



Marketing Performance Evaluation - The Marketing Cost Analysis Way

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Abstract

The increasing acceptance of the marketing concept whereby the organization looks outwards to the satisfaction of consumers' needs – chose of society in establishing its competitive position, rather than looking inwards to its entrenched technology has created a deeper interest in analyzing marketing costs for the purposes of establishing marketing strategy and controlling marketing efforts in executing that strategy. The present paper tries to elaborate on the dynamics of the marketing cost analysis way of marketing performance evaluation.

Key Words:

Cost Analysis, Marketing, Marketing Performance Evaluation, Market share, Ratio Analysis

Introduction

Marketing is the management process for identifying, anticipating and satisfying customers requirements profitably (**The Institute of Marketing**). The currently accepted total marketing concept of business focuses on customer–orientation– a significant shift from the earlier production – Orientation. Marketing orientation started in the U.S.A. and other industrialized countries in the 1950's and is now in full swing in most companies of the world. The emphasis has shifted from production and selling to marketing, which is characterized by a close coordination between product planning, product engineering, manufacturing and marketing. Instead of trying to sell what they

produces, more and more companies are trying to find out what their customers want, and produce those goods and services. Companies in the future will no longer be satisfied with marketing orientation. They will tend to become marketing companies (Bell, 1972).

The modern Marketing manager has to discharge his function for attaining the following objectives:

- (a) Creation of demand for new products.
- (b) Identify market potential for existing products.
- (c) Develop latent potential and revitalize marketing effort.
- (d) Smooth out uneven demand by adopting suitable marketing strategies
- (e) Meeting the excess demand situation.
- (f) Correlating the product demand with production capacity and reduce excess demand.

Analysis of Marketing Cost

The marketing cost refers to the cost of selling function *i.e.* the cost of activities relating to create and stimulate demand for company's products and to secure orders. The marketing costs include the following:

- Salaries, commissions and travelling expense to sales staff.
- Remuneration of sales director.
- Administration and upkeep of sales office and showrooms.
- Advertising and publicity expense
- Cost of catalogues, prize costs and samples
- Depreciation, insurance, repairs, maintenance of sales and showrooms
- Bad debts and cost incurred for collection of bad debts
- Discount and rebates.

Marketing cost analysis is a detailed examination of the costs incurred in the organization and administration of the sales and marketing function and its impact on sales volume. It is a fact finding analysis which relates costs to sales volume and resultant profitability. A marketing cost analysis is a detailed study of a company's marketing costs. It is undertaken to discover which segments (territories, products, Customers) of the company's marketing program are profitable and which are not. A marketing cost analysis is a part of a company's evaluation of its marketing performance.

Marketing Cost Analysis is Beneficial

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Successful conduct of marketing cost analysis benefits the Sales manager in ascertaining:

- I. relative cost and profitability of sales operations,
- II. profitable, not so profitable and not profitable territories, products, pack sizes, market segments, distribution channels etc.
- III. minimum order level quantities,
- IV. productivity of sales persons,
- V. profitability of different sales promotion techniques and
- VI. profitability of different marketing mix programs.

Approaches in Marketing Cost Analysis

There are basically two approaches adopted in practice:

- I. **Full-cost Approach** – In this approach, all costs are allocated to products, customers or other categories, including fixed and common costs. With all costs allocated, profitability can be easily determined by subtracting costs from sales. This assumes that costs have been allocated correctly. However, the allocation of marketing costs is not an easy task in practice.
- II. **Contribution-Margin Approach** - In this approach, not all costs are allocated in all situations. This approach focuses on variable costs and allocates them, leaving fixed costs unallocated. It helps managers avoid conflict over the allocation of fixed costs.

Accurate Cost Data is Required

In majority practical situations, data for marketing cost analysis is inaccurate and need is of accurate data.

