Chapter Nineteen

Implementing and Controlling Marketing Plans: Evolution and Revolution

When You Finish This Chapter, You Should

1. Understand how information technology is speeding up feedback for better implementation and control.

2. Know why effective implementation is critical to customer satisfaction and profits.

3. Know how total quality management can improve implementation—including implementation of service quality.

4. Understand how sales analysis can aid marketing strategy planning.

5. Understand the differences in sales analysis, performance analysis, and performance analysis using performance indexes.

6. Understand the difference between the full-cost approach and the contribution-margin approach.

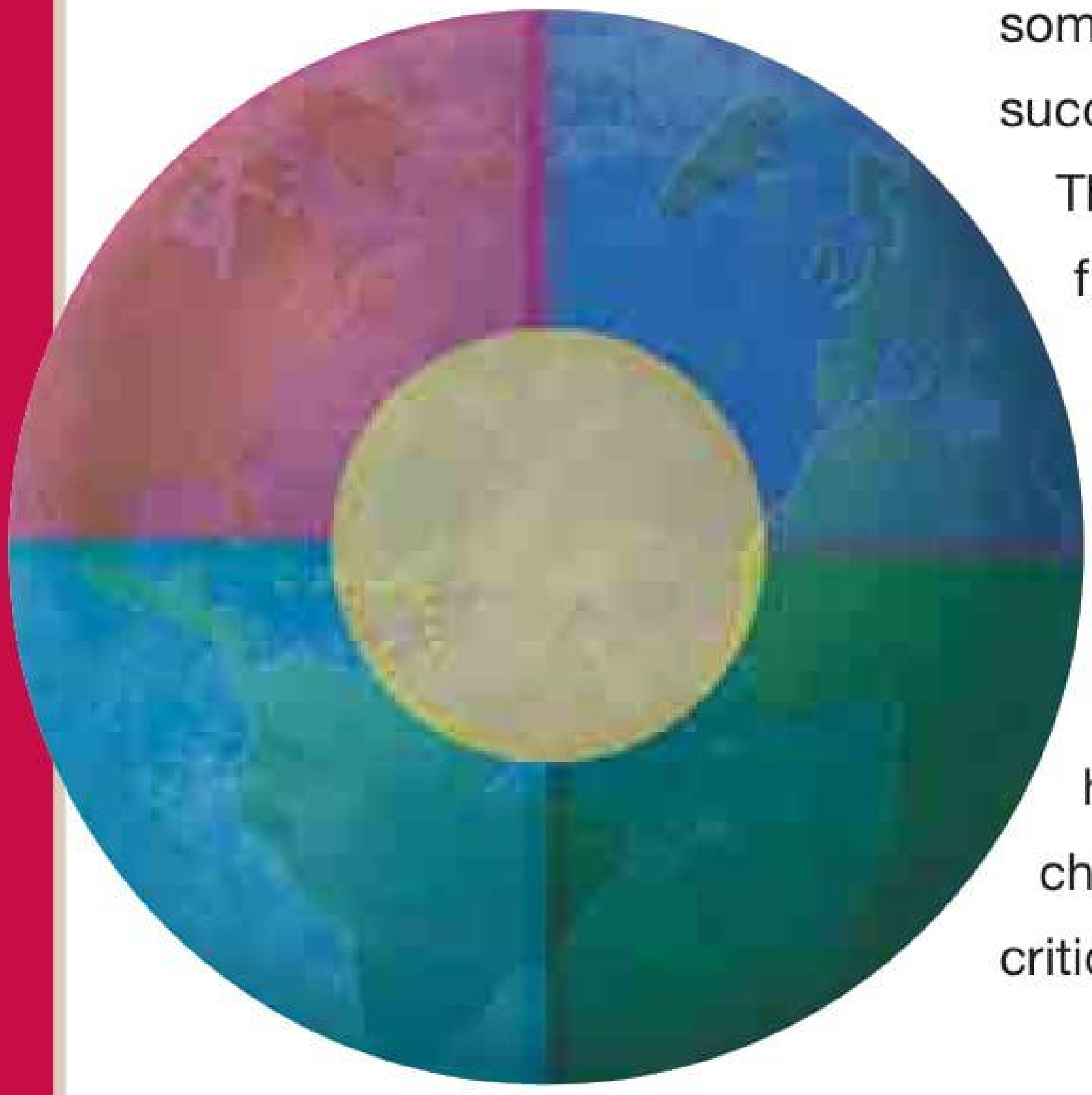
7. Understand how planning and control can be combined to improve the marketing management process.

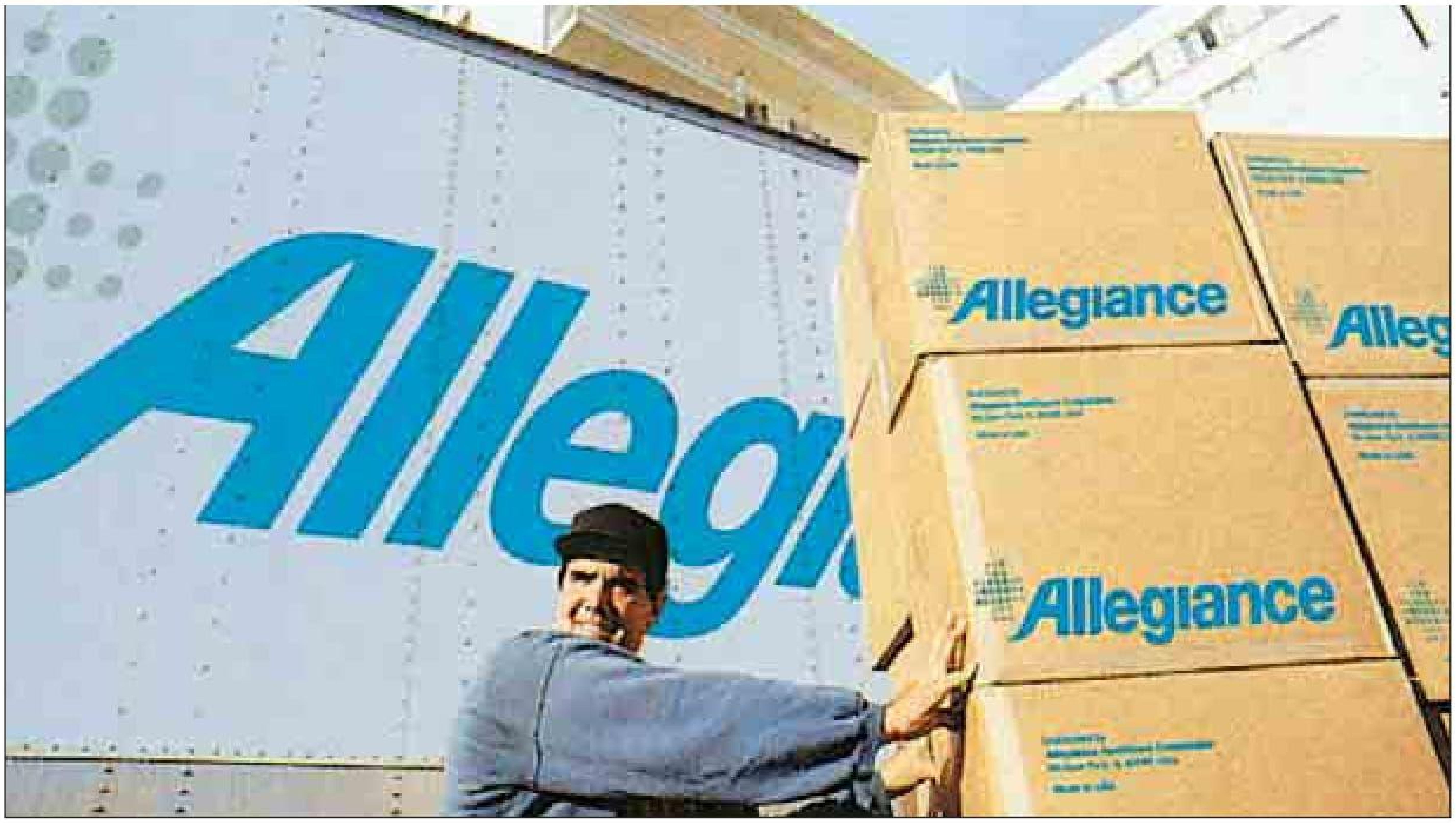
8. Understand what a marketing audit is and when and where it should be used.

9. Understand the important new terms (shown in red).

Allegiance Healthcare Corporation supplies goods and services to hospitals. Hospitals everywhere are under pressure to cut costs but still provide excellent care. So if Allegiance is going to charge prices that are profitable and still keep the hospitals' business, it must find ways to give them better value on each dollar they spend. There's some evidence that Allegiance is successful doing just that.

That's not to suggest that the firm was doing poorly before. It wasn't. But its strategy wasn't producing the profits that were expected. New products and improved services—designed to help hospitals cut the costs of purchasing, handling, and storing critical supplies—were well





received but were producing slim profit margins. So management asked employees throughout the company to make suggestions on ways to improve how the firm was implementing its strategy. They came up with a variety of suggestions.

For example, Allegiance carries over 100,000 products. Some it manufactures, but it also sells products produced by thousands of other suppliers. It seemed that this variety was what hospitals needed. Yet many of the employee concerns were related to the massive assortment of goods. Moreover, when marketing managers did a careful analysis of sales by region and product line they found that the company's profitable level of sales was masking a problem: 57 percent of the products accounted for just 2 percent of sales. Further analysis showed that these same products accounted for a larger than average share of the total costs. While they were waiting to be ordered, they were sitting in warehouses all over the country, running up storing costs. By analyzing sales within product categories, marketing managers were able to see where there was duplication and what they could drop. After all, they probably didn't need to give hospitals a choice among 47 different types of bedpans. Then they worked to make distribution of the products they kept more efficient.

Products that hospitals order frequently—popular styles of gloves, caps, needles, and sutures—are stocked in the 68 regional distribution centers close to customers. Items that hospitals order somewhat less frequently—like odd sizes of surgical gloves—are shipped nationwide from a single distribution center in Illinois. The changes allowed the firm to cut out 30 local warehouses and still offer hospitals a just-in-time delivery program by using its own trucks. With just-in-time delivery, the hospitals carry very few supplies in inventory. For example, the same day a patient is scheduled to go into surgery a package arrives with the 200 items needed for that patient's procedure. They're all packed in the precise order that the surgeons and nurses will use them. There's a skin marker to trace a seven-inch incision, bone wax to stanch the bleeding, suction tips to clear blood, plus scalpels, sutures, and, oh yes, gloves, and gowns.

With these changes in how distribution is implemented, it's the sales rep's job to show the hospitals that these systems save money. Each hospital has to agree to pay a fee for the special services, as well as the price of the supplies. This improves Allegiance's profit margins. But Allegiance also promises that this collaboration will cut the hospital's total cost of supplies. Then they split the savings. For many hospitals, millions of dollars are saved.

What's more, by continuously improving the system, the level of customer satisfaction has increased. For example, Allegiance now uses EDI and e-commerce to deal with 90 percent of its suppliers, which reduces stockouts. As a result, 95 percent of the items that hospitals order are available immediately. Further, customers can now easily order any of 100,000 products online at www.allegiance.net. With this kind of help, hospitals can focus on their real job: helping patients get well.[1]

Good Plans Set the Framework for Implementation and Control

Our primary emphasis in this book is on the strategy planning part of the marketing manager's job. There's a good reason for this focus. The one-time strategy decisions—those that decide what business the company is in and the strategies it will follow—set the firm on a course either toward profitable opportunities or, alternatively, toward costly failure. If a marketing manager makes an error with these basic decisions, there may never be a second chance to set things straight. In contrast, if good strategies and plans are developed, the marketing manager—and everyone else in the organization—knows *what* needs to be done. Thus, good marketing plans set the framework for effective implementation and control.

Implementation puts plans into operation—and control provides feedback

Even so, developing a potentially profitable plan does not ensure either satisfied customers or profit for the firm. Achieving the outcomes envisioned in the plan requires that the whole marketing management process work well. As you learned in Chapter 2, the marketing management process includes not only marketing strategy planning but also implementation and control. See Exhibit 2-5. In fact, in today's highly competitive markets customer satisfaction often hinges on skillful implementation. Further, the ongoing success of the firm is often dependent on **control**—the feedback process that helps the marketing manager learn (1) how ongoing plans and implementation are working and (2) how to plan for the future.

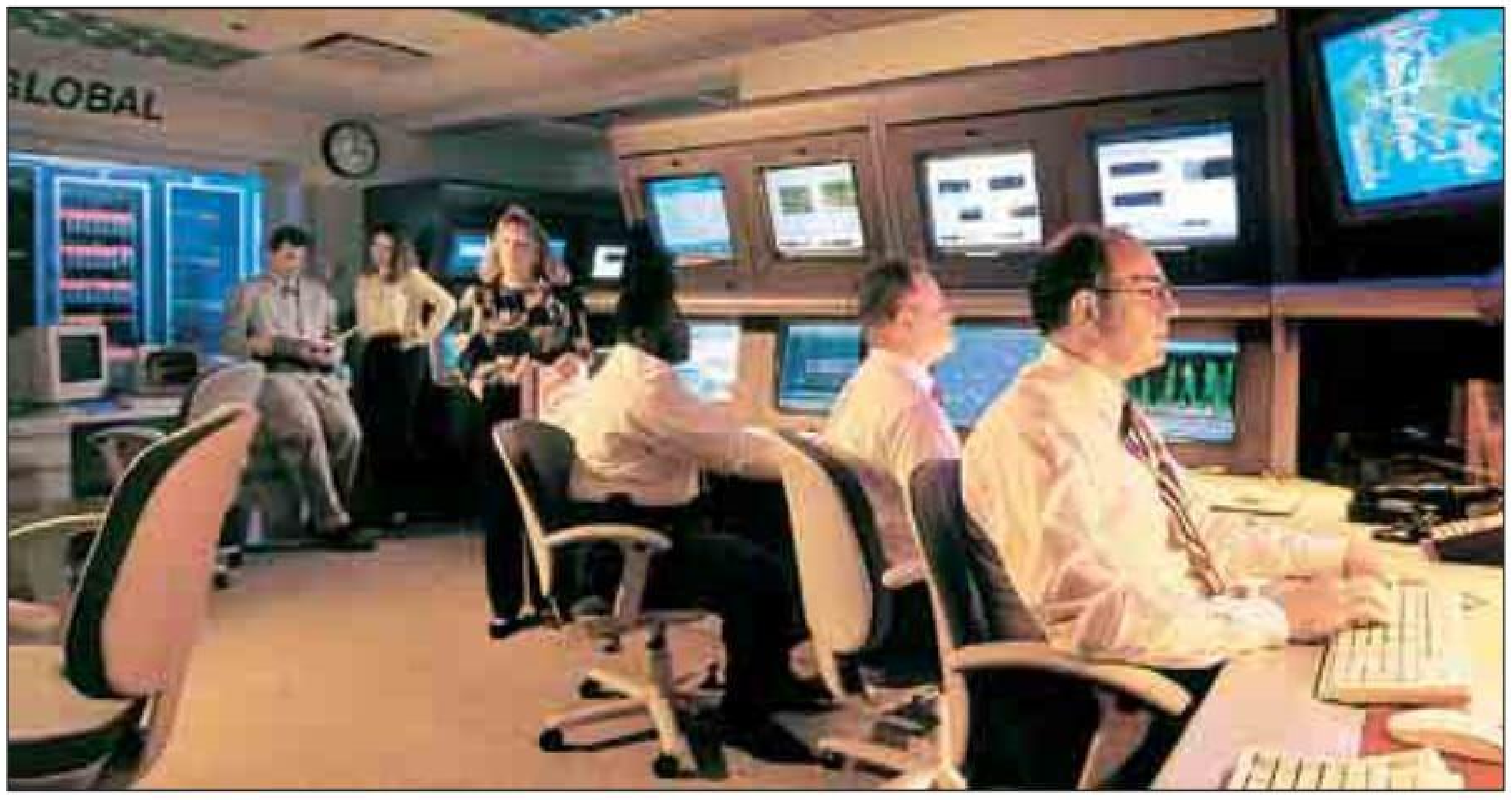
We discussed some specific opportunities and challenges with respect to implementation and control as we introduced each of the marketing strategy decision areas. In this chapter, we'll go into more depth on concepts and how-to approaches for making implementation and control more effective. We'll start with a discussion of how dramatic improvements in information technology and e-commerce are resulting in changes in implementation and control—and in the whole strategy planning process. For many firms, these changes are critically important. They offer revolutionary new ways to meet customer needs. Next we'll highlight some of the new approaches, including total quality management, that are improving marketing implementation. Then we'll explain how marketing managers use control-related tools, such as sales and performance analysis, to improve the quality of planning and implementation decisions. We'll conclude with a discussion of what a marketing audit is, and why it is sometimes necessary.

