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John W. Barry

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The accounting function can improve the marketing function greatly—if past misunderstandings and poor communications can be overcome. This article suggests some specific areas where closer coordination can benefit the company profit picture—

ACCOUNTING'S ROLE IN MARKETING

by John W. Barry
John W. Barry & Associates

For the management seeking to enhance corporate profitability, marketing is one of the undeveloped frontiers. Marketing as a function should have its own productivity and profitability standards, and an alert accounting staff can play a major part in developing them. However, it takes some special understanding on the part of financial executives to function effectively in this role.

As is well known, the marketing function has been undergoing major changes during the last decade or so. These changes are symbolized by the new name—this function used to be called sales—and by the growing adoption of the so-called marketing concept.

Three aspects of marketing

In its fullest sense the marketing concept has three aspects: (1) customer orientation, that is, study of customer needs and wants before the selling process (if possible, before the manufacturing process) begins; (2) an organizational structure in which all marketing activities are performed by the marketing department and in which the chief marketing executive is accorded a status equal to that of the top financial or manufacturing executive; and (3) emphasis on improving the profitability and productivity of marketing operations.

As a number of studies have shown, the marketing concept has been adopted to a large extent by both large and medium-size manufacturing companies—but not nec-

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A major function of the marketing concept is customer orientation—determining what the potential customer wants before selling begins.

essarily to the same extent in all its aspects. Most generally accepted are the first two aspects, customer orientation and high status for the top marketing executive. Attention to the third aspect has lagged.

One recent study[1] showed that while virtually all the companies surveyed measured product profitability, only two-thirds measured territory profitability and only a little more than half assessed customer or salesman profitability.

Barriers

This points up obvious opportunities for the accounting function. The accountant should proceed with the utmost caution, however, for there are long-standing differences between the two areas. Their relationship is traditionally characterized by lack of mutual understanding and indifferent (if not downright poor) communications.

All too often accountants regard the marketing function as mostly selling, and the marketing men have an image of the accountant as "just a scorekeeper." Sometimes the accountant deserves that label.

Consider the approach taken by a beverage company a few years ago. An analysis of sales costs showed that the cost of maintaining old sales volume (selling to established customers) was 4 per cent of that sales volume while the cost of getting new volume (obtaining new customers) was 50 per cent of that volume. When these findings were noised around, the company decided to abandon seeking new business. In a short time it went broke. Can't you hear the sales-oriented people saying, "I could have told you so?"

The attitude of sales executives was epitomized in a recent speech by the sales vice president of National Cash Register Company. He said, in essence, "I don't know any better way to ruin a good sales organization than to start emphasizing profits. First thing you know, more attention is put on cost-cutting than on business-getting, and when creativity is diverted this way, the business suffers."

Bridge-building

Actually, of course, it is possible to put creativity into both business-getting and cost control. (Please note that we are interested in cost control, not necessarily cost-cutting.) Before a financial executive attempts to establish new cost control concepts in marketing, however, he should build a bridge—perhaps a new bridge—between the finance and marketing functions. The best way to build such a bridge is by undertaking to help the marketing people do a better job in the same terms as those in

JOHN W. BARRY is head of the New York consulting firm, John W. Barry Associates, which he founded in 1958. After spending his early years in banking, Mr. Barry was with Scott Paper Company for many years in various marketing capacities. He entered consulting work in 1945 and served with several large firms. An honors graduate of Harvard, he did graduate study at the University of Pennsylvania in marketing and statistics. He has written a number of magazine articles and is a frequent speaker to business audiences.

[1] Michael Schiff and Martin Mellman, *Financial Management of the Marketing Function*, Financial Executives Research Foundation, New York, 1962.

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which they themselves conceive of their job.

Training sales force

One good approach to this problem is through sales training. The accountant's first reaction to this suggestion may well be, "What do I know about sales training?" But a financial man who participates in any way in final purchase decisions may know a good deal and be in a position to make a significant contribution.