Much of the cost data for marketing cost analysis is inaccurate for the following reasons as:

- Marketing costs may be allocated to individual products, sales areas, customer groups etc. on the basis of sales value or sales volume, but this involves circular reasoning. Costs should be allocated in relation to causal factors, and it is marketing expenditures that cause sales to be made.
- General overheads and administrative costs are arbitrarily (and erroneously) allocated to segments on the basis of sales volume.
- Many marketing costs are not allocated at all as marketing costs as they are not identified as such but are classified as manufacturing, general or administrative costs instead.

- If costs are inappropriately allocated to products, then some products will be overpriced and some underpriced.
- Some important marketing costs are hidden in manufacturing costs or in general and administrative costs, including finished goods inventory costs in the former and order-processing costs in the latter.
- Useful computations of marketing costs and profit contribution in the multi-product company require the adoption of analytical techniques that are not difficult in principle but which are not widely adopted in accounting.
- Marketing budgets for individual products are too small and increasing returns would result from an increase in expenditure.
- The marketing mix is inefficient, with an incorrect balance and incorrect amounts being spent on the constituent elements such as too much on advertising and insufficient on direct selling activities.

The Practical Problems

A large number of difficulties are in the way of marketing cost Analysis.

Marketing cost analysis is practically difficult for the following reasons:

- I. The marketing costs have long-run effects. For e.g. the effect of an advertising campaign lasts longer than the period of campaign period.
- II. There is difficulty in measuring productivity of marketing costs, since standards are not easily determined.
- III. The marketing costs are in the nature of non-symmetrical costs. For example, costs increase more in changing from regional to national distribution than would be saved by changing from national to regional distribution.
- IV. Costs are frequently indivisible or joint costs, often intended to support a product group.
- V. Some costs has discontinuity or a stepped up nature.
- VI. The marketing cost budgets are mostly based on sales forecasts. The actual sales may be more or less than the budgeted one.
- VII. The outputs of the marketing subsystem intimately affect the outputs of the firms other subsystems.
- VIII. The enormous range of strategic possibilities makes it impossible to include all of them in formal marketing cost analysis.

- IX. The ever-changing environment - including the impacts of competitive activities, developments in technology, changes in consumer tastes, Government action and other factors makes planning difficult.
- X. The effectiveness of marketing costs (i.e. productivity or efficiency) is not easy to measure.
- XI. The interface of marketing subsystem with external agencies is fraught with difficulties.
- XII. Marketing is concentrated on human factor like salesmen, consumer etc. which creates more difficulties in analysis.
- XIII. Problems arise in connection with special marketing projects, such as the development of a new product, a major advertising campaign, or entry into a new territory, in analysis of costs and profitability.
- XIV. There is lack of effective financial analysis of customers, channels of distribution and salesmen.
- XV. There is an overemphasis on net profit based reporting or the full cost allocation approach.
- XVI. There are inadequacies in marketing cost classification *e.g.* little distinction was made between fixed and variable costs or between controllable and non-controllable costs.
- XVII. There was a general lack of integration between accounting and marketing functions.
- XVIII. Accounting builds from an analysis of internal financial data whereas marketing builds from the diagnosis of external marketing solution.

Ratio Analysis May Be Helpful

The following ratios are generally computed and analyzed in Marketing Management Ratio of Marketing contribution of Marketing assets.

$$\frac{\text{Marketing contribution}}{\text{Marketing Assets}} \times 100$$

The above ratio can be further segregated into:

- (i) Ratio of Marketing costs to Sales

$$\frac{\text{Marketing Costs}}{\text{Sales}} \times 100$$

- (ii) Ratio of sales to Marketing assets

$$\frac{\text{Sales}}{\text{Marketing assets}} \times 100$$

(iii) Ratio of Variable production cost to sales

$$\frac{\text{Variable production cost}}{\text{Sales}} \times 100$$

The ratio of Marketing costs to Sales can be further analyzed as follow:

a) Ratio of Warehouse costs to Sales

$$\frac{\text{Warehouse costs}}{\text{Sales}} \times 100$$

b) Ratio of Advertising costs to sales

$$\frac{\text{Advertising costs}}{\text{Sales}} \times 100$$

c) Ratio of Selling costs to sales

$$\frac{\text{Selling cost}}{\text{Sales}} \times 100$$

d) Ratio of sales office costs to sales

$$\frac{\text{Sales office costs}}{\text{Sales}} \times 100$$

e) Ratio of Bad debts to sales

$$\frac{\text{Bad debts}}{\text{Sales}} \times 100$$

f) Ratio of Distribution costs to sales

$$\frac{\text{Distribution costs}}{\text{Sales}} \times 100$$

g) Ratio of promotional Costs of sales

$$\frac{\text{Promotional costs}}{\text{Sales}} \times 100$$

h) Ratio of Discount to sales

$$\frac{\text{Discount}}{\text{Sales}} \times 100$$

i) Ratio of Market research costs to sales

$$\frac{\text{Market research costs}}{\text{Sales}} \times 100$$

The ratio sales of Marketing assets can be further analyzed into the following:

- a) Ratio of Finished goods stock to sales

$$\frac{\text{Finished goods stock}}{\text{Sales}} \times 100$$

- b) Ratio of Debtors to Sales

$$\frac{\text{Debtors}}{\text{Sales}} \times 100$$

- c) Ratio of Sales and distribution vehicles to sales

$$\frac{\text{Selling distribution vehicles}}{\text{Sales}} \times 100$$

Marketing Share Measurement

It is one of the most important planning decisions and involves the share of the market a product currently holds compared to the status of the market in terms of growth. Market share is a percentage of the total market captured by a single product or company. The correct market share gives the strategic planner some indication as to where emphasis should be placed. Marketing managers are more concerned with the size of the company's market share, though this not a primary objective. The primary objective should be an increase in profitable sales. Increase in market share may or may not contribute to the primary objective.

Market share is measured by

$$= \frac{\text{Company X's sales}}{\text{Industry's sales}} \times 100$$

Ratio holds good if both company's and industry's sales are measured for the same period, in the same units and for reasonably similar products. Factors like market penetration, brand loyalty, customer preferences price sensitivity etc. are to be considered in calculating market share.

Cost Benefit Analysis of Advertising

Advertising can be viewed as an addition or as an alternative to other forms of order-getting activity notably direct selling and sales promotion. The investment of funds in advertising must be made in relationship between total sales and advertising outlays rather than in relationship between advertising expenditure and total marketing expenditure. In a majority of companies, it will probably be found that the money spent on advertising is the largest outlay that is not accompanied by strict accountability for reasons. The major reason for this seemingly absurd situation is the great

difficulty of measuring the effectiveness of advertising expenditure and its results. Measurement of advertising costs presents considerable problems and as such, rational analysis of cost-benefit is sometimes not possible due to the following reasons:

- (a) Time lag between the incurrence of cost and the obtaining of benefits is more. Sales may be made progressively over a period, only in a later period.
- (b) The most important effect of advertising is reflected in increased sales. But favourable sales may be due to several factors other than advertising.
- (c) Effectiveness of advertising is related to the general economic conditions in the country.
- (d) Advertising may not create demand, it may merely advance the timings of sales.

As far as the advertising is concerned, the benefit of advertising expenditure may not be seen in that period i.e. increasing sale is due to certain period's advertising so it is useful for a marketer to have a lagged ratio for this expenditure as:

$$\frac{\text{Advertising for a previous period}}{\text{Sale of this period}} \times 100$$

Conclusion:

In many companies, the cost of marketing greatly exceed factory overhead costs, yet very little attention has been given to the analysis of marketing costs compared to the extensive attention given to production costs. So, a marketing cost analysis may be an effective way of evaluating marketing performance of a company. Marketing cost analysis is beneficial. Although a large number of difficulties are in the way, but, with accurate cost data we can make proper decision and draw conclusions. In this exercise, ratio analysis may be helpful. Market share measurement and cost- benefits analysis of advertising will certainly help in re-engineering marketing function finally achievement of cost reduction.

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