Speed Up Information for Better Implementation and Control

Feedback improves the marketing management process

Not long ago, marketing managers planned their strategies and put them into action—but then it usually took a long time before they got feedback to know if the strategy and implementation were really working as intended. For example, a marketing manager might not have much feedback on what was happening with sales, expenses, and profits until financial summaries were available—and that sometimes took months or even longer. Further, summary data wasn't very useful in pinpointing which specific aspects of the plan were working and which weren't. In that environment, the feedback was so general and took so long that there often wasn't anything the manager could do about a problem except start over.

That situation has now changed dramatically in many types of business. In Chapter 8, we discussed how firms are using intranets, databases, and marketing information systems to track sales and cost details day by day and week by week. Throughout the book you've seen examples of how marketers get more information faster and use it quickly to improve a strategy or its implementation. For example, scanner data from a consumer panel can provide a marketing manager with almost immediate feedback on whether or not a new consumer product is selling at the expected level in each specific store and whether or not it is actually selling to the intended target market rather than some other group. Similarly, e-commerce order systems can feed into real-time sales reports for each product.



This state-of-the-art information center has replaced over 25 individual processing centers worldwide and allows Colgate managers to monitor activities across the entire supply chain worldwide, all of which brings products to consumers faster and more efficiently than ever before.

Fast feedback can be a competitive advantage

Marketing managers who can get faster feedback on their decisions can often take advantage of it to develop a competitive advantage. They can quickly fine tune a smooth-running implementation to make it work even better. If there are potential problems, they can often spot them early and keep them from turning into big problems.

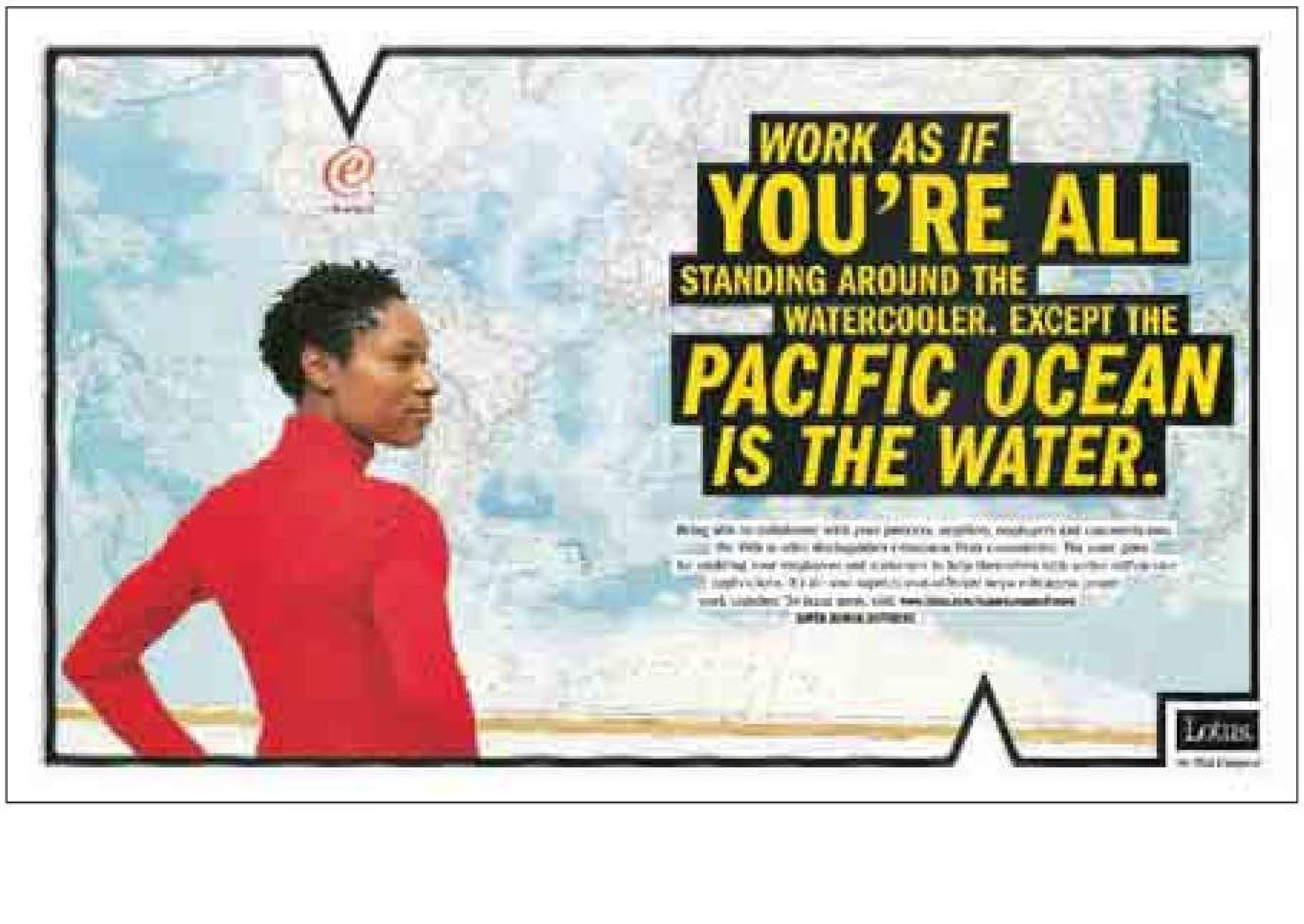
For example, a manager who gets detailed daily reports that compare actual sales results in different cities with sales forecasts in the plan is able to see very quickly if there is a problem in a specific city. Then the manager can track down the cause of the problem. If sales are going slowly because the new salesperson in that city is inexperienced, then the sales manager might immediately spend more time working with that rep. On the other hand, if the problem is that a chain of retail stores in that particular city isn't willing to allocate much shelf space for the firm's product, then the salesperson might need to develop a special analysis to show the buyers for that specific chain how the product could improve the chain's profit.

When information is slow coming in and there is less detail, making implementation changes is usually more difficult. By the time the need for a change is obvious, a bigger change is required for it to have any effect.

The basic strategy planning concepts we've emphasized throughout the text are enduring and will always be at the heart of marketing. Yet the fast pace that is now possible with e-commerce in getting information for control is resulting in fundamental changes in how many managers work, make decisions, plan, and implement their plans. Managers who can quickly adjust the details of their efforts to better solve customer problems or respond to changes in the market can do a better job for their firms—because they can make certain that their plans are really performing as expected.

The marketing manager must take charge

Fast feedback improves implementation and control. And computers now take the drudgery out of analyzing data. But this kind of analysis is not possible unless the data is in machine-processible form—so it can be sorted and analyzed quickly. Here the creative marketing manager plays a crucial role by insisting that the necessary data be collected. If the data he or she wants to analyze is not captured as it comes in, information will be difficult, if not impossible, to get later.



Lotus software allows managers in different locations, including different countries, to quickly share information, which helps to make implementation and control faster and more effective.

A marketing manager may need many different types of information to improve implementation efforts or develop new strategies. In the past, this has often caused delays—even if the information was in a machine-processible form. In a large company, for example, it could take days or even weeks for a marketing manager to find out how to get needed information from another department. Imagine how long it could take for a marketing manager to get needed sales data from sales offices in different countries around the world.

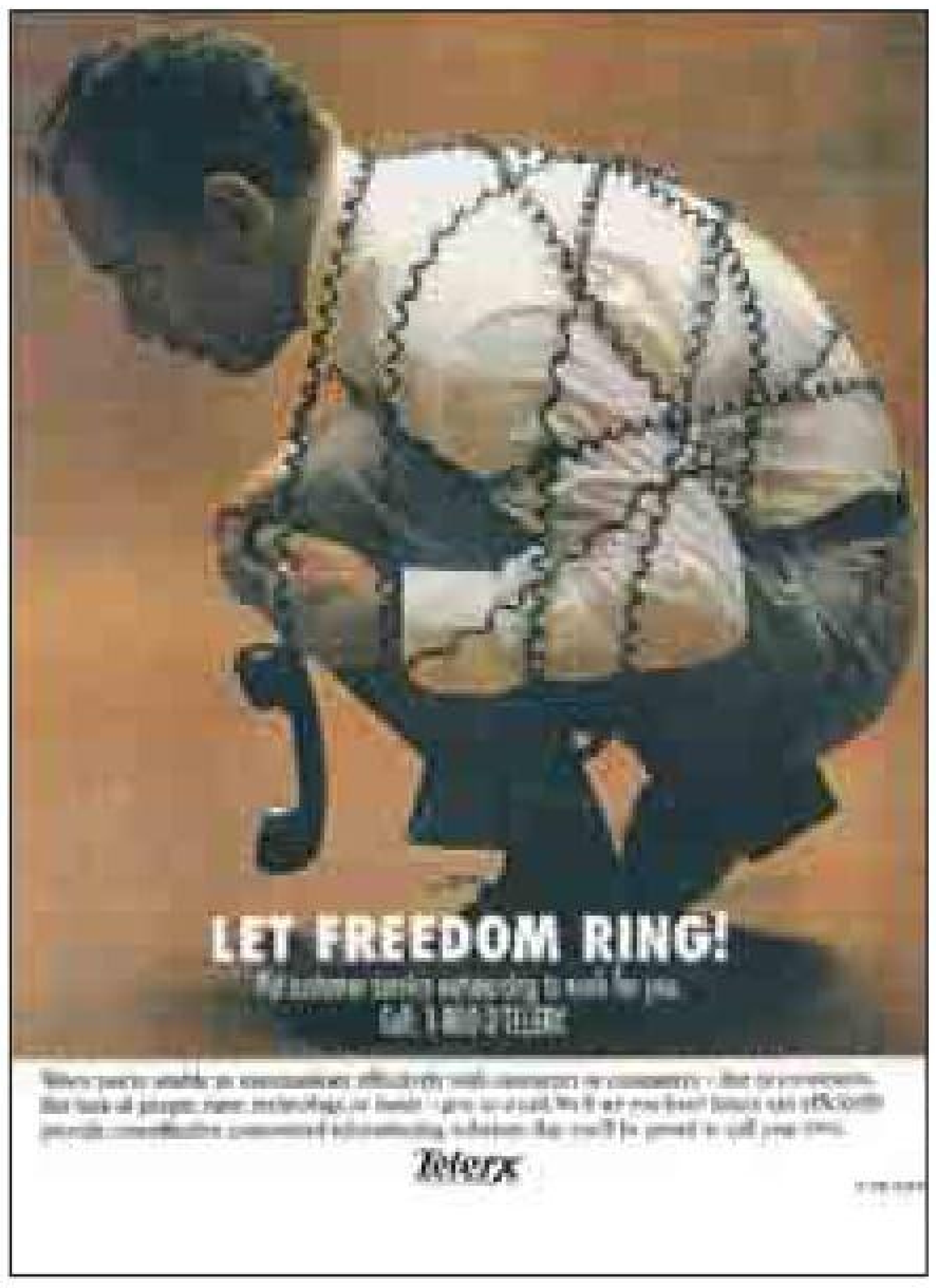
New information technologies offer speed and detail

New approaches for electronic communication and e-commerce help solve these problems. For example, many companies are using the Internet, fiber-optic telephone lines, or satellite transmission systems to *immediately* transfer data from a computer at one location to another. A sales manager with a laptop can pull data off the firm's network computer from anywhere in the world. And marketing managers working on different aspects of a strategy can use e-mail messaging or online video conferencing to communicate. A simple PC, the Internet, and software such as LapLink make it possible for a manager to work at a computer on the other side of the world as if he or she were sitting in front of it. Computer programs that run on a website give even easier access.

This type of electronic pipeline makes data available instantly. A report—such as one that summarizes sales by product, salesperson, or type of customer—that in the past was done once a month now might be done weekly, daily, or whenever an online user wants it. Software can be programmed to search for and flag results that indicate a problem of some sort. Programs like Microsoft Excel can link to the new flow of data and instantly create graphs that make the information vivid and easy to interpret. Then the manager can allocate more time to resolving whatever particular problems show up.

Of course, many firms don't consider or use these types of approaches. But they are becoming much more common—especially as more marketing managers find that they are losing out to more nimble competitors who get information more quickly and adjust their implementation and strategies more often.[2]

NOT SINCE SANTA CLAUS HAS ANYONE MADE THIS MANY KIDS THIS HAPPY IN ONE DAY.
amazon.com
FedEx Home Delivery



The marketing strategy for the kid's book, *Harry Potter and the Goblet of Fire,* called for it to be released everywhere on the same day. It was an implementation challenge for Amazon.com to get copies to 250,000 eager kids all at once, but FedEx helped solve the delivery problem. On another front, Telerx helps other firms implement their strategies by providing customer service outsourcing.

Effective Implementation Means That Plans Work as Intended

When a marketing manager has developed a good marketing plan, the challenge of implementing it often involves hundreds, or thousands, of operational decisions and activities. In a small company, these may all be handled by a few people, or even by a single person. In a large corporation, literally hundreds of different people may be involved in implementation. That may require a massive amount of careful coordination and communication. Either way, when operational decisions and activities are executed well, customers get what is intended. And if the original plan is good, customers will be satisfied and come back again the next time the need arises. However, even a great plan can leave customers unhappy, and switching to someone else's offering, if implementation is poor.