Here is an example cited by Dr. Michael Schiff:[2]

A corporation had a large force of industrial sales engineers who were thoroughly familiar with the technical capabilities and applications of their products. However, the buyers' final decisions were made more in financial terms than in terms of technical capabilities.

Dr. Schiff worked with these sales engineers to help them develop understanding of the fundamental concepts of capital asset acquisition decisions. He taught them how to make a total presentation covering both the technical features and the financial considerations—the investment returns on a payback and discounted flow basis. Thus, the prospective customer got a total business analysis of the advantages of the acquisition, thorough enough to use in raising the funds to finance it.

[2] Dr. Michael Schiff, chairman of the accounting department at New York University, and his brother Jack, professor of marketing at Pace College, have done more to build bridges between the accounting and marketing functions than anyone else. Many useful suggestions can be found in the book cited earlier and in Dr. Michael Schiff's "The Sales Territory as a Fixed Asset," *Journal of Marketing*, October, 1960.

Bridges created

All this was not done easily. The salesmen had to learn to understand depreciation, cash flow, investment, the tax aspects of various depreciation methods, and the like. In some cases Dr. Schiff has made a financial man a permanent part of the sales team to help in this kind of work. Giving help in sales training has paid off in more than increased sales; in these companies real bridges—carrying profitable two-way traffic—exist between accounting and marketing.

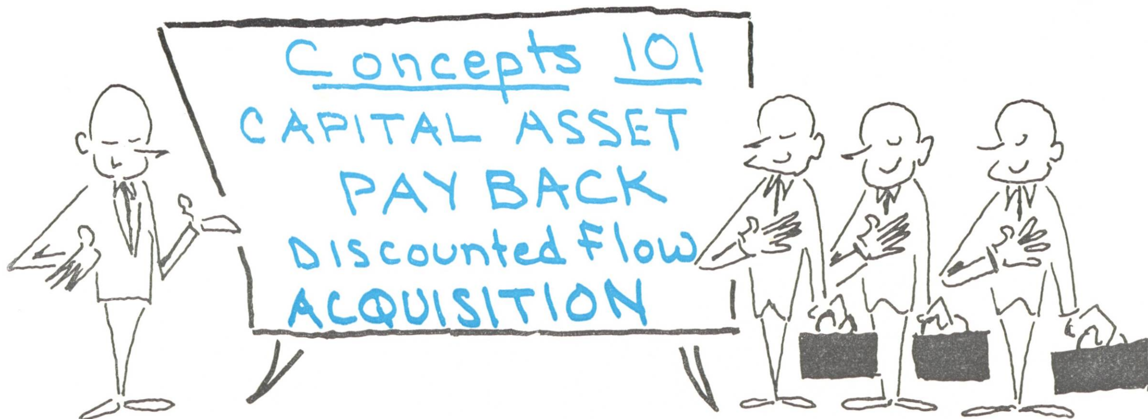
Another bridge-building device is to have a member of the controller's staff in the marketing department who has line responsibility to the marketing manager but a close working relationship with the controller. Such arrangements are not uncommon in manufacturing departments; they are less frequently used in marketing.

There are many ways to build closer, more productive relationships between accounting and marketing. The important thing is to make a beginning. Before trying to sell most kinds of profitability ideas, the financial man would be wise to see whether he can first make a contribution to marketing effectiveness in the marketing manager's own terms (and the sales training approach is as good as any). His counsel on profit planning, controls, and reports will be both more knowledgeable and more welcome if he first makes this effort—and makes it successfully.

What are some of these profit-enhancing ways accountancy can contribute to marketing profitability? A number of them are suggested by the profit-analyzing deficiencies mentioned earlier: distributor profitability, marketing channel profitability, salesman profitability, customer profitability, and the like.

