners. The communication procedures that your organization has developed for its strategic and operational budgeting process may provide the best blueprint for effective, efficient interorganizational communication.

KEEP YOUR BUDGETS

Talk regarding the budgeting process frequently revolves around target revenues and costs and how these targets are set, used—and misused. But rather than suggest dumping the budget, a much better approach is to determine why problems exist and fix them. If your process promotes a command-and-control environment, then incorporate more participation. If your incentive system is too restrictive or if it invites managers to create slack, then revise it. If the financial targets are no longer appropriate for your evolving organization, then expand or change the targets. Many companies have successfully implemented and used balanced scorecards and other methods to identify targets, and, even before balanced scorecards, they used performance evaluation based on world-class benchmarks.

Any revisions to your budgeting procedures should recognize that the biggest benefit of the current process is probably in enhancing interdepartmental communication throughout your organization in order to coordinate efforts and attain strategic and operational goals. The budgeting process allows upper-level operating and financial managers to communicate information about the strategic and operational goals of the organization. These executives have access to business intelligence efforts and to the tools to assess the competitive environment. They need to communicate many aspects of the big picture (the organization and the environment) and how these aspects impact each part of the organization.

The budgeting process also allows lower-level operating and financial managers and frontline employees to have their fingers on the pulse of the organization. They understand the business processes and procedures. Because they often have valuable information that can impact both short- and long-term goals and priorities, they need to have a process for communicating both internal and external perspectives on their assigned tasks.

This communication is critical because information asymmetries exist among departments and levels within the organization. Also, a company needs to recognize and

deal with uncertainties in its environment, such as the changing nature of competition.

B2B COLLABORATION

As business-to-business partnerships flourish, many organizations are developing closer ties than ever before.

These relationships involve interorganizational coordination, communication, and information sharing at an unprecedented level. If your budgeting process has been done correctly, it has already identified the information that needs to flow from one unit to another within your organization, so it should provide a good baseline

for communicating with your B2B partners. In both intra- and interorganizational planning, the type and amount of information, as well as the level of communication, depend on the situation, the interdependence and interactions between units, and whether those interactions are product or process focused.

Table 1 shows several types of information that will need to be communicated for the different levels of interdependencies—low, medium, high, and very high. Some software packages address many technical and procedural difficulties involved in communication between organizations. For larger organizations, MySAP.com Business Suite has applications that link global buyers, sellers, logistics providers, financial institutions, and even customs and trade authorities. It also offers a range of business functions including analysis, forecasting, and collaborative planning. For smaller organizations, NetSuite offers applications that include partner relationship management, purchasing and vendor management, and shipping integration with FedEx and UPS.

Let's take a look at what's involved in each type of B2B relationship.

Low Level of Interdependence

At the lowest level of interdependence, B2B relationships arise from occasional or recurring transactions that involve exchanging relatively standardized goods or services. In these situations, multiple providers and customers exist in the market. Coordination between organizations is low to nonexistent, and collaborative planning rarely needs to take place. But, similar to internal budgeting and control processes, information about the trading partner may be accumulated and evaluated.

Information such as price and delivery options is usually available on the supplier's website, and suppliers also may operate online marketplaces. Dell Computers and

Table 1: Types of Information in B2B Collaboration

| LEVEL OF INTERDEPENDENCE AND INFORMATION SHARING | SITUATION | PRODUCT-FOCUSED RELATIONSHIPS (EXCHANGE AND SUPPLY CHAIN RELATIONSHIPS) | PROCESS-FOCUSED RELATIONSHIPS (OUTSOURCING OF TECHNOLOGY, SERVICE, OR SUPPORT FUNCTIONS) |
|--|--|--|--|
| LOW | Standardized goods or services with multiple providers and customers | Price Quantity Quality Lead-time Delivery options | Price Volume Processing or turnaround time |
| MEDIUM | Specialized goods or services with few providers and customers Some supply chain relationships | Specification assurance Quality assurance Cost data and price constraints Projected demand and supply | Description of procedures Interoperability issues Auditability Required input and output data Costing and pricing procedures |
| HIGH | Supply chain alliances Project joint ventures | Open information on cost data Production capacity Profit/loss fairness Target costing Business intelligence Going-concern assurance | Processing capacity Profit/loss fairness Target costing Business intelligence Going-concern assurance |
| VERY HIGH | Strategic alliances or networks Collaborative business ventures for primary or important products or services | Goal setting for market niche Risk preferences Risk behavior Profit/loss sharing | Goal congruence Risk preferences Risk behavior Profit/loss sharing |

Staples, for instance, offer goods to both businesses and consumers. Staples Online Marketplace offers more than office supplies—it also offers services like copying and photo developing, among others.