Good implementation builds relationships with customers

Implementation is especially critical in mature and highly competitive markets. When several firms are all following basically the same strategy—quickly imitating competitors' ideas—customers are often won or lost based on differences in the quality of implementation. Consider the rental car business. Hertz has a strategy that targets business travelers with a choice of quality cars, convenient online reservations, fast pick-up and drop-off, accessories like cell phones, availability at most major airports, and a premium price. Hertz is extremely successful with this strategy even though there is little to prevent other companies from trying the same approach. But a major part of Hertz's success is due to implementation. Customers keep coming back because the Hertz service is both reliable and pain-free.

Hertz Return Center

When a Hertz #1 Club Gold customer calls to make a reservation, the company already has the standard information about that customer in a computer database. At the airport, the customer skips over the line at the Hertz counter and instead just picks up an already-completed rental contract and goes straight to the Hertz bus. The driver gets the customer's name and radios ahead to have someone start the specific car that customer will drive. That way the air conditioner or heater is already doing its job when the bus driver delivers the customer right to the parking slot for his or her car. Customers are certain they're at the right place because there's an electronic sign beside each car with the customer's name on it. When the customer returns the car, an agent comes to the car, scans the customer's contract with a hand-held computer, and prints the receipt.

It's all very smooth. Making this work—day in and day out, customer after customer—isn't easy. But Hertz has set up systems to make it all easier because that's what it takes to implement its plan and to keep customers loyal.[3]

Implementation deals with internal or external matters

As the Hertz example illustrates, marketing implementation usually involves decisions and activities related to both internal and external matters. Figuring out how the correct car will end up in the right parking slot, how the Hertz bus driver will contact the office, and who will coordinate getting the message to the person that starts the car are all internal matters. They are invisible to the customer—as long as they work as planned. On the other hand, some implementation issues are external and involve the customer. For example, the contract must be completed correctly and be in the right spot when the rental customer comes to pick it up, and someone needs to have filled the car with gas and cleaned it.

Implementation has its own objectives

Whether implementation decisions and activities are internal or external, they all must be consistent with the objectives of the overall strategy and with the other details of the plan. However, there are also three general objectives that apply to all implementation efforts. Other things equal, the manager wants to get each implementation job done:

Better, so customers really get superior value as planned.

Faster, to avoid delays that cause customers problems.

At lower cost, without wasting money on things that don't add value for the customer.

The ideal of doing things better, faster, and at lower cost is easy to accept. But in practice implementation is often complicated by trade-offs among the three objectives. For example, doing a job better may take longer or cost more.

So just as a marketing manager should constantly look for new strategy opportunities, it's important to be creative in looking for better solutions to implementation problems. That may require finding ways to better coordinate the efforts of the different people involved, setting up standard operating procedures to deal with recurring problems, or juggling priorities to deal with the unexpected. When the Hertz bus driver is sick, someone still has to be there to pick up the customers and deliver them to their cars.

Implementation requires innovation too

Sometimes the implementation effort can be improved by approaching the task in a new or different way. Exhibit 19-1 shows some of the ways that firms are using information technology to improve specific implementation jobs. Note that some of the examples in Exhibit 19-1 focus on internal matters and some on external, customer-oriented matters.

While finding new approaches helps with some implementation problems, getting better implementation often depends on being vigilant in improving what the firm and its people are already doing. So let's take a closer look at some important ways that managers can improve the quality of their implementation efforts.[4]

Exhibit 19-1 Examples of Approaches to Overcome Specific Marketing Implementation Problems

Marketing Mix Decision Area	Operational Problem	Implementation Approach
Product	Develop design of a new product as rapidly as possible without errors	Use 3-D computer-aided design software
	Pretest consumer response to different versions of a label	Prepare sample labels with PC graphics software and test on Internet
Place	Coordinate inventory levels with middlemen to avoid stock-outs	Use bar code scanner, EDI, and computerized reorder system
	Get franchisee's inputs and cooperation on a new program	Set up a televideo conference
Promotion	Quickly distribute TV ad to local stations in many different markets	Distribute final video version of the ad via satellite link
	Answer final consumers' questions about how to use a product	Put a toll-free telephone number and website address on product label
Price	Identify frequent customers for a quantity discount	Create a "favored customer" club with an ID card
	Figure out if price sensitivity impacts demand for a product; make it easier for customers to compare prices	Show unit prices (for example, per oz.) on shelf markers; set different prices in similar markets and track sales, including sales of competing products

Building Quality into the Implementation Effort

As we've seen on previous occasions throughout this book, even people with the best intentions sometimes lapse into a production orientation. When the pressure is on to get a job done, they forget about satisfying the customer—let alone consider working together! When the product manager is screaming for a budget report, the accountant may view a customer's concerns about a billing error as something a salesperson can smooth over—alone.

Total quality management meets customer requirements

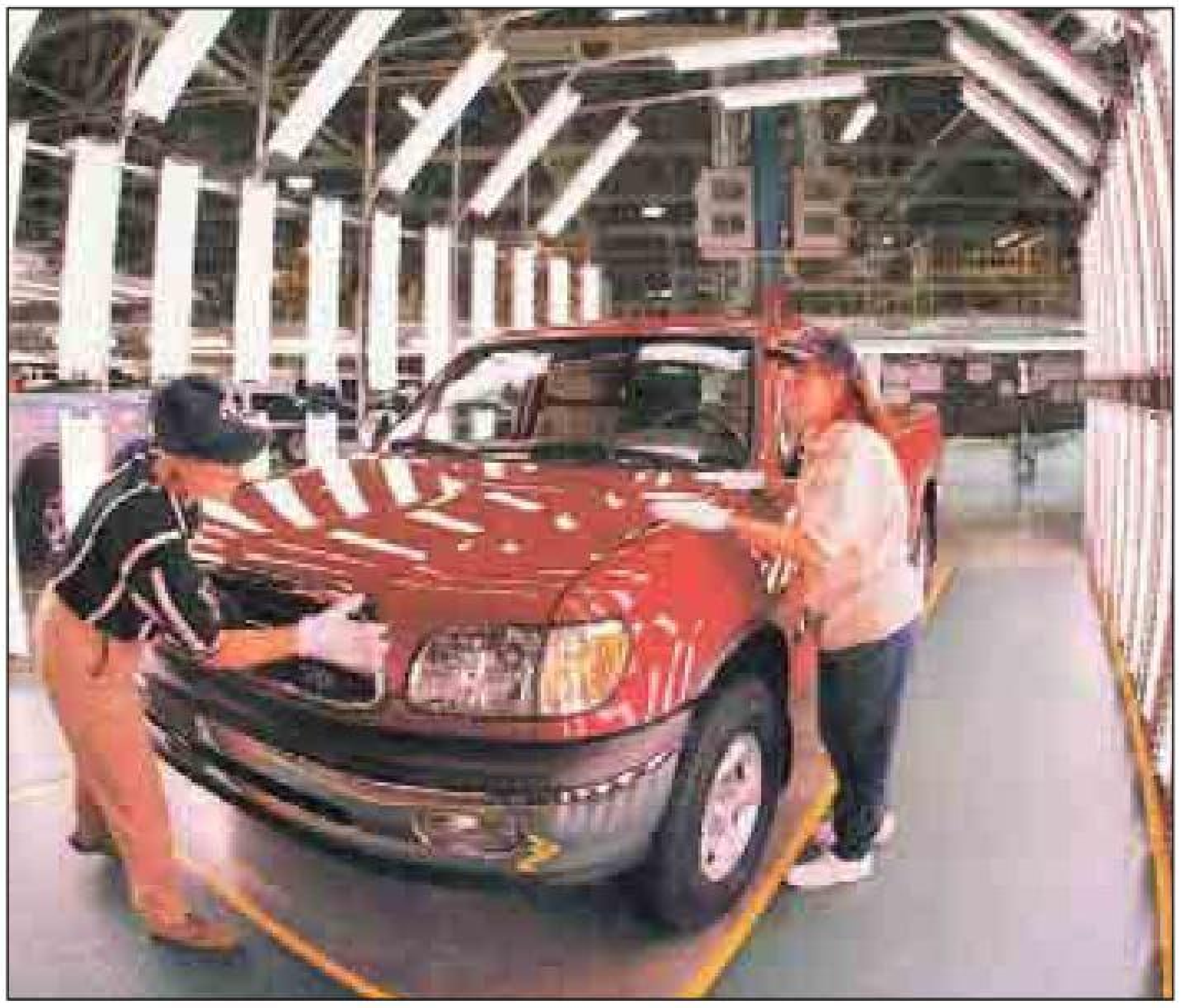
There are many different ways to improve implementation in each of the four Ps decision areas, but here we will focus on total quality management, which you can use to improve *any* implementation effort. With **total quality management (TQM),** everyone in the organization is concerned about quality, throughout all of the firm's activities, to better serve customer needs.

In Chapter 9 we explained that product quality means the ability of a product to satisfy a customer's needs or requirements. Now we'll expand that idea and think about the quality of the whole marketing mix and how it is implemented—to meet customer requirements.

Total quality management is not just for factories

Most of the early attention in quality management focused on reducing defects in goods produced in factories. Reliable goods are important, but there's usually a lot more to marketing implementation than that. Yet if we start by considering product defects, you'll see how the total quality management idea has evolved and how it applies to implementing a marketing program.

At one time most firms assumed defects were an inevitable part of mass production. They assumed the cost of replacing defective parts or goods was just a cost of doing business—an insignificant one compared to the advantages of mass production. However, many firms were forced to rethink this assumption when Japanese producers of cars, electronics, and cameras showed that defects weren't inevitable. And their success in taking customers away from established competitors made it clear that the cost of defects wasn't just the cost of replacement!



Customers want the paint on their new Toyota Tundra to be free from any scratches and that requires attention to implementation details. Factory workers take off their jewelry, wear shirts with rubber buttons, and use belts with special buckles that leave no metal exposed.

Pillsbury Rings in Satisfied Customers

There are thousands of ways that a plan or its implementation can go astray. The consumer's box of laundry detergent may be missing the measuring scoop. The VCR's instructions may be very clear about how to record a program but not explain how to hook the VCR to a consumer's cable box. Left unresolved, implementation glitches like these might result in dissatisfied customers. So most producers now have toll-free telephone lines and Internet websites to help customers with questions and complaints.

Pillsbury's line is typical. Some calls involve a question or praise, but about a third are complaints. For example, one caller reported that a cake mix had a funny taste. The service rep asked the caller for a code number on the box and, after keying it in on her computer, found that the box of mix was six years old. Perhaps the consumer forgot it in her pantry, or perhaps it was lost in some retailer's storeroom. Either way, the Pillsbury rep apologized and sent a coupon for a free replacement box.

The calls can also provide important feedback. For example, soon after Pillsbury introduced Funfetti cake mix with bits of edible confetti, callers began complaining that the confetti packet was missing from their box. A check of the manufacturing line showed the confetti packets were too light to alert weight scales when they were missing from the boxes. After the firm changed to a foil package the complaints stopped.

Toll-free lines and easy-response features built into websites probably don't win many new customers. But they do help a firm keep its current customers. Further, one study found that callers who had their complaints resolved on average told five people about the help they got. Yet there is also a risk. Those who weren't satisfied told twice as many people.[5]

Having dissatisfied customers is costly

From the customer's point of view, getting a defective product and having to complain about it is a big headache. The customer can't use the defective product and suffers the inconvenience of waiting for someone to fix the problem—if *someone* gets around to it. It certainly doesn't deliver superior value. Rather, it erodes goodwill and leaves customers dissatisfied. The big cost of poor quality is the cost of lost customers.

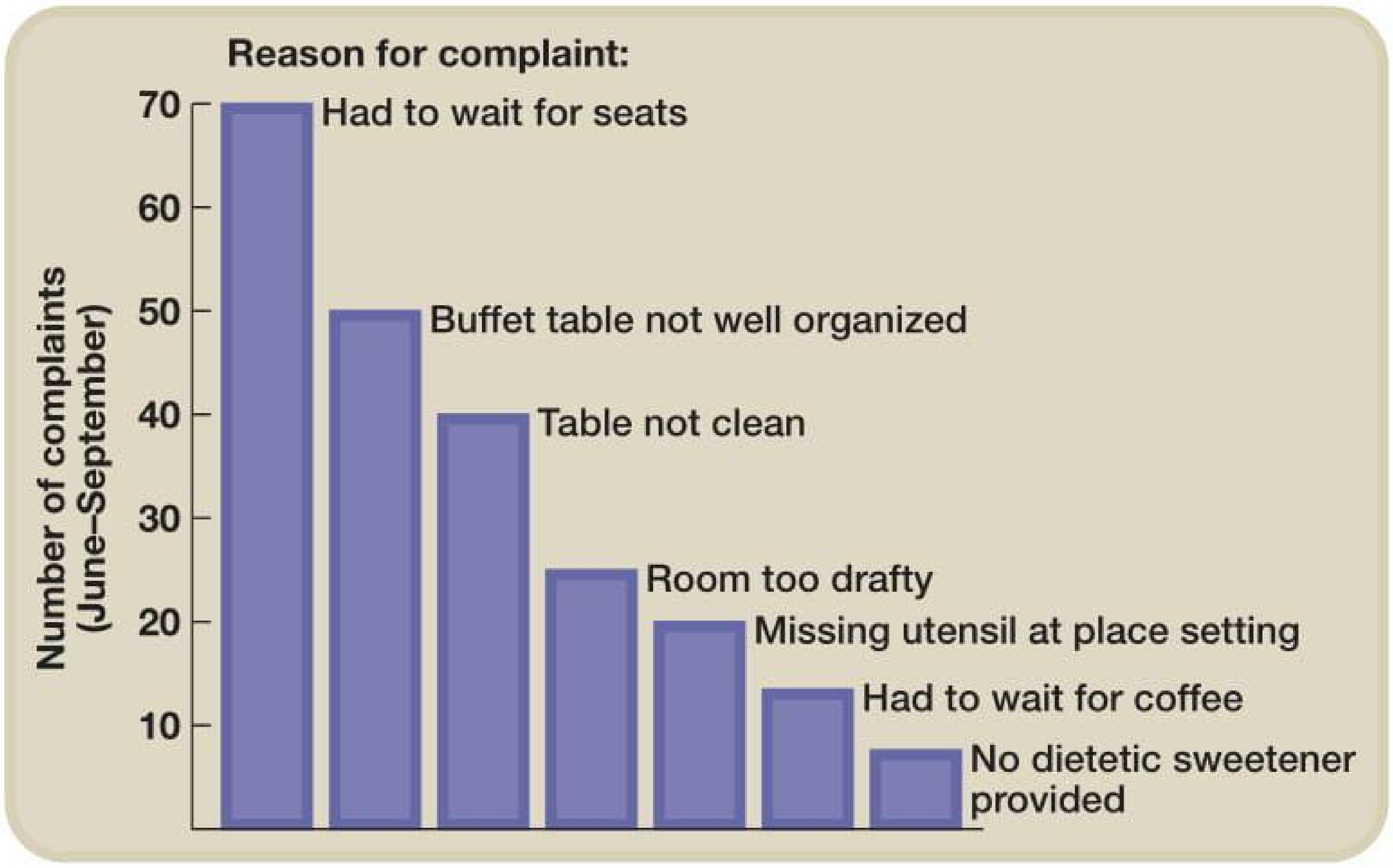
Much to the surprise of some production-oriented managers, the Japanese experience showed that it is less expensive to do something right the first time than to pay to do it poorly and *then* pay again to fix problems. And quality wasn't just a matter of adding more assembly-line inspections. Products had to be designed to meet customer needs from the start. One defective part in 10,000 may not seem like much, but if that part keeps a completed car from cranking at the end of the automaker's production line, finding the problem is a costly nightmare.