Territorial profitability analysis

One of the most constructive—if it is undertaken in conjunction with the market research department and the traffic department—is to prepare territorial profit and loss statements. This is an old but an under-utilized technique. It involves setting down all the sales costs and profit factors applicable to each sales territory, including advertising, transportation costs,



Sales engineers were given an accounting orientation, allowing them to make a total presentation covering financial considerations as well as technical features.

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Investigation and analysis of actual market potential in each geographic area will often result in redistricting and remanning of sales areas.

etc., together with data on each territory's market potential.

Every marketing man knows that some sales territories make money and some break even. He knows that still others contribute needed volume or represent investments for the future. He probably has a rough idea of what actions he wants in given areas and which areas he wants to leave alone.

However, a rough idea isn't enough. Too many marketing executives make decisions by reflex, relying solely on rule-of-thumb judgments. Those who don't analyze each of their territories from time to time are overlooking a sound device for improving the profitability of their operations. They are also overlooking a key way to win support for their decisions from above and from below.

How to do it

To analyze profit and loss by territory, set down all the sales costs and profit factors applicable to each territory, together with data on each territory's market potential. (The last-named is often left out, although it enters heavily into the marketing manager's thinking. However, his peers and subordinates may suspect him of making decisions in a vacuum if he does not show it.)

For each territory, list the following elements down the lefthand side of a sheet: sales potential, current sales, production cost of product(s), transportation costs, direct selling costs, indirect selling costs, and local factors (such as nearness to competitor's plant, local competition, sales or inventory taxes). Then, to the right of that column, enter the figure that shows how things stand right now. To the right of the second column, list the targeted objectives for each of the elements (with the dates on which you expect to hit the target). In the final righthand column, list the actions you think necessary to achieve your immediate objectives in each area.

In most cases, this analysis will require the combined efforts of the market research department, the traffic manager, and the sales accounting people. This is, in fact, one of its chief benefits. When each of these people sees how the information he provides leads to a marketing decision, he is much more likely to support that decision. The traditional battle lines that tend to separate these functions will melt away.

This kind of analysis clearly points up whether the marketing manager should increase or decrease the sales effort and sales expense dollars entrusted to him—and what the stakes are and the returns should be in each case. Properly done, it differs little from the Schiff principle of treating each sales territory as a fixed asset. The accountant, the marketing manager, and the market research man who collaborate on this kind of an analysis usually complete it with enormously increased respect for one another.

Examples

One decision made as the result of such an analysis concerned a Midwestern state. Its sales potential for the company making the analysis was high, and so was the expense for national advertising, which was, of course, allocated on the basis of circulation. Personal sales efforts were only nominal, however. As a result, sales were quite low, and the territory showed a loss. When these facts were exposed, the decision was to hire enough salesmen for this Midwestern market to achieve at least a breakeven level of sales.

A territorial analysis, of course, needs to be done only once every few years. In general, it should be performed only when there are fresh and informative data available on market potentials.

Here is a case in which territorial profitability analysis helped turn a company around to better profitability:

A company made electrical prod-

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Long production runs may keep manufacturing costs down. But they can also result in losses through large inventories of slow-moving goods.

ucts for industry. Its annual sales were slightly over $25 million, but it carried a heavy debt load, and profit margins were uncomfortably narrow. The chief marketing executive, a relative newcomer, decided his area needed the most attention. He began probing for soft spots.

Years before, when the company was founded, there was little money for hiring salesmen. Accordingly, management had hired independent agents, offering them a commission rate high enough to ensure their interest in pioneering the company's products. A few years later, in certain sparsely populated areas where no agent could be induced to take the line on a commission basis, direct salesmen were hired.

Commissions unrealistic

Since this choice of marketing channels had been largely fortuitous, the marketing executive's first step was to analyze territorial potentials and sales costs. His analysis confirmed many previous suspicions, uncovered a few surprises, and, most important of all, justified certain necessary steps.

Some samples from the chart he worked up are shown in the exhibit on page 48.