Third parties may operate portals where buyers and providers can place and respond to bids for goods and services via auctions or reverse auctions.

ChemConnect.com helps buyers and sellers of chemicals, plastics, and related products find trading partners. They offer three marketplaces: one where prequalified members buy and sell commodities in real time; one for sellers to find new customers, which includes electronic catalogs and forward auctions, where buyers bid on products or services and the bidding price increases over time during

the bidding period; and one for buyers to purchase items via requests for quotes and reverse auctions, where sellers are invited to bid on fulfilling an order for products or services and the bidding price decreases during the bidding periods.

The information exchanged between organizations through online marketplaces may not be proprietary and may have been used for the make-or-buy or do-or-outsource decision. If the information is proprietary, portals like ChemConnect offer the opportunity for completely anonymous trades. In an internal budgeting situation, the analyses leading to the cost and quantity data would be communicated as part of the operational budgeting process. To allow for informed transactions, ChemConnect offers chemical market information and e-mail alerts for completed deals.

Medium Level of Interdependence

Interdependence and information sharing increase when goods or services have special characteristics, when systematic sourcing (a longer-term relationship) is desired, and/or when there are only a few providers or customers. For this type of relationship, some coordination between each organization's activities and processes is needed to attain both operational and strategic goals.

For this level of interdependence, companies need to communicate price and cost constraints, product specifications, and other proprietary data so negotiations similar to internal budget negotiations can take place. Companies may also share or jointly establish supply-and-demand forecasts and production schedules. Take, for example, Boeing's relationships with aircraft engine suppliers, such as General Electric and Rolls Royce. General Electric worked for two years to develop engines for the 777-200 and 777-300 models in Boeing's 777 commercial airplane family. For Boeing's 7E7 Dreamliner, GE and Rolls Royce developed commercial jet engines that had the same standard interface, allowing either engine to be fitted to the 7E7.

For process outsourcing, companies may need to resolve interoperability issues concerning systems, processes, and data. Budget information previously used only internally for business process management may need to be shared for successful business process integration. Amazon.com, for example, provides a comprehensive set of technology services, order fulfillment, and customer service for Target at Amazon.com and Target's

online sites—Target.com, MarshallFields.com, and Mervyns.com. Amazon.com also cobranded with Toys “R” Us to provide an efficient Internet distribution system for the toy store.

In some alliances, the members are actually competitors who cooperate to purchase materials and supplies, transport goods, share warehouses, or share technology-based services. Marriot and Hyatt, although competitors, own a procurement consortium for the hotel industry. And Borders, a mall bookseller, dropped its money-losing Web venture and teamed with online competitor Amazon.com for services similar to those Amazon provides for its other alliances.

For control purposes, the user may require the same level of auditability of the provider's process as is needed for its own processes. For example, Dell Computers' supply chain management system requires that suppliers have the ISO 14001 certification, a standard for environmental management systems, and the OHSAS 18001 certification, a standard for workplace health and safety management systems. Dell provides training for suppliers on what it expects of them, asks key suppliers to conduct self-audits, and holds regular reviews with key suppliers to attain that control.

High Level of Interdependence

Interdependence and information sharing increase even further in strong supply chain alliances and project joint ventures. Collaborative planning and coordination take place at both the operational and strategic levels. These networks operate almost as if they're members of a single organization, with electronic data interchange (EDI) communications and electronic funds transfer (EFT) transactions taking place between the systems and people from each organization.