Firms that adopted TQM methods to reduce manufacturing defects soon used the same approaches to overcome many other implementation problems. Their success brought attention to what is possible with TQM—whether the implementation problem concerns unreliable delivery schedules, poor customer service, advertising that appears on the wrong TV show, or salespeople who can't answer customers' questions.

Getting a handle on doing things right the first time

The idea of doing things right the first time seems obvious, but it's easier said than done. Problems always come up, and it's not always clear what isn't being done as well as it could be. Most people tend to ignore problems that don't pose an immediate crisis. But firms that adopt TQM always look for ways to improve implementation with **continuous improvement**—a commitment to constantly make things better one step at a time. Once you accept the idea that there *may* be a better way to do something and you look for it, you may just find it! The place to start is to clearly define "defects" in the implementation *process,* from the customer's point of view. Because continuous improvement hinges on employee involvement and communication, many companies display all suggestions for improvements where employees can see them.

Exhibit 19-2
Pareto Chart Showing Frequency of Different Complaints



Things gone right and things gone wrong

Managers who use the TQM approach think of quality improvement as a sorting process—a sorting out of things gone right and things gone wrong. The sorting process calls for detailed measurements related to a problem. Then managers use a set of statistical tools to analyze the measurements and identify the problem areas that are the best candidates for fixing. The statistical details are beyond our focus here, but it's useful to get a feel for how managers use the tools.

Starting with customer needs

Let's consider the case of a restaurant that does well during the evening hours but wants to improve its lunch business. The restaurant develops a strategy that targets local businesspeople with an attractive luncheon buffet. The restaurant decides on a buffet because research shows that target customers want a choice of good healthy food and are willing to pay reasonable prices for it—as long as they can eat quickly and get back to work on time.

As the restaurant implements its new strategy, the manager wants a measure of how things are going. So she encourages customers to fill out comment cards that ask "How did we do today?" After several months of operation, things seem to be going reasonably well—although business is not as brisk as it was at first. The manager reads the comment cards and divides the ones with complaints into categories—to count up different reasons why customers weren't satisfied.

Slay the dragons first

Then the manager creates a graph showing a frequency distribution for the different types of complaints. Quality people call this a **Pareto chart**—a graph that shows the number of times a problem cause occurs, with problem causes ordered from most frequent to least frequent. The manager's Pareto chart, shown in Exhibit 19-2, reveals that customers complain most frequently that they have to wait for a seat. There were other common complaints—the buffet was not well organized, the table was not clean, and so on. However, the first complaint is much more common than the next most frequent.

This type of pattern is typical. The worst problems often occur over and over again. This focuses the manager's attention on which implementation problem to fix first. A rule of quality management is to slay the dragons first—which simply means start with the biggest problem. After removing that problem, the battle moves on to the next most frequent problem. If you do this *continuously,* you solve a lot of problems—and you don't just satisfy customers, you delight them.

Internet

Internet Exercise BaRaN Systems Ltd. has developed a software product called SQC for Excel that works with the Microsoft Excel spreadsheet program and makes it easy to do the types of analyses that are useful for quality management. Go to its website (www.baran-systems.com) and click on the link for *SQC for Excel.* Then at that page scroll down and look at the "Quick Tour" section. What is it about the graphs that makes it easy to see which areas need special attention?

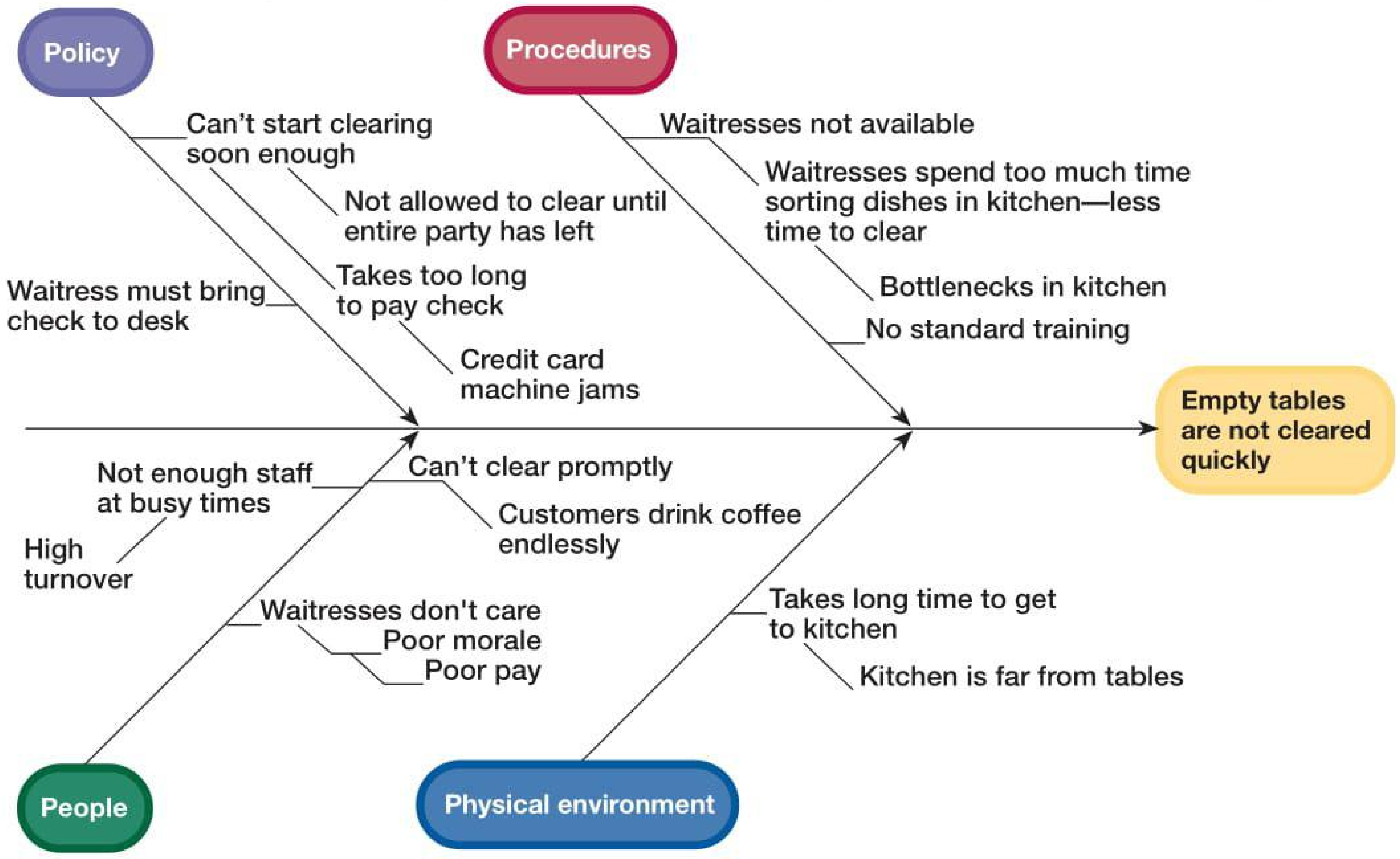
Figure out why things go wrong

So far, our manager has only identified the problem. To solve it, she creates a **fishbone diagram**—a visual aid that helps organize cause-and-effect relationships for "things gone wrong."

Our restaurant manager, for example, discovers that customers wait to be seated because tables aren't cleared soon enough. In fact, the Pareto chart (Exhibit 19-2) shows that customers also complain frequently about tables not being clean. So the two implementation problems may be related.

The manager's fishbone diagram (Exhibit 19-3) summarizes the various causes for tables not being cleaned quickly. There are different basic categories of causes—restaurant policy, procedures, people problems, and the physical environment. With this overview of different ways the service operation is going wrong, the manager can decide what to fix. She establishes different formal measures. For example, she counts how frequently different causes delay customers from being seated. She finds that the cashier's faulty credit card scanning machine holds up check processing. About half the time the cashier has to stop and enter the credit card information by hand. The fishbone diagram shows that restaurant policy is to clear the table after the entire party leaves. But customers have to wait at their tables while the staff deals with the faulty credit card machine, and cleaning is delayed. With the credit card machine replaced, the staff can clear the tables sooner—and because they're not so hurried they do a better cleaning job. Two dragons are on the way to being slayed!

Exhibit 19-3 Fishbone Diagram Showing Cause and Effect for "Why Tables Are Not Cleared Quickly"


Policy
Can't start clearing soon enough
Not allowed to clear until entire party has left
Waitress must bring check to desk
Takes too long to pay check
Credit card machine jams
Procedures
Waitresses not available
Waitresses spend too much time sorting dishes in kitchen—less time to clear
Bottlenecks in kitchen
No standard training
Empty tables are not cleared quickly
Not enough staff at busy times
High turnover
Can't clear promptly
Customers drink coffee endlessly
Waitresses don't care
Poor morale
Poor pay
Takes long time to get to kitchen
Kitchen is far from tables
People
Physical environment

Our case shows that people in different areas of the restaurant affect customer satisfaction. The waitperson couldn't do what was needed to satisfy customers because the cashier had trouble with the credit card machine. The TQM approach helps everyone see and understand how their job affects what others do and the customer's satisfaction.[6]

Building quality into services

The restaurant case illustrates how a firm can improve implementation with TQM approaches. We used a service example because providing customer service is often a difficult area of implementation. Recently, marketers in service businesses have been paying a lot of attention to improving service quality.

But some people seem to forget that almost every firm must implement service quality as part of its plan—whether its product is primarily a service, primarily a physical good, or a blend of both. For example, a manufacturer of ball bearings isn't just providing wholesalers or producers with round pieces of steel. Customers need information about deliveries, they need orders filled properly, and they may have questions to ask the firm's accountant, receptionist, or engineers. Because almost every firm must manage the service it provides customers, let's focus on some of the special concerns of implementing quality service.

Train people and empower them to serve

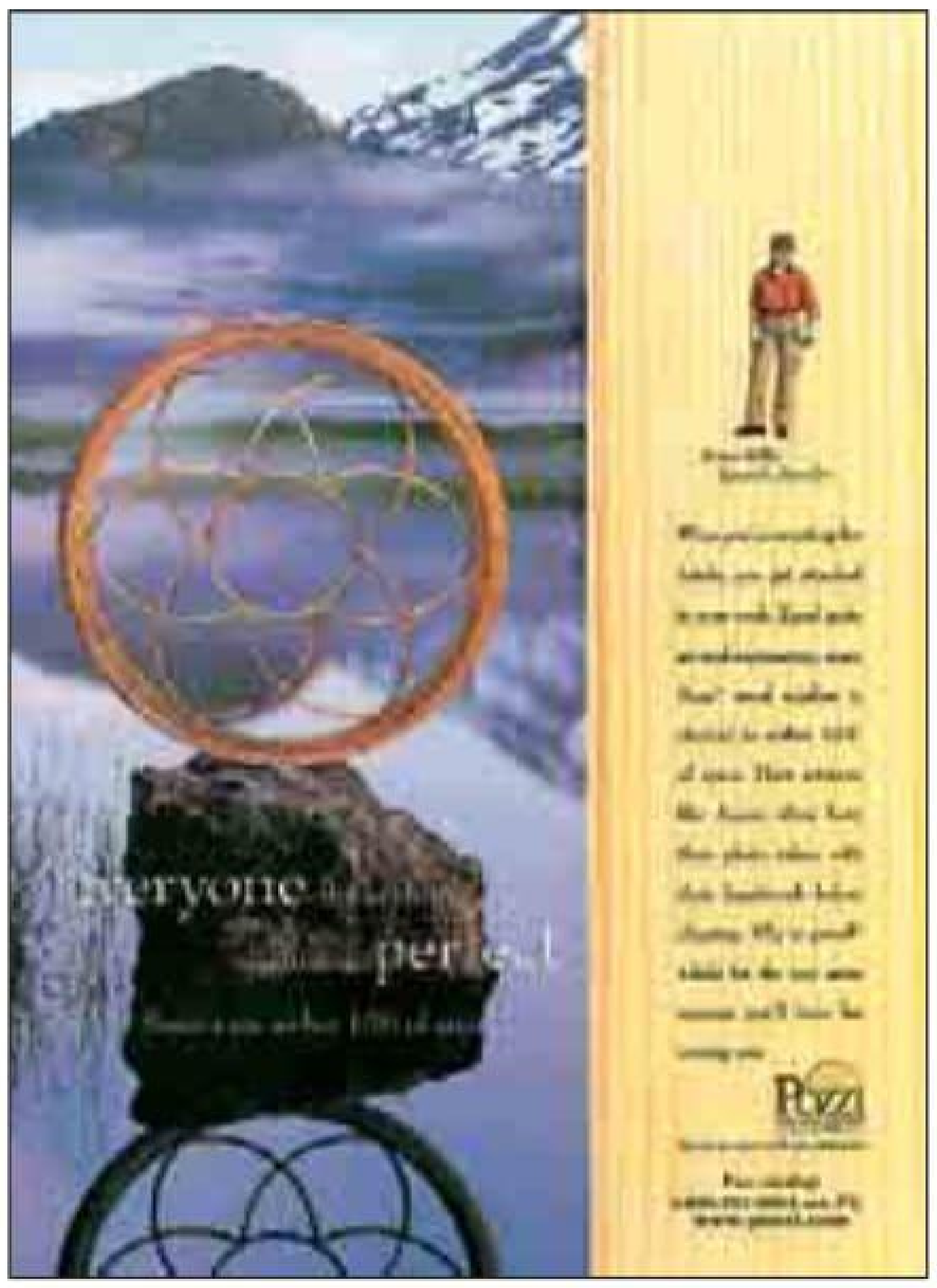
Quality gurus like to say that the firm has only one job: to give customers exactly what they want, when they want it, and where they want it. Marketing managers have been saying that for some time too. But customer service is hard to implement because the server is inseparable from the service. A person doing a specific service job may perform one specific task correctly but still annoy the customer in a host of other ways. Customers will not be satisfied if employees are rude or inattentive—even if they "solve the customer's problem." There are two keys to improving how people implement quality service: (1) training and (2) empowerment.