The original commission rates may have been low for new products, but they had become unrealistically high now that the products no longer required much pioneering. Territory No. 14 (covered by a direct salesman) probably represented the ideal situation: The 40 per cent market penetration was considered as high as was realistic to shoot for, and the 4 per cent cost seemed to be the lowest that was consistent with good coverage of the market.

The actions taken were all orthodox as well as humane. The agents in Territories No. 1 and No. 16 (as well as some other agents in territories showing similar figures) were given realistic sales volume and expense quotas. Eventually, both became direct factory branches, retaining the best of the old personnel.

The salesman in Territory No. 14, with 40 per cent market penetration and a 4 per cent sales cost, was given a substantial bonus. The salesman in sparsely populated Territory No. 18 was encouraged to become an independent agent and was given a sub-office in another part of his territory to supervise. The marketing vice president helped him obtain two good product lines from noncompeting companies to sell. The commission rate was dropped slightly. Territory No. 18 probably still remained unprofitable to the company, but management decided not to risk having a marketing vacuum near an adjoining high-potential market area.

As a result of building up the kind of sales force required to meet the company's current market needs, sales rose 30 per cent over the next two years, and profits increased by 50 per cent. During the same period creditors began to give the company better interest rates on the money they had loaned. The turnaround was completed within 30 months.

Physical distribution

Similar analysis—with similar results—can be made of the profitability of individual salesmen, of products, and of such special factors as various aspects of physical distribution. Here is another case in which accounting collaborated in a marketing turnaround—in this case as a result of a physical distribution system analysis.

This company produced some 7,000 items, about half of which were industrial supplies. The industrial supplies division had yearly sales of about $8 million, nearly all through a chain of company-owned branch warehouses.

With such a wide product line, management had emphasized long production runs to keep manufacturing costs down. This seemingly laudable policy had, unfortunately, put the company in a loss position. Large inventories of slow-selling goods had accumulated. Out-of-stock situations arose frequently. Deliveries of bread-and-butter products were slow, and

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TERRITORIAL ANALYSIS

Territory	Total annual industry potential	Annual company sales	Percentage of penetration	Field sales cost $	%
No. 1 Agent	$20,000,000	$1,000,000	5%	$130,000	13%
No. 16 Agent	5,000,000	1,000,000	20%	130,000	13
No. 14 Direct Salesman	1,000,000	400,000	40%	16,000	4
No. 18 Direct Salesman (sparsely populated)	200,000	120,000	60%	18,000	15

customers were going elsewhere to get them. Coordination between manufacturing and sales was non-existent. Salesmen were getting too little of the right goods to sell and too much merchandise they couldn't move.

Annual cost of owning the excessive, poorly balanced finished goods inventories equalled gross profit margins on some product groups and exceeded them on others.

The marketing vice president decided to act. Since his top management had always stressed cost analysis in evaluating new moves, he decided to do likewise.

1. With the controller, he developed accurate data on the cost of owning finished goods inventories, product group by product group. Not surprisingly, it averaged about 25 per cent of value per year.

2. He developed careful estimates of the amount of business lost by the branches because of lack of the merchandise on order from the plants. He supplemented this by internal studies showing the cost of handling back orders.

3. Finally, with the help of his branch managers, the marketing vice president conservatively estimated the business lost the past year because customers had shifted their business elsewhere and because salesmen had dissuaded some of them from ordering chronically out-of-stock items.

When all his figures were ready, he sent the president a short, well documented report. It showed, almost incontestably, that:

1. The annual cost of owning the excessive, poorly balanced finished goods inventories—both in factory warehouses and in branches, both those ordered and those shipped unordered—equalled gross profit margins on some product groups and exceeded them on others.

2. The branches were incurring excessive costs because of heavy ill balanced inventories, lost business, and back orders, and these excess costs approximated the difference between budgeted sales costs and actual sales costs.

The second part of the marketing executive's memo outlined his proposed and already partially tested remedial program. Over the next few months, all its major elements were put into effect, as follows:

1. The company plants agreed to abandon the practice of shipping unordered goods to the branches.

2. Based on sales forecasts, minimum and maximum stock levels and standard order quantities were established for all the products carried by the branches.

3. Numerous changes were made in the procedures for handling branch stock orders on the plants. Orders were still placed monthly, but they were staggered throughout the month. Orders from the most distant branches were scheduled for placement early in the

month, while those for nearby branches were scheduled for later in the month. As a result, plant shipping rooms began to complete the filling of branch stock orders within 48 hours of receipt instead of the three or four weeks that had prevailed before. This improvement was made possible largely by a steady, uniform flow of work in the plant shipping rooms and by the use of new stock replenishment order forms matching factory warehouse layouts, which reduced order picking time.

The marketing executive's system was not intended to be a sophisticated one initially, and many refinements, such as improving sales forecasting techniques and setting up each branch as a profit center, were left to be added later. Even so, the results achieved within about eight months from the time the marketing vice president started his studies were dramatic:

- Sales increased 18 per cent, as a result of better merchandise availability.
- Finished goods inventories were cut nearly 60 per cent and their annual carrying costs were reduced by some $200,000.
- The number of out-of-stock and back-ordered items was reduced substantially, enabling the branches to regain some previously disaffected customers.

The longer-term improvements were also gratifying. Production management, having had its attention called rather forcibly to the importance of total costs rather than just manufacturing costs, initiated a major effort to improve one of the root causes of the problem: its production scheduling.

Broad-based study

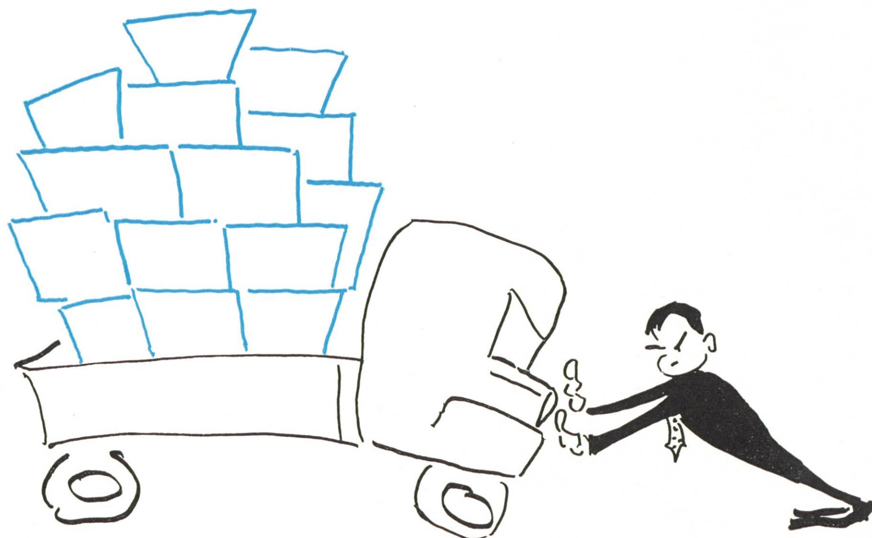
Here is an example of an analytical study that covered various aspects of the marketing function:

A company made power generation specialties sold to public utilities, private power generation facilities, and certain process industries. It was a long-established firm, and its products enjoyed an exceptional reputation for quality. However, profits were low. For years annual sales had remained at a relatively static level of about $8 million. There was little awareness of a marketing problem at all until the company hired a brilliant young industrial engineer, who improved production scheduling so substantially that considerable excess productive capacity was disclosed. Management became disturbed about the idle facilities and manpower, and the company's marketing manager decided to find out just what was wrong.

It was generally known that the key individuals specifying the purchase of power generation specialties in customer organizations were the piping draftsmen and designers. However, the marketing executive found that neither he nor his salesmen were as familiar as they should have been with the details of the selection and decision making processes that took place in the drafting rooms.

