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Managing Marketing - Finance Interface

The Need of Today

ABSTRACT

Now a day's wave of marketing is in full swing everywhere in corporate world. Marketing functions have become pivot of the business world by replacing the financial functions, which were in focus and crucial few decades ago. Even today finance functions are important but not as important as the Marketing functions. Friction between the marketing and finance functions would be detrimental to the smooth development and functioning of any business organization. Finance objectives like as value maximization to shareholders is integral parts of any new strategy adopted by the organization e.g. expansion or diversification. But this objective seems to have been lost amidst the flurry of marketing activities focusing on market share. Conscious efforts must be taken to avoid the missing core objective and for sales growth.

1. INTRODUCTION

One area which is of strategic importance to an organization is the relationship between the objectives of the organization spelt out in terms of financial parameters like return on investment and the objectives of the marketing being specified in terms of market share, market development or gross margin. Traditionally, it has been assumed by marketers that dominant market share will automatically translate itself into positive financial results. This assumption might be true for a few firms that are dominant players in a particular segment. But what about the others?

For these companies, it is absolutely essential to make meaningful assumptions about the market place and other external variables, along with the organization's core competency. The financial objectives must be translated into marketing objectives, not vice versa, clearly spelling out these realistic assumptions. Financial objectives like shareholder value maximization are integral components of any new strategy adopted by the organization like expansion or diversification. But this objective seems to have been lost amidst the flurry of marketing activities focusing on market share. Conscious efforts must be taken to avoid this pitfall of missing the core objective for the sake of sales growth. There is evidence in the Indian environment where companies like Philips, which enjoy as a dominant market position, very good product acceptance and brand loyalty.But smaller companies like Satyam Software far below the rate of return provide the cumulative rate of return for shareholders of Philips during the period of 2000-2004. This clearly brand loyalty, alone does not automatically maximize shareholder's wealth.

2. MARKETING EXPENSES AS INVESTMENTS

The second area, which also equally important is the distinction between the way the finance or accounting department treat many of the marketing expenses and the way it is being viewed by marketers. Conventionally, expenses incurred by the marketing function for brand building, developing channels and improving relationship with customers through after

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sales service is often viewed by the finance department as "overheads." This implies that these items are indirect expenses that are likely to give benefits over a short period, and hence should be treated like administrative overheads. This treatment of all marketing expenses as overheads has some serious implications for marketing as well as for the organization. While examining profitability of a product line, these overheads are unitized for the period in which it is incurred and applied to the product costs; this is likely to over-cost the product and may finally lead to a wrong decision to drop the line. Similarly, many ambitious programmes of marketing like new product launches, or product mix change or supporting a losing brand, might be rejected by finance or might be under-funded, based on profitability criteria. To resolve this issue, it is advisable to treat expenses like initial product launch and promotional expenses as life-cycle costs for the product, and should be compared against the overall profitability of the product-line over its expected life span. For accounting purposes, these expenses may be written off in the year in which they are incurred. For the purpose of analysis and decision making, however, these expenses must be treated as investments in intangible assets. Brand equity, brand loyalty and channel loyalty are very important intangible assets created out of these marketing expenses. The intangible assets are often more valuable than tangible assets like plant and machinery. These assets are at the root of generating above normal returns for an organization. Companies having strong brand identities like Hindustan Lever and Colgate are able to get margins of a small player manufacturing the same product.

So the whole attitude of finance towards marketing expenses incurred to create and sustain these valuable intangible assets must change. They should avoid the mistake of looking at marketing expenses only from the point of view of cost control.

The question as to how these expenses can be monitored and controlled then arises. The answer is to look at a much more broad-based measure like cash flow generation because these intangible assets, also called "market based assets", can be leveraged to lower costs, attain barriers, which ultimately translates into positive cash flows for the organization.

3. MARKETING DECISIONS AND WORKING CAPITAL

Many managers carry a wrong notion that working capital management is something which working capital management is something which only finance managers should be worried about. This is not true. Barring working capital financing, like when to borrow, and how much from banks and from other sources, all other elements of working capital are determined by decisions taken by other line managers.

Cash inventories and receivables are the major components of working capital. These are the important variables that are directly affected by many short-run marketing decisions like product mix, pricing, credit policies etc. Working capital level is an important variable that affects the profitability of an organization directly. For a given sales level, if the working capital level is minimized, profitability will be maximized and vice versa.Level of cash flow and receivables depends upon the proportion of credit sales to cash sales, which is a marketing decision. Though industry practices on credit sales is a predominant factor in this respect, the relative market standing of the organization can be leveraged to reduce the credit period as well as the credit sales. This requires dynamic co-ordination between marketing and finance in setting the credit policy variables like credit standard and credit

terms. The finance department must understand the requirements of marketing regarding these variables; marketing department should also realize that these decisions should be evaluated by finance from the angle of profitability etc. The level of finished goods inventory depends upon the service level prescribed by the marketing department to avoid lost sales. But this level of inventory will be the minimum requirement for all the units in that particular industry. A level of inventory that is above this minimum required safety stock depends upon the accuracy, of demand estimation and the "pushing" capabilities of the marketing department. If the marketing department estimates over the demand for the product optimistically, the market will not be able to absorb all the produced units. The remaining stock will lie in the godowns. It will become non-moving stock and funds will get locked in without generating any profits. Finished goods inventory may also pile up when the production department wishes to produce the maximum possible quantity to reap benefits of scale, but the marketing department finds it difficult to push that product. Or, production department might have produced those items that are easy to produce and thereby, could show favorable production cost variances. These products may not have adequate market, or the marketing department may not want this product.

Inventory levels might also rise due to strained relationship between marketing and finance functions. If the finance function takes a conservative attitude and does not provide adequate finance for supporting advertisement and promotional activities of marketing department, the inventory will pile up. This will lead the company into a sash flow trap ______ low sales ____ low cash realization _____ high cost of funds ——— operating losses - inadequate cash flow. This is a very serious situation for any company to be in.

4. CONCLUSION

To sum up, we have argued that marketing tends to focus on sales growth and market share and fails to recognize the impart of marketing decisions on important finance variables like share holder value maximization, cash flows and working capital. There is an increasing need to have a re-look at the traditional assumptions about the relationship between marketing and finance, to create and sustain market-based assets as a means to create and sustain the market value of the firm.

Developing performance measures that would balance the marketing objectives with financial objectives can do this.

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