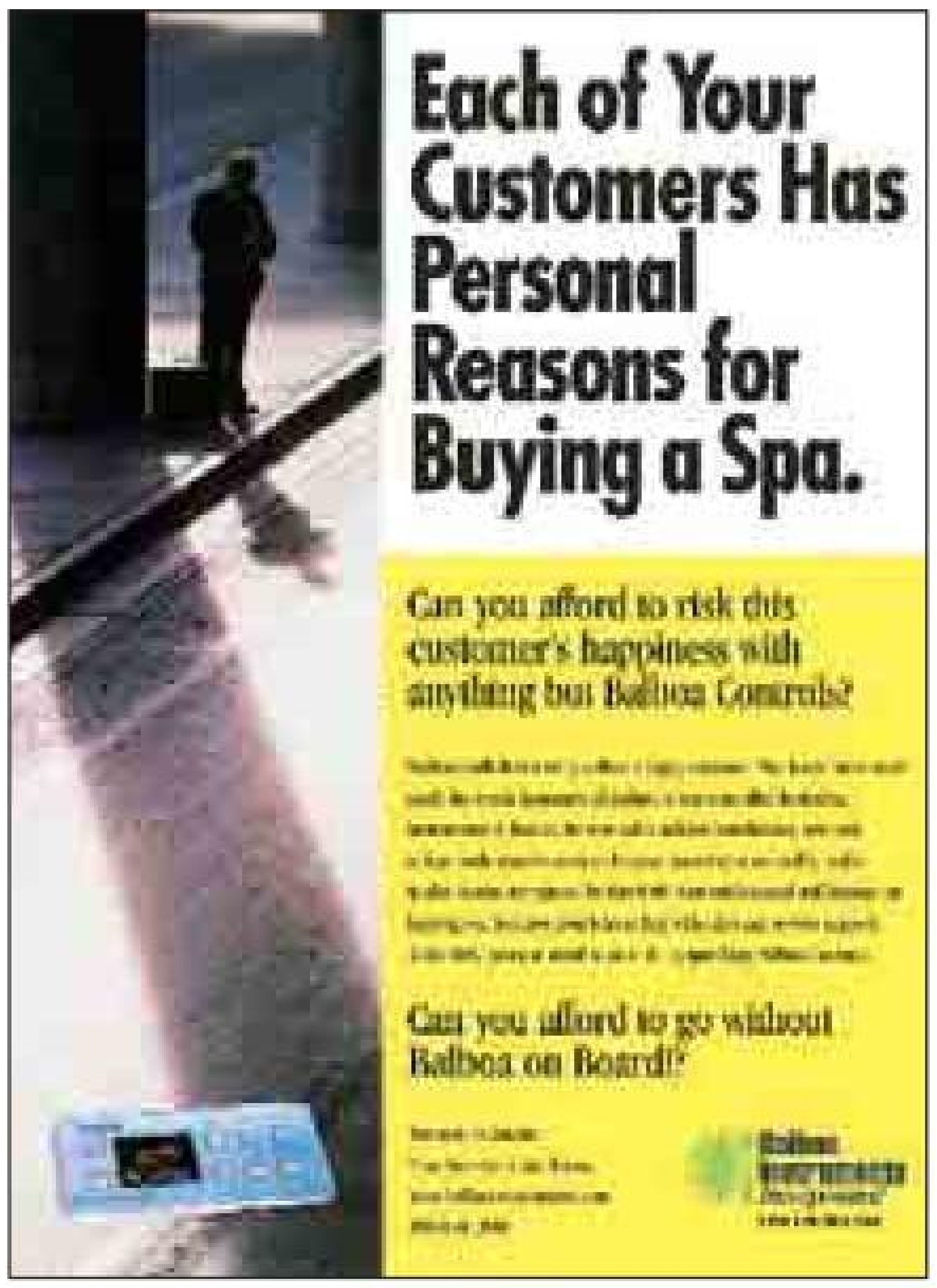
Firms that commit to customer satisfaction realize that all employees who have any contact with customers need training—many firms see 40 hours a year of training as a minimum. Simply showing customer-contact employees around the rest of the business—so that they learn how their contribution fits in the total effort—can be very effective. Good training usually includes role-playing on handling different types of customer requests and problems. This is not just sales training! A rental car attendant who is rude when a customer is trying to turn in a car may leave the customer dissatisfied—even if the rental car was perfect. How employees treat a customer is as important as whether they perform the task correctly.

Companies can't afford an army of managers to inspect how each employee implements a strategy—and such a system usually doesn't work anyway. Quality cannot be "inspected in." It must come from the people who do the service jobs. So firms that commit to service quality empower employees to satisfy customers' needs. **Empowerment** means giving employees the authority to correct a problem without first checking with management. At a Guest Quarters hotel, an empowered room-service employee knows it's OK to run across the street to buy the specific bottled water a guest requests. In the Saturn car manufacturing plant, employees can stop the assembly line to correct a problem rather than passing it down the line.

Manage expectations—with good communication

The implementation effort sometimes leaves customers dissatisfied because they expect much more than it is possible for the firm to deliver. Some firms react to this by shrugging their shoulders and faulting customers for being unreasonable. Research in the service quality area, however, suggests that the problems often go away if marketers clearly communicate what they are offering. Customers are satisfied when the service matches their expectations, and careful communication leads to reasonable expectations. Sometimes the solution is simple. At Disney World, for example, waiting in line for a popular ride can be very tiring. Disney found, however,


Everyone is looking for perfect
Pozzi


Each of Your Customers Has Personal Reasons for Buying a Spa.
Can you afford to risk this customer's happiness with anything but Balboa Controls?
Can you afford to go without Balboa on Board?
Balboa Instruments

Pozzi wants its artisans to be proud of the high-quality windows they produce, so they often have their photos taken with their handiwork before it's shipped. Balboa wants producers of spas to know that its controls meet ISO 9001 quality standards and that, as a supplier, it is dedicated to satisfying the needs of the spa producer's final consumers.

that by posting signs that show how long the wait will likely be, it reduced customer frustration. And it allowed people to know how to pick another ride with less waiting time.

Customers often tolerate a delay and remain satisfied with the service when they are given a full explanation. Most airline passengers seethe at the announcement of a takeoff delay but are happy to wait and stay safe if they know the delay is caused by a thunderstorm high over the airport.

Separate the routine and plan for the special

Implementation usually involves some routine services and some that require special attention. Customer satisfaction increases when the two types of service encounters are separated. For example, banks set up special windows for commercial deposits and supermarkets have cash-only lines. In developing the marketing plan, it's important to analyze the types of service customers will need and plan for both types of situations. In some cases, completely different strategies may be required.

Increasingly, firms try to use computers and other equipment to handle routine services. ATMs are quick and convenient for dispensing cash. American Airlines' Dial a Flight system allows customers to use a touchtone phone to check schedules and arrival times—without the need for an operator. Similarly, the UPS website (www.ups.com) makes it easy for customers to check the status of a delivery.

Firms that study special service requests can use training so that even unusual customer requests become routine to the staff. Every day, hotel guests lose their keys, bank customers run out of checks, and supermarket shoppers leave their wallets at home. A well-run service operation anticipates these special events so service providers can respond in a way that satisfies customers' needs.

Managers lead the quality effort

Quality implementation—whether in a service activity or in another activity—doesn't just happen by itself. Managers must show that they are committed to doing things right to satisfy customers and that quality is everyone's job. Without top-level support, some people won't get beyond their business-as-usual attitude—and TQM won't work. The top executive at American Express had his board of directors give him the title Chief Quality Officer so that everyone in the company would know he was personally involved in the TQM effort.

Specify jobs and benchmark performance

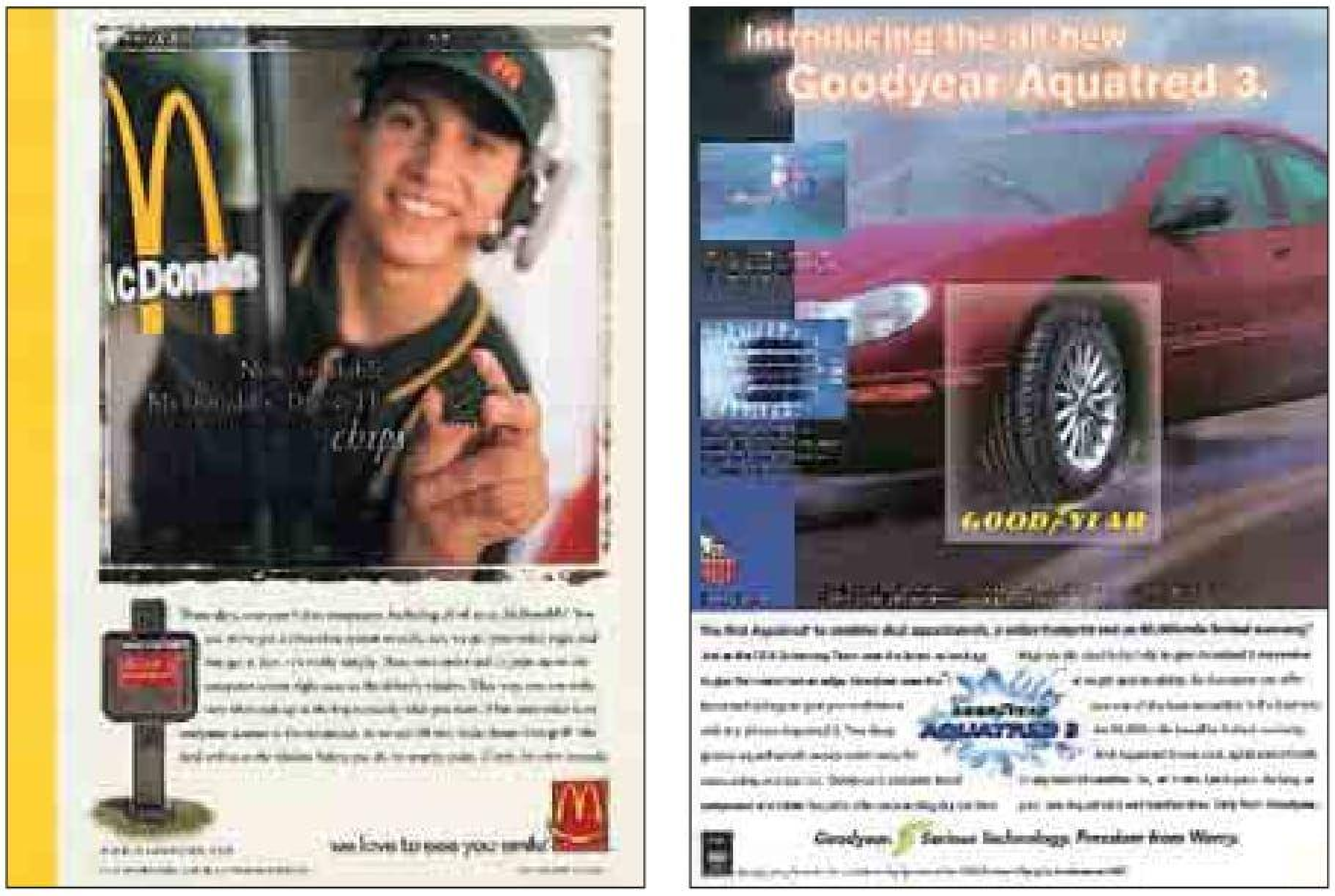
Firms that are successful with quality programs usually go to the effort to clearly specify and write out exactly what tasks need to be done, how, and by whom. This may seem unnecessary. After all, most people know, in general, what they're supposed to do. However, if the tasks are clearly specified, it's easier to see what criteria should be used to measure performance.

Once criteria are established, there needs to be some basis on which to evaluate the job being done. In our restaurant example, one part of the job specification for the cashier is to process credit card payments. In that case, relevant criteria might include the amount of time that it takes and the number of people waiting in line to pay. If the restaurant manager had seen a record of how long it was taking to process credit cards, she would have known that for many customers it was taking too long. Without the measure, the precise nature of the problem was hidden.

That takes us to the issue of **benchmarking**—picking a basis of comparison for evaluating how well a job is being done. For example, consider a case in which a firm asks each of its customers to rate their satisfaction with the sales rep with whom they work. Then the company might benchmark each sales rep against other sales reps on the basis of average customer satisfaction. But if the firm's sales reps as a group are weak, that isn't a sensible approach. The ones that stink the least would look good on a relative basis. Many firms try to benchmark against some external standard. For example, a sales manager might want to benchmark against a competitor's sales reps. Or better, the manager might identify firms in which sales reps earn superlative customer satisfaction ratings, regardless of their industry, and benchmark against them. That approach can also reveal job specifications—things that should be done—that the sales manager had not considered or measured in the first place. For example, salespeople at Saturn dealers earn high customer satisfaction ratings. Office Max doesn't sell cars, but it might benchmark against Saturn's sales reps to find ways to improve its office equipment sales effort.

Getting a return on quality is important

While the cost of poor quality is lost customers, keep in mind that the type of quality efforts we've been discussing also result in costs. It takes time and energy to keep records, analyze the details of implementation efforts, and search for ways to reduce whatever type of defects might appear. It's important to find the right balance between quality in the implementation effort and what it costs to achieve it.


McDonald's
we love to see you smile
Introducing the all-new Goodyear Aquatred 3.
GOODYEAR
Aquatred 3
Goodyear. Serious Technology. Freedom from Worry.

Getting every customer's order exactly correct is a challenge, but it's a basic ingredient of high-quality service for a drive-through restaurant. To improve order accuracy, McDonald's has added computerized displays so the customer can confirm the order. With tires, quality means safety and durability, so Goodyear has continued to improve these features with its new design for the Aquatred tire.

Marketing managers who lose sight of that balance have often created quality programs that cost more than they're worth. It's easy to fall into the trap of running up *unnecessary costs* trying to improve some facet of implementation that really isn't that important to customer satisfaction or customer retention. When that happens, customers may still be satisfied, but the firm can't make a profit because of the extra costs. In other words, there isn't a financial return on the money spent to improve the quality of the implementation effort. Remember that getting everyone to work together to satisfy customers should be the route to profits. If the firm is spending money on quality efforts that don't really provide the customer with superior value—that cost more to provide than customers will ultimately be willing to pay—then someone has lost sight of the marketing concept.

As this suggests, TQM is not a cure-all. Further, it is not the only method for improving marketing implementation, but it is an important approach. Some firms don't yet use TQM; they may be missing an opportunity. Other firms apply some quality methods but act like they are the private property of a handful of "quality specialists" who want to control things. That's not good either. Everyone must own a TQM effort and keep a balanced view of how it improves customer satisfaction and what it costs.

As more marketing managers see the benefits of TQM, it will become a more important part of marketing thinking, especially marketing implementation. And when managers really understand implementation, they can do a better job developing strategies and plans in the first place.[7]

Control Provides Feedback to Improve Plans and Implementation

Keeping a firmer hand on the controls

We've said that computers and other types of information technology are speeding up the flow of feedback and prompting a revolution by allowing managers to improve plans and implementation quickly and continuously. On the other hand, the basic questions that a modern marketing manager wants to answer to make better implementation and strategy decisions are pretty similar to what they've always been.

A good manager wants to know which products' sales are highest and why, which products are profitable, what is selling where, and how much the marketing process is costing. Managers need to know what's happening, in detail, to improve the bottom line.

Unfortunately, traditional accounting reports are usually too general to be much help in answering these questions. A company may be showing a profit, while 80 percent of its business comes from only 20 percent of its products—or customers. The other 80 percent may be unprofitable. But without special analyses, managers won't know it. This 80/20 relationship is fairly common—and it is often referred to as the *80/20 rule*.

What happened with Ben & Jerry's Peace Pops premium ice-cream bars is a good example. The initial plan called for intensive distribution of boxes of Peace Pops in supermarket freezer cases—to compete with competitors like Dove Bar and Häagen-Dazs. But after six months total sales were 50 percent lower than expected. However, detailed sales analysis by package and channel revealed a bright spot: Individual Peace Pops were selling very well in local delis. After further work to better understand the reasons for this focused success, Ben & Jerry's marketing people realized that most of their target customers saw the premium-price Peace Pop as an impulse product rather than as a staple they were willing to heap into a shopping cart. So Ben & Jerry's revised the strategy to better reach impulse buyers at convenience stores. Within a year, the revised strategy worked. Sales increased

60 percent, and sales analysis showed that 70 percent of the sales were at convenience stores. A few years later, however, sales analysis showed that sales were slowly trending down. Rather than wait for a painful death of the product, they replaced it with a new item.[8]

As the Ben & Jerry's example shows, it *is* possible for marketing managers to get detailed information about how marketing plans are working—but only if they ask for and help develop the necessary data. In this section, we'll discuss the kinds of information that can be available and how to use it. The techniques are not really complicated. They basically require only simple arithmetic—and of course computers quickly and easily take care of that when a large volume of sorting, adding, and subtracting is required.

Sales Analysis Shows What's Happening

Sales analysis—a detailed breakdown of a company's sales records—can be very informative. Detailed data can keep marketing executives in touch with what's happening in the market. In addition, routine sales analyses prepared each week or month may show trends and allow managers to check their hypotheses and assumptions.[9]

Some managers resist sales analysis, or any analysis for that matter, because they don't appreciate how valuable it can be. One top executive in a large firm made no attempt to analyze company sales, even by geographic area. When asked why, the executive replied: "Why should we? We're making money!"

But today's profit is no guarantee that you'll make money tomorrow. In fact, ignoring sales analysis can lead not only to poor sales forecasting but to poor decisions in general. One manufacturer did much national advertising on the assumption that the firm was selling all over the country. But a simple sales analysis showed that most present customers were located within a 250-mile radius of the factory! In other words, the firm didn't know who and where its customers were—and it wasted most of the money it spent on national advertising.

But a marketing manager must ask for it

Detailed sales analysis is only possible if a manager asks for the data. Valuable sales information is often buried—perhaps on sales invoices or in billing records on an accountant's computer.

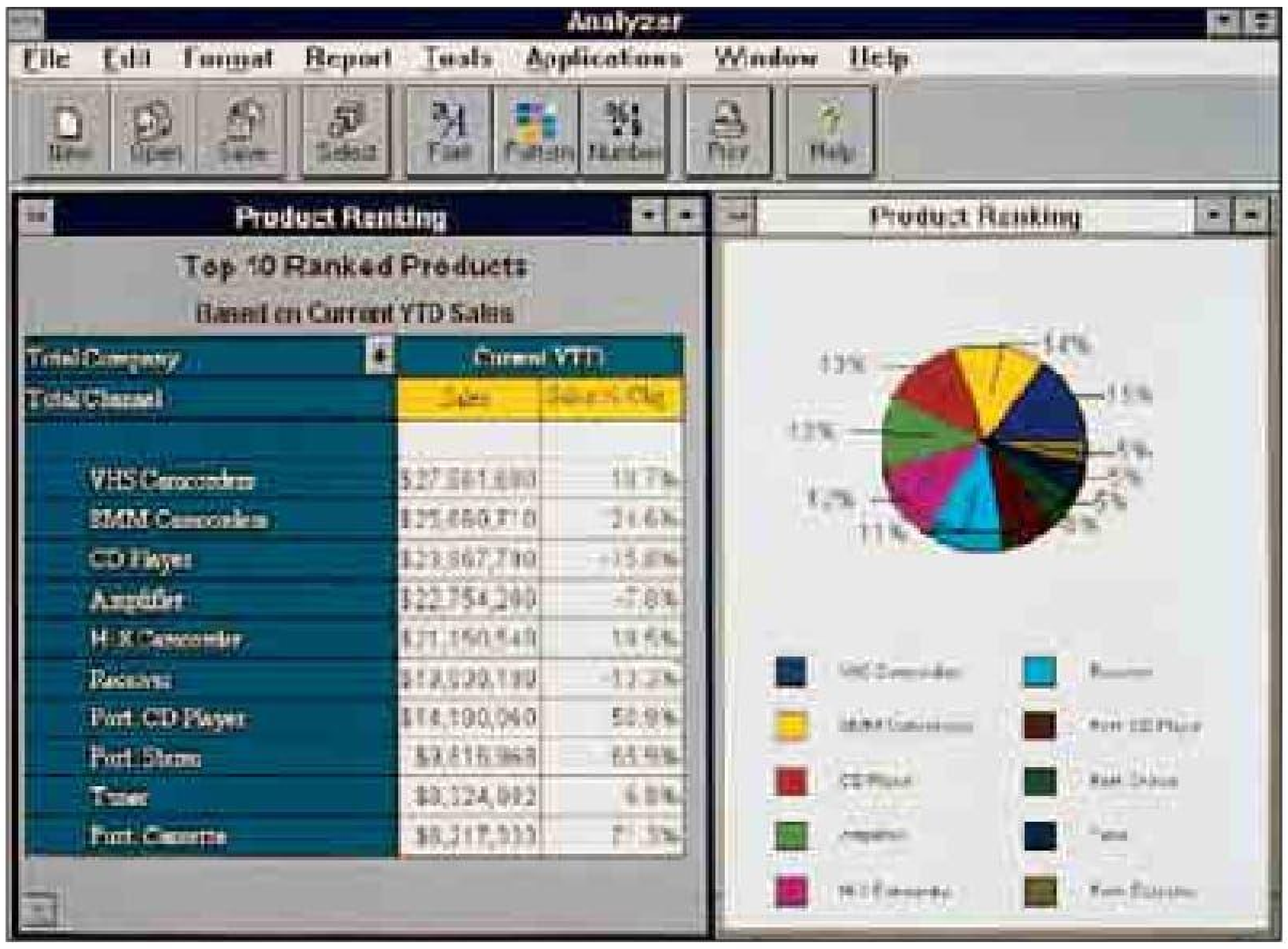
Today, with computer networks and organized marketing information systems, effective sales analysis can be done easily and at relatively small cost—if marketing managers decide they want it done. In fact, the desired information can be obtained as a by-product of basic billing and accounts receivable procedures. The manager simply must make sure the company captures identifying information on important dimensions such as territory, sales reps, product model, customer, and so forth. Then computers can easily run sales analyses and simple trend projections.

What to ask for varies

There is no one best way to analyze sales data. Several breakdowns may be useful—depending on the nature of the company and product and what dimensions are relevant. Typical breakdowns include:

1. Geographic region—country, state, county, city, sales rep's territory.
2. Product, package size, grade, or color.
3. Customer size.
4. Customer type or class of trade.

Information Resources, Inc., developed the DataServer Analyzer Software, illustrated here, to make it easy to do sales analysis and produce graphs that make it easy to see patterns that might otherwise be hidden in a table of numbers.


Analyzer
File Edit Format Report Tools Applications Window Help
New Open Save Select Font Pattern Number Print Help
Product Ranking
Product Ranking
13%
12%
15%
12%
12%
11%
5%
5%
5%
5%

Top 10 Ranked Products

Based on Current YTD Sales

Total Company	Current YTD	
Total Channel	Sales	Sales % Chg
VHS Camcorders	$27,861,680	18.7%
8MM Camcorders	$25,680,710	21.6%
CD Player	$23,867,790	-15.8%
Amplifier	$22,754,240	-7.8%
H-8 Camcorder	$21,150,540	18.5%
Receiver	$18,020,180	-13.2%
Port. CD Player	$14,100,060	50.9%
Port. Stereo	$9,615,968	65.9%
Tuner	$8,324,082	6.8%
Port. Cassette	$8,217,533	71.3%

5. Price or discount class.
6. Method of sale—online, telephone, or sales rep.
7. Financial arrangement—cash or charge.
8. Size of order.
9. Commission class.

Too much data can drown a manager

While some sales analysis is better than none—or better than getting data too late for action—sales breakdowns that are too detailed can drown a manager in reports. Computers can spew out data faster than any manager can read. So wise managers only ask for breakdowns that will help them make decisions. Further, they use computer programs that draw graphs and figures to make it easy to see patterns that otherwise might be hidden scrolling through online tables with a browser. But to avoid coping with mountains of data—much of which may be irrelevant—most managers move on to *performance analysis*.

Performance Analysis Looks for Differences

Numbers are compared

Performance analysis looks for exceptions or variations from planned performance. In simple sales analysis, the figures are merely listed or graphed—they aren't compared against standards. In performance analysis, managers make comparisons. They might compare one territory against another, against the same territory's performance last year, or against expected performance.

The purpose of performance analysis is to improve operations. The salesperson, territory, or other factors showing poor performance can be identified and singled out for detailed analysis and corrective action. Or outstanding performances can be analyzed to see if the successes can be explained and made the general rule.

Performance analysis doesn't have to be limited to sales. Other data can be analyzed too. This data may include inventory required, number of calls made, number of orders, or the cost of various tasks.

Exhibit 19-4 Comparative Performance of Sales Reps

Sales Area	Total Calls	Total Orders	Order-Call Ratio	Sales by Sales Rep	Average Sales Rep Order	Total Customers
A	1,900	1,140	60.0%	$ 912,000	$800	195
B	1,500	1,000	66.7	720,000	720	160
C	1,400	700	50.0	560,000	800	140
D	1,030	279	27.1	132,000	478	60
E	820	165	20.1	62,000	374	50
Total	6,650	3,284	49.3%	$2,386,000	$634	605

A performance analysis can be quite revealing, as shown in the following example.

Straight performance analysis—an illustration

A manufacturer of business products sells to wholesalers through five sales reps, each serving a separate territory. Total net sales for the year amount to $2,386,000. Sales force compensation and expenses come to $198,000, yielding a direct-selling expense ratio of 8.3 percent—that is, $198,000 ÷ $2,386,000 × 100.

This information—taken from a profit and loss statement—is interesting, but it doesn't explain what's happening from one territory to another. To get a clearer picture, the manager compares the sales results with other data *from each territory*. See Exhibits 19-4 and 19-5. Keep in mind that exhibits like these and others that follow in this chapter are now very easy to generate. Common computer programs like Microsoft Office make it easy to apply the ideas discussed here. Larger companies make such analysis available at a website so the manager can sort out whatever is needed.

The reps in sales areas D and E aren't doing well. Sales are low and marketing costs are high. Perhaps more aggressive sales reps could do a better job, but the number of customers suggests that sales potential might be low. Perhaps the whole plan needs revision.

The figures themselves, of course, don't provide the answers. But they do reveal the areas that need improvement. This is the main value of performance analysis. It's up to management to find the remedy, either by revising or changing the marketing plan.

Exhibit 19-5 Comparative Cost of Sales Reps

Sales Area	Annual Compensation	Expense Payments	Total Sales Rep Cost	Sales Produced	Cost-Sales Ratio
A	$ 22,800	$11,200	$ 34,000	$ 912,000	3.7%
B	21,600	14,400	36,000	720,000	5.0
C	20,400	11,600	32,000	560,000	5.7
D	19,200	24,800	44,000	132,000	33.3
E	20,000	32,000	52,000	62,000	83.8
Total	$104,000	$94,000	$198,000	$2,386,000	8.3%

Performance Indexes Simplify Human Analysis

Comparing against "what ought to have happened"

With a straight performance analysis, the marketing manager can evaluate the variations among sales reps to try to explain the "why." But this takes time. And poor performances are sometimes due to problems that bare sales figures don't reveal. Some uncontrollable factors in a particular territory—tougher competitors or ineffective middlemen—may lower the sales potential. Or a territory just may not have much potential.

To get a better check on performance effectiveness, the marketing manager compares what did happen with what ought to have happened. This involves the use of performance indexes.

A performance index is like a batting average

When a manager sets standards—that is, quantitative measures of what ought to happen—it's relatively simple to compute a **performance index**—a number like a baseball batting average that shows the relation of one value to another.

Baseball batting averages are computed by dividing the actual number of hits by the number of times at bat (the possible number of times the batter could have had a hit) and then multiplying the result by 100 to get rid of decimal points. A sales performance index is computed the same way—by dividing actual sales by expected sales for the area (or sales rep, product, etc.) and then multiplying by 100. If a sales rep is batting 82 percent, the index is 82.

A simple example shows where the problem is

We show how to compute a performance index in the following example, which assumes that population is an effective measure of sales potential.

In Exhibit 19-6, the population of the United States is broken down by region as a percent of the total population. The regions are Northeastern, Southern, Midwestern, and Western.

A firm already has $1 million in sales and now wants to evaluate performance in each region. Column 2 shows the actual sales of $1 million broken down in proportion to the population in the four regions. This is what sales *should* be if population were a good measure of future performance. Column 3 in Exhibit 19-6 shows the actual sales for the year for each region. Column 4 shows measures of performance (performance indexes)—Column 3 ÷ Column 2 × 100.

The Western region isn't doing as well as expected. It has 20 percent of the total population—and expected sales (based on population) are $200,000. Actual sales, however, are only $120,000. This means that the Western region's performance index is only 60—(120,000 ÷ 200,000) × 100—because actual sales are much lower than expected on the basis of population. If population is a good basis for

Exhibit 19-6 Development of a Measure of Sales Performances (by region)

	(1)	(2)	(3)	(4)
Regions	Population as Percent of United States	Expected Distribution of Sales Based on Population	Actual Sales	Performance Index
Northeastern	20	$ 200,000	$ 210,000	105
Southern	25	250,000	250,000	100
Midwestern	35	350,000	420,000	120
Western	20	200,000	120,000	60
Total	100	$1,000,000	$1,000,000	

measuring expected sales (an important *if*), the poor sales performance should be analyzed further. Perhaps sales reps in the Western region aren't working as hard as they should. Perhaps promotion there isn't as effective as elsewhere. Or competitive products may have entered the market.

Whatever the cause, it's clear that performance analysis does not solve problems. Managers do that. But performance analysis does point out potential problems—and it does this well.

Internet

Internet Exercise SPSS sells software that can be used for a variety of purposes, including analyses of sales, cost, and customer data. Browse the SPSS website (www.spss.com) and identify three ways that SPSS could make it easier for a manager to do a performance analysis.

A Series of Performance Analyses May Find the Real Problem

Performance analysis helps a marketing manager see if the firm's marketing plans are working properly—and, if they aren't, it can lead to problem solving. But a marketing manager may need a series of performance analyses, as shown in the following example.

To get a feel for how performance analysis can be part of a problem-solving process, follow this example carefully—one exhibit at a time. Try to anticipate the marketing manager's decision.

The case of Stereo, Inc.

Stereo's sales manager finds that sales for the Pacific Coast region are $130,000 below the quota of $14,500,000 (that is, actual sales are $14,370,000) for the January through June period. The quota is based on forecast sales of the various types of stereo equipment the company sells. Specifically, the quota is based on forecasts for each product type in each store in each sales rep's territory.

Pam Dexter, the sales manager, thinks this difference isn't too large (1.52 percent) and is inclined to forget the matter—especially since forecasts usually err to some extent. But she thinks about sending an e-mail message to all sales reps and district supervisors in the region—a message aimed at stimulating sales effort.

Exhibit 19-7
Sales Performance—Pacific Coast Region, January–June ($000)

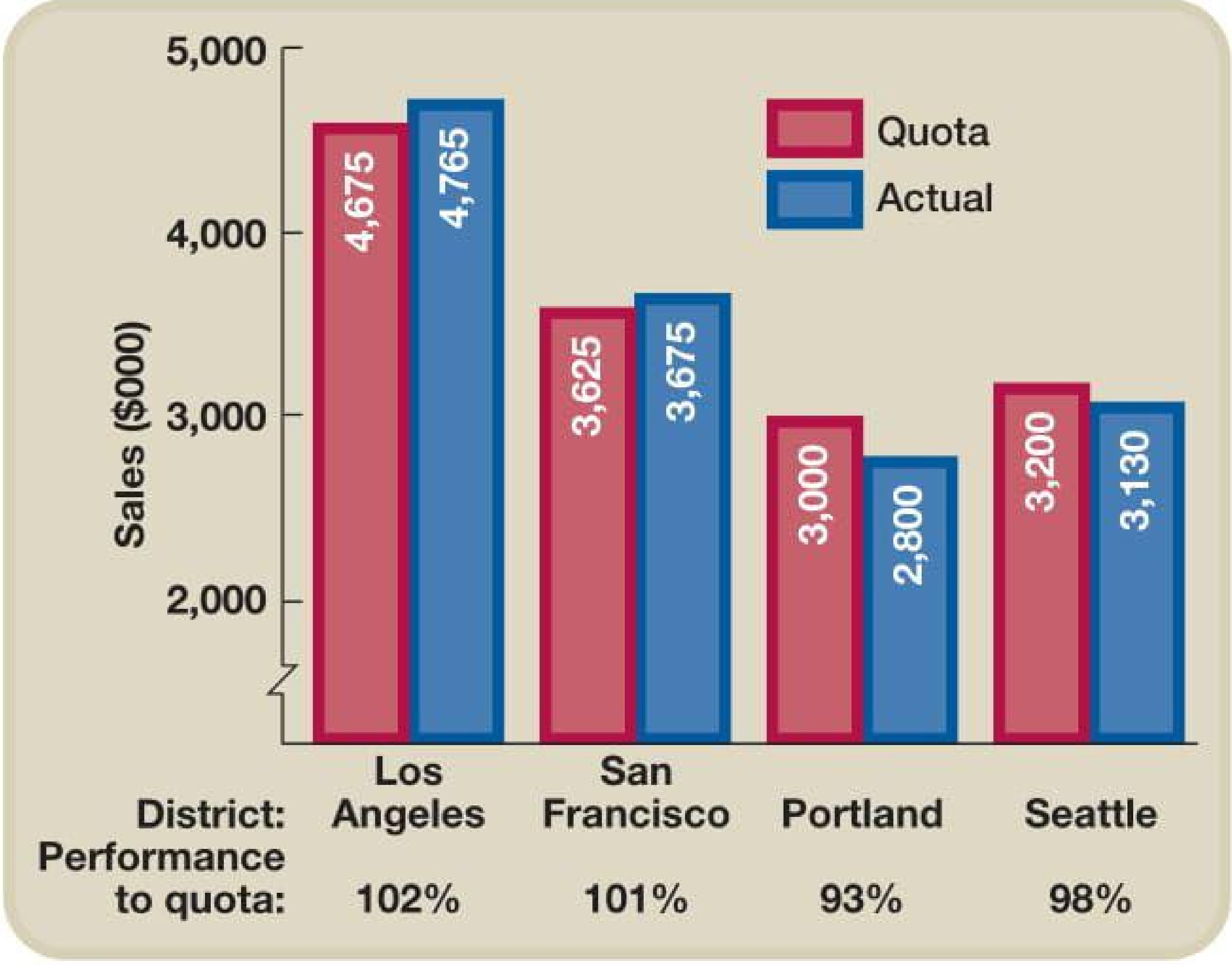


Exhibit 19-8
Sales Performance—Portland District, January–June ($000)

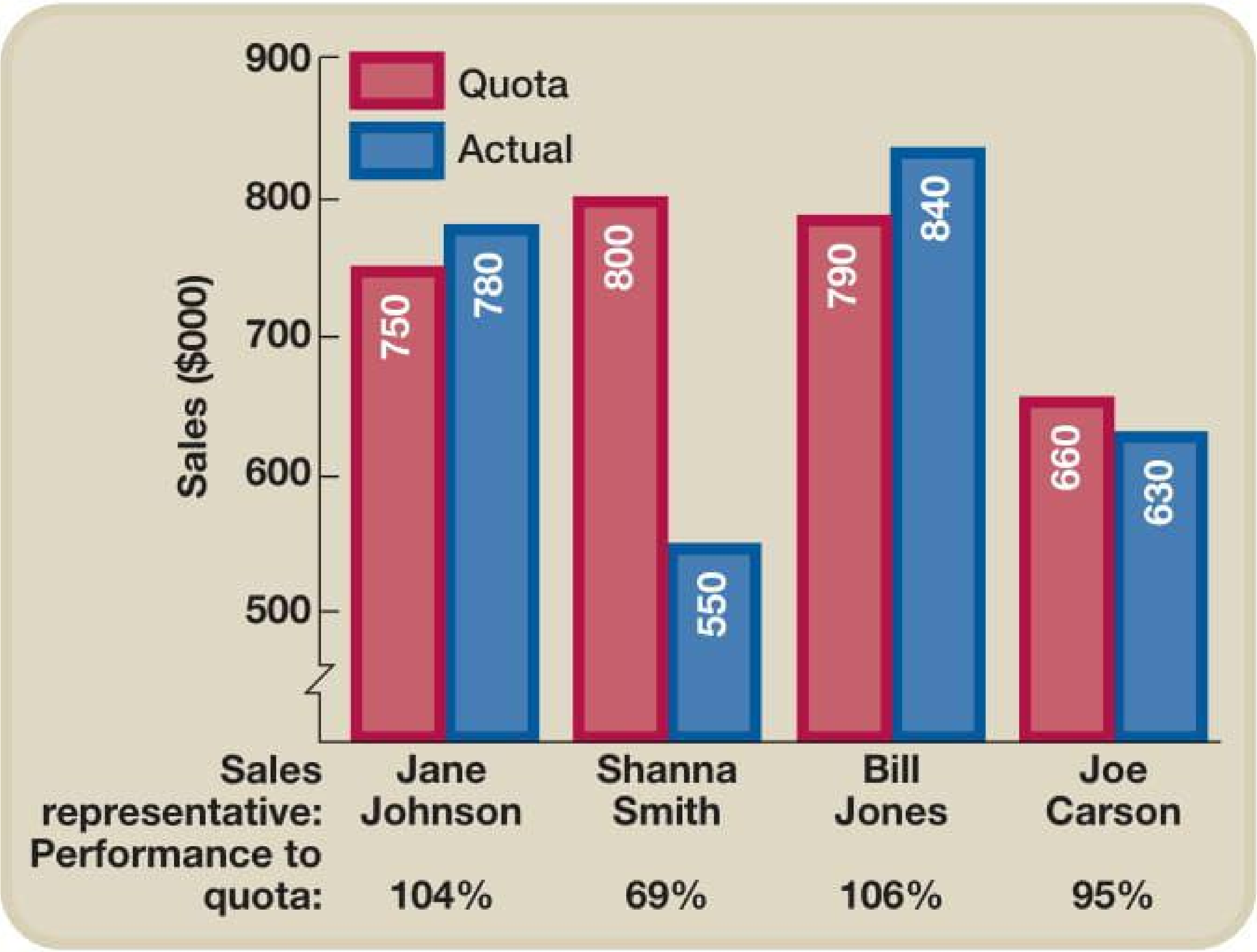


Exhibit 19-7 shows the overall picture of Stereo's sales on the Pacific Coast. What do you think the manager should do?

The Portland district has the poorest performance—but it isn't too bad. Before writing a "let's get with it" letter to Portland and then relaxing, the sales manager decides to analyze the performance of the four sales reps in the Portland district. Exhibit 19-8 shows a breakdown of the Portland figures by sales rep. What conclusion or action do you suggest now?

Since Shanna Smith previously was the top sales rep, the sales manager wonders if Smith is having trouble with some of her larger customers. Before making a drastic move, she obtains an analysis of Smith's sales to the five largest customers. See Exhibit 19-9. What action could the sales manager take now? Should Smith be fired?

Smith's sales in all the large stores are down significantly—although her sales in many small stores are holding up well. Smith's problem seems to be general. Perhaps she just isn't working. Before calling her, the sales manager decides to look at Smith's sales of the four major products. Exhibit 19-10 shows Smith's sales. What action is indicated now?

Exhibit 19-9
Sales Performance—Selected Stores of Shanna Smith in Portland District, January–June ($000)

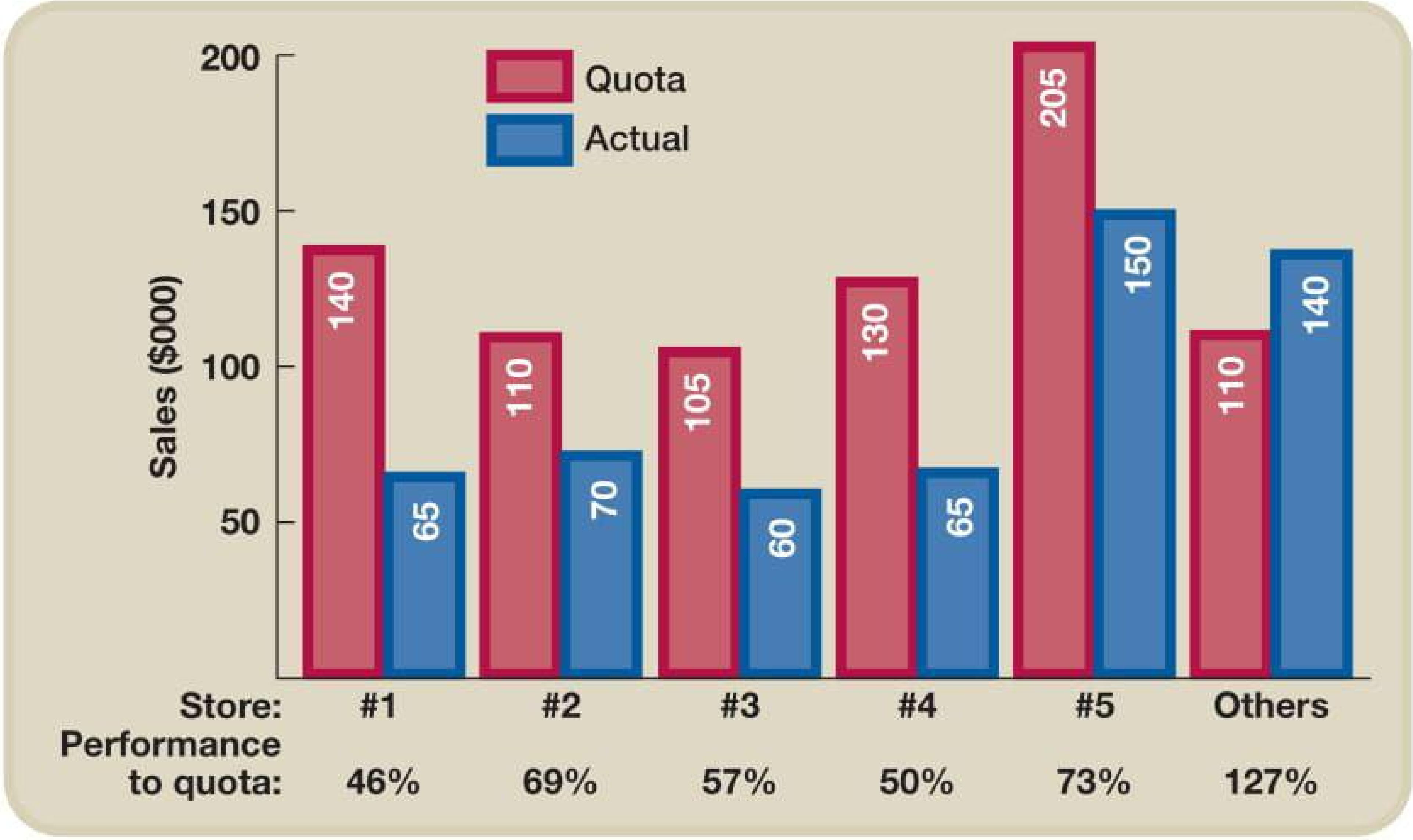
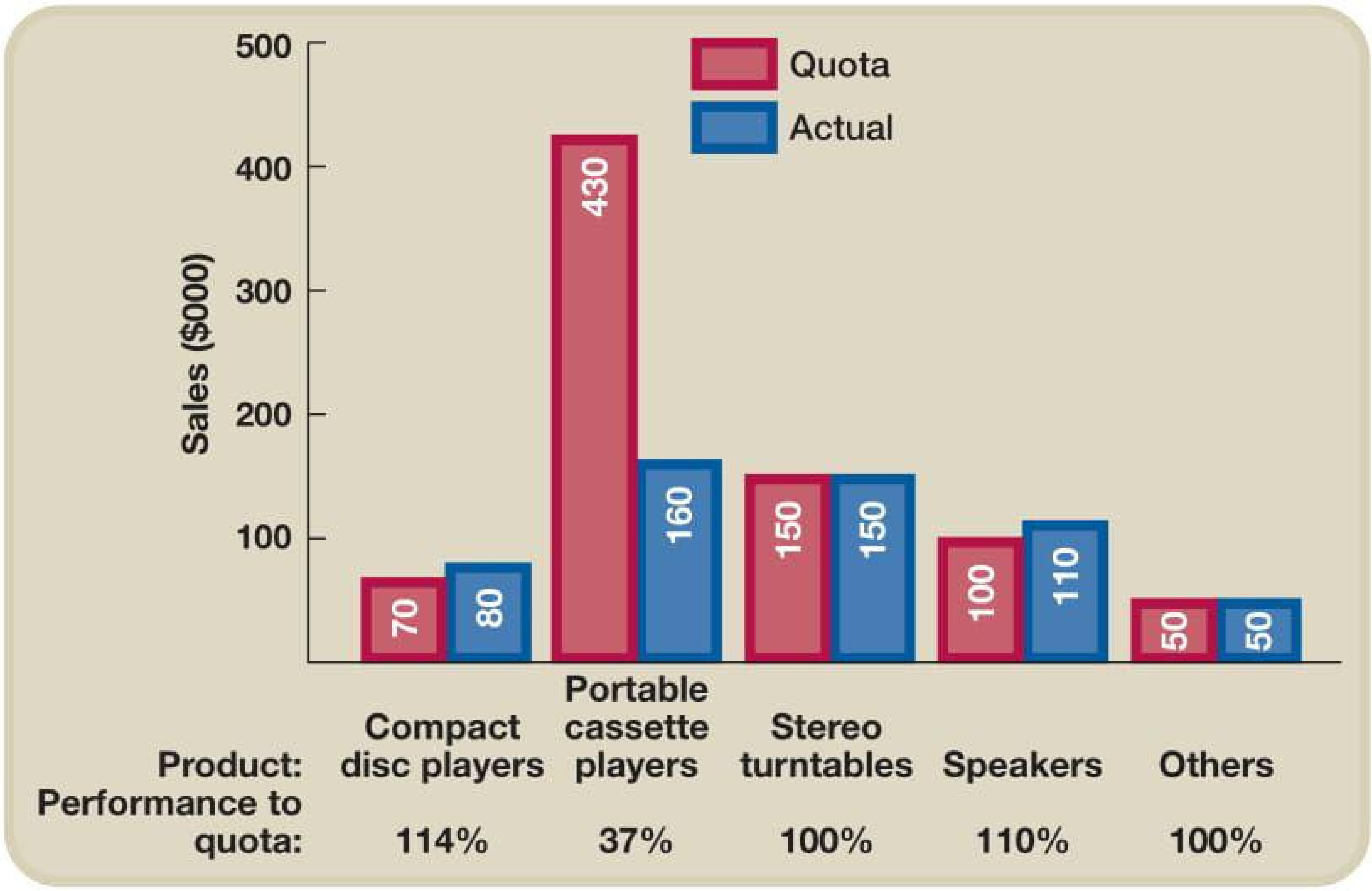


Exhibit 19-10
Sales Performance by Product for Shanna Smith in Portland District, January–June ($000)



Smith is having real trouble with portable cassette players. Was the problem Smith or the players?

Further analysis by product for the whole region shows that everyone on the Pacific Coast is having trouble with portable players because customers there are buying MP3 players that come from another company. But higher sales on other products hid this fact. Since portable player sales are doing all right nationally, the problem is only now showing up. You can see that this is the *major* problem. If Stereo doesn't offer an MP3 player, it will just slowly lose sales as more customers shift to MP3.

Since overall company sales are fairly good, many sales managers wouldn't bother with this analysis. Some might trace the problem to Smith. But without detailed sales records and performance analysis, they might assume that Smith—rather than the missed opportunity to add a new product—is at fault. And Smith herself might not be able to pinpoint what's happening.

Stay home and use the computer

This case shows that total figures can be deceiving. Marketing managers need facts to avoid rash judgments based on incomplete information. Some students want to fire Smith after they see the store-by-store data (Exhibit 19-9).

The home office or computer network should have the records to isolate problem areas—managers then rely on the field staff for explanations and help with locating the exact problem. Continuing detailed analysis usually gives better insights into problems, as this case shows. With computers, managers can obtain information routinely and in great detail, *provided they ask for it*.

The iceberg principle—90 percent is below the surface

One of the most interesting conclusions from the Stereo illustration is the **iceberg principle**—much good information is hidden in summary data. Icebergs show only about 10 percent of their mass above water level. The other 90 percent is below water level, and not directly below either. The submerged portion almost seems to search out ships that come too near.

The same is true of much business and marketing data. Since total sales may be large and company activities varied, problems in one area may hide below the surface. Everything looks calm and peaceful. But closer analysis may reveal jagged edges that can severely damage or even sink the business. The 90:10 ratio—or the 80/20 rule we mentioned earlier—must not be ignored. Averaging and summarizing data are helpful, but be sure summaries don't hide more than they reveal.

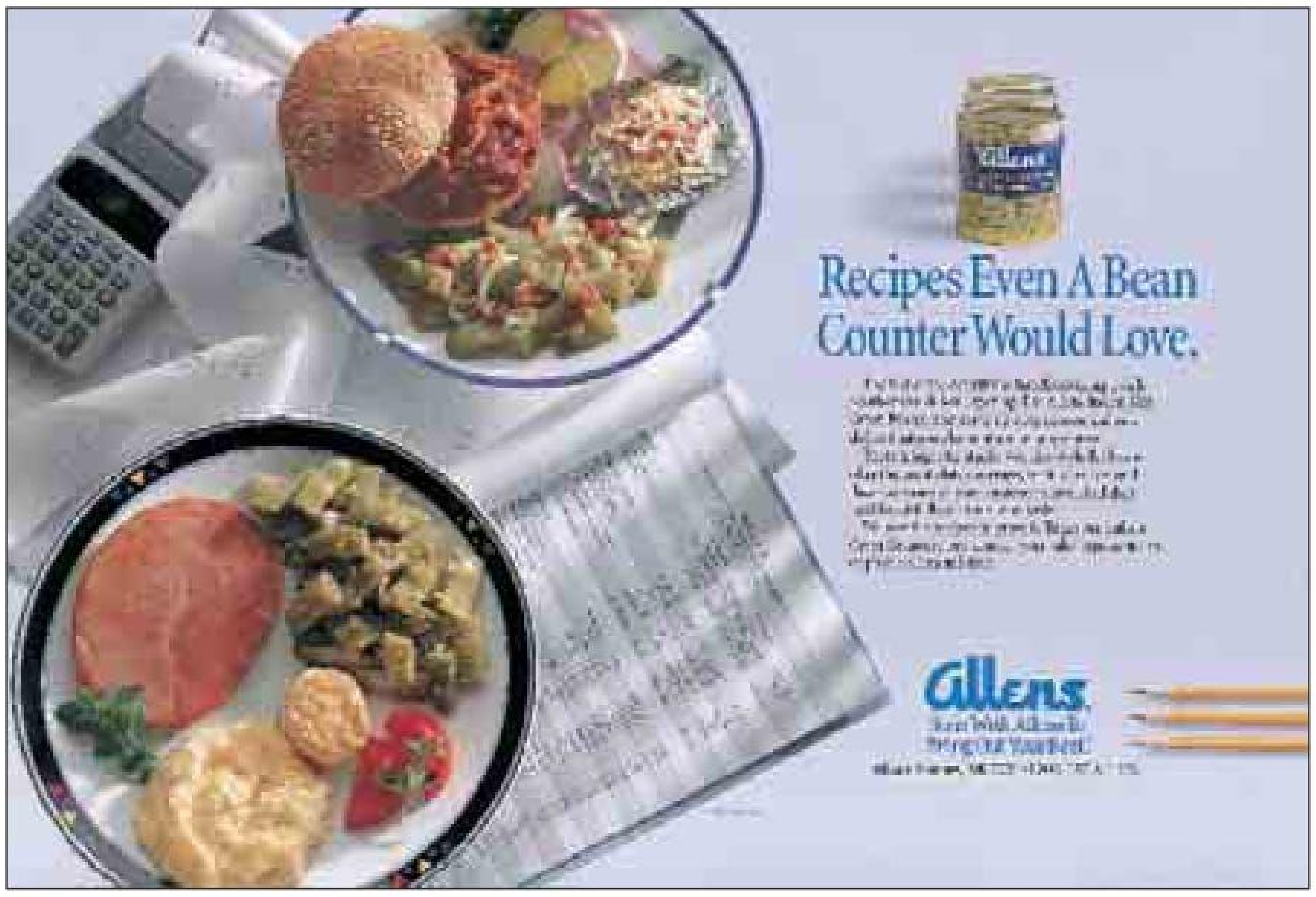
Marketing Cost Analysis—Controlling Costs Too

So far we've emphasized sales analysis. But sales come at a cost. And costs can and should be analyzed and controlled too. You can see why in the case of Watanake Packaging, Ltd. (WPL). WPL developed a new strategy to target the packaging needs of producers of high-tech electronic equipment. WPL designed unique Styrofoam inserts to protect electronic equipment during shipping. It assigned order getters to develop new accounts and recruited agent middlemen to develop overseas markets. The whole marketing mix was well received—and the firm's skimming price led to good profits. But over time competing suppliers entered the market. When marketing managers at WPL analyzed costs, they realized their once-successful strategy was slipping. Personal selling expense as a percent of sales had doubled because it took longer to find and sell new accounts. It was costly to design special products for the many customers who purchased only small quantities. Profit margins were falling too because of increased price competition. In contrast, the analysis showed that online sales of ordinary cardboard shipping boxes for agricultural products were very profitable. So WPL stopped calling on *small* electronics firms and developed a new plan to improve its website and build the firm's share of the less glamorous, but more profitable, cardboard box business.

Marketing costs have a purpose

Detailed cost analysis is very useful in understanding production costs—but much less is done with *marketing cost analysis*.[10] One reason is that many accountants show little interest in their firm's marketing process—or they don't understand the different marketing activities. They just treat marketing as overhead and forget about it.

In the next chapter, when we discuss the relationship between marketing and accounting in more detail, we'll explain how some accountants and marketing managers are working together to address this problem. For now, however, you should see that careful analysis of most marketing costs shows that the money is spent for a specific purpose—for example, to develop or promote a particular product or to serve particular customers.



For a restaurant to be profitable, the manager needs to worry not only about satisfying customers but also about how much each item contributes to overall costs.

Let's reconsider Exhibit 19-5 from this perspective. It shows that the company's spending on sales compensation and sales expenses varies by salesperson and market area. By breaking out and comparing the costs of different sales reps, the marketing manager has a much better idea of what it is costing to implement the strategy in each sales area. In this example, it's clear that the sales reps in sales areas D and especially E are not only falling short in sales, but also that their costs are high relative to other reps who are getting more results. The table shows that the difference isn't due to annual compensation; that's lower. Rather, these reps have expenses that are two or three times the average. The smaller number of total customers in these sales areas (Exhibit 19-4) might explain the lower levels of sales, but it probably doesn't explain the higher expenses. Perhaps the customers are more spread out and require more travel to reach. Here again, the cost analysis doesn't explain *why* the results are as they are—but it does direct the manager's attention to a specific area that needs improvement. A more detailed breakdown of costs may help pinpoint the specific cause.

Allocate costs to specific customers and products

Because marketing costs have a purpose, it usually makes sense to allocate costs to specific market segments, or customers, or to specific products. In some situations, companies allocate costs directly to the various geographical market segments they serve. This may let managers directly analyze the profitability of the firm's target markets. In other cases, companies allocate costs to specific customers or specific products and then add these costs for market segments depending on how much of which products each customer buys.

Should all costs be allocated?

So far we've discussed general principles. But allocating costs is tricky. Some costs are likely to be fixed for the near future, regardless of what decision is made. And some costs are likely to be *common* to several products or customers, making allocation difficult.

Two basic approaches to handling this allocating problem are possible—the full-cost approach and the contribution-margin approach.

Full-cost approach—everything costs something

In the **full-cost approach,** all costs are allocated to products, customers, or other categories. Even fixed costs and common costs are allocated in some way. Because all costs are allocated, we can subtract costs from sales and find the profitability of various customers, products, and so on. This *is* of interest to some managers.

The full-cost approach requires that difficult-to-allocate costs be split on some basis. Here the managers assume that the work done for those costs is equally beneficial to customers, to products, or to whatever group they are allocated. Sometimes this allocation is done mechanically. But often logic can support the allocation—if we accept the idea that marketing costs are incurred for a purpose. For example, advertising costs not directly related to specific customers or products might be allocated to *all* customers based on their purchases—on the theory that advertising helps bring in the sales. We'll go into more detail on allocating costs in the next chapter.

Contribution-margin—ignores some costs to get results

When we use the **contribution-margin approach,** all costs are not allocated in *all* situations. Why?

When we compare various alternatives, it may be more meaningful to consider only the costs directly related to specific alternatives. Variable costs are relevant here.

The contribution-margin approach focuses attention on variable costs rather than on total costs. Total costs may include some fixed costs that do not change in the short run and can safely be ignored or some common costs that are more difficult to allocate.[11]

Exhibit 19-11 Profit and Loss Statement by Department

	Totals	Dept. 1	Dept. 2	Dept. 3
Sales	$100,000	$50,000	$30,000	$20,000
Cost of sales	80,000	45,000	25,000	10,000
Gross margin	20,000	5,000	5,000	10,000
Other expenses:				
Selling expenses	5,000	2,500	1,500	1,000
Administrative expenses	6,000	3,000	1,800	1,200
Total other expenses	11,000	5,500	3,300	2,200
Net profit or (loss)	$ 9,000	$ (500)	$ 1,700	$ 7,800

The two approaches can lead to different decisions

The difference between the full-cost approach and the contribution-margin approach is important. The two approaches may suggest different decisions, as we'll see in the following example.

Full-cost example

Exhibit 19-11 shows a profit and loss statement, using the full-cost approach, for a department store with three operating departments. (These could be market segments or customers or products.)

The administrative expenses, which are the only fixed costs in this case, have been allocated to departments based on the sales volume of each department. This is a typical method of allocation. In this case, some managers argued that Department 1 was clearly unprofitable and should be eliminated because it showed a net loss of $500. Were they right?

To find out, see Exhibit 19-12, which shows what would happen if Department 1 were eliminated.

Several facts become clear right away. The overall profit of the store would be reduced if Department 1 were dropped. Fixed costs of $3,000, now being charged to Department 1, would have to be allocated to the other departments. This would reduce net profit by $2,500, since Department 1 previously covered $2,500 of the $3,000 in fixed costs. Such shifting of costs would then make Department 2 look unprofitable!

Contribution-margin example

Exhibit 19-13 shows a contribution-margin income statement for the same department store. Note that each department has a positive contribution margin. Here the Department 1 contribution of $2,500 stands out better. This actually is the

Exhibit 19-12 Profit and Loss Statement by Department if Department 1 Were Eliminated

	Totals	Dept. 2	Dept. 3
Sales	$50,000	$30,000	$20,000
Cost of sales	35,000	25,000	10,000
Gross margin	15,000	5,000	10,000
Other expenses:			
Selling expenses	2,500	1,500	1,000
Administrative expenses	6,000	3,600	2,400
Total other expenses	8,500	5,100	3,400
Net profit or (loss)	$ 6,500	$ (100)	$ 6,600

Exhibit 19-13 Contribution-Margin Statement by Departments

	Totals	Dept. 1	Dept. 2	Dept. 3
Sales	$100,000	$50,000	$30,000	$20,000
Variable costs:				
Cost of sales	80,000	45,000	25,000	10,000
Selling expenses	5,000	2,500	1,500	1,000
Total variable costs	85,000	47,500	26,500	11,000
Contribution margin	15,000	$ 2,500	$ 3,500	$ 9,000
Fixed costs				
Administrative expenses	6,000			
Net profit	$ 9,000			

amount that would be lost if Department