Investigation showed that these decision makers in the drafting rooms considered the company's catalogs inconvenient to use and often not complete. They had not been modernized in some years. The first step, therefore, was to obtain an appropriation to get the catalogs up to date and complete.

The chief engineer was given this assignment, heading a task force that included one of the younger home-office sales executives who had had recent, intensive drafting room experience. Three chief draftsmen in the employ of friendly nearby customers were persuaded to serve as an informal advisory committee. One of them was a man with unusually inventive ideas on how to make both the selection and the drafting procedures easy and foolproof. They served with the approval of their employers and were compensated for their time. The catalog that finally evolved—in record



Finally, as part of a remedial program, the company plants agreed to abandon shipment of unordered goods to the branches.

The first step, therefore, was to make the catalog up to date and complete.

time—was clear, complete, and attractive; contained numerous innovations; and is now widely regarded in the industry as a model of ease and convenience.

Sales potentials were estimated—the company had not undertaken forecasting in any serious manner before—and the company's sales results were compared with them. This led to the discontinuance of certain manufacturers' representatives who had obviously been lethargic in their activities on the company's behalf, the opening of two new company sales offices in new market areas, and considerable redeployment of sales manpower to accord better with the opportunities for sales. In addition, several house accounts were assigned to the field sales organization to assure more effective coverage.

These moves to improve coverage of the market created opportunities to promote several salesmen. This also helped to stimulate morale.

Two other changes were made that improved the field sales organization. The first involved training; the second, compensation. With the assistance of the most successful company salesmen, the marketing department prepared instructional material to guide the sales office managers in showing their men how to explain the use of the new catalog. This new material also showed how the salesmen could be more helpful to the men in the customers' and prospects' companies who were responsible for specifying the choice of power generation specialties. The importance of continuing to cover purchasing executives was also stressed, of course. In revamping the compensation setup, a simple sales incentive plan was installed to replace the previous salary-only policy. It provided a commission on sales over quotas agreed to by the marketing manager and the individual men.

Some of these actions paid off quickly, but most required a few months to show results. The significant achievements were these: a sales increase of 20 per cent; an increase in pretax profits that was more than commensurate with the sales increase, since the increased volume was produced on existing, already depreciated facilities; and full use of the company's previously idle manpower and machinery.

Other areas

There are many other ways in which accountancy can help marketing, outside the obvious areas of budgeting and forecasting:

Analyses showing profitability at varying sales volumes

Class of trade profitability

Product-group profitability for product managers (making certain to distinguish between those costs they can control and those they can't)

Analyses for special sales managers. (Nearly every business has some of these—national accounts manager, government sales manager, etc.)

The accountant can be very useful in helping the marketing executive determine—and not in too theoretical terms—the most profitable product mix. He also can cost out practical alternatives the marketing manager should consider, different channels of distribution, for example. This sort of analysis is probably done best when the controller has his own man in the marketing department.

Typically, the marketing department is one in which many essentials are nebulously defined. Authority is usually clearly delegated, but responsibility for profit is seldom clear-cut; often the marketing man has little more than profit awareness to go on.

Even more than other departments, marketing tends to be deluged with reports it cannot utilize. Accounting should try to cut down the number of these and devise ways to make those that survive more actionable.

Marketing has, in the main, paid relatively little attention to the profitability and productivity of its own operations. There are enormously fruitful opportunities for the accounting and controllership functions to contribute to improvement in this area. But, to be listened to, to hope for action, be sure you first have a good understanding of your company's marketing activity. An approach modeled after techniques used in manufacturing will almost certainly get you into hot water.

If you can possibly find the opportunity to do so, first see if you cannot make the marketing function more effective in its own terms—this usually means getting more business—by cranking some basic understanding of customer and prospects accounting into your salesmen's thinking and into their sales presentations. This effort can be rewarding not only for its own sake but also for the doors it will open to let you help make the marketing function more profitable.