A common problem in supply chains is the bullwhip effect, where erratic shifts in orders up and down the chain cause production and inventory problems. In some industries, this problem has been solved by multiple organizations along the supply chain setting up networks that share demand information. Consider Wal-Mart. The world's largest retailer is known for its supply chain alliances and continuous improvement efforts in the handling, moving, and tracking of inventory. One of its most notable examples of information sharing is with Procter & Gamble, a supplier that has access to information on every P&G item Wal-Mart sells. By monitoring inventory

levels at the stores, P&G uses knowledge of Wal-Mart's desired thresholds to electronically manage its inventory replenishment for Wal-Mart.

In some cases, the term "dependence" is more appropriate than interdependence. For example, Wal-Mart and the U.S. Department of Defense have mandated that many of their suppliers not use bar codes and instead use RFID (radio frequency identification), a wireless form of product identification. It allows noncontact reading of data through tags that emit a radio signal and that contain more information, such as product expiration dates, than traditional bar codes.

Many budgeting and control issues arise between organizations that arise within vertically integrated organizations. Some of the following issues may require iterative negotiations involving simulations and revised calculations:

- ◆ How to distribute profits or losses and cost savings in a fair manner to all those involved;
- ◆ How to allocate overhead and support services costs;
- ◆ How to best acquire, distribute, and use business intelligence; and
- ◆ How to set and achieve target-costing goals.

For some longer-term alliances and project joint ventures, enough information must also be communicated to assure partners that each one is truly a going concern. Some enterprise risk management techniques used for strategic and tactical planning may reduce financial, operational, and technological uncertainties by identifying, measuring, and monitoring risks in those areas. Much communication in supply chain alliances is intended to reduce the information asymmetries between the organizations and the uncertainties in the environment.

Very High Level of Interdependence

Strategic alliances and collaborative business ventures involve the highest amount of interdependence and communication. Companies may need to collaborate to shape and determine the venture's strategic direction and assure goal congruence between or among the organizations. Communication may become more interactive and iterative, with negotiations possibly involving research, development, and substantial investments. Companies may also need to align risk preferences and limit risky behavior of alliance members.

Hewlett-Packard and Disney, for example, have been strategic partners for many years, with HP engineers and Disney imagineers collaborating on ventures such as Epcot Center's new attraction called Mission: SPACE. HP has also partnered with SAP AG to deliver integrated

solutions for customers, such as P&G. Former HP Chairman and CEO Carly Fiorina stated at SAPPHERE 2003, SAP's annual event, that she believed HP and SAP "share a common vision" and used "SAP's NetWeaver, which allows companies to create and improve business processes across their value chain without changing out all the underlying technology foundation" as an example.

Another example is the alliance between SAP and Microsoft known as Project Mendocino. This alliance's strategic objective was to jointly develop a software application that used the familiar Microsoft Office environment to access selected SAP business processes and data, including financial reporting. The result? The release of Duet Software, which SAP and Microsoft jointly market, sell, and support.

COMMUNICATION IS KEY TO B2B COLLABORATIONS

Be aware that the same problems that arise in the internal budgeting process can arise in B2B relationships. If one partner has more power than the other, the powerful partner may need to take steps to incorporate the less powerful partner in the decision-making process. Agreements and contracts need to be prepared carefully to avoid incentives to create slack and untruthful reporting. Targets and performance evaluations should be based on a balanced scorecard.

But always keep in mind that communication is a key ingredient in successful relationships. Just as communication is critical to reducing information asymmetries that exist among departments and levels within an organization and to reducing uncertainties that exist in the organization's environment, communication is imperative to reducing information asymmetries and uncertainties that exist in B2B relationships. The best role model for B2B collaborations that require effective, efficient interorganizational communication should be your internal budgeting process. ■

Penelope Sue Greenberg, Ph.D., is an associate professor in the department of management information systems and decision science in the School of Business Administration at Widener University in Chester, Pa. You can reach her at (610) 499-4475 or psg0001@mail.widener.edu.

Ralph H. Greenberg, Ph.D., is an associate professor in The Fox School of Business and Management's department of accountancy at Temple University in Philadelphia. You can contact him at (215) 204-6830 or Ralph.Greenberg@Temple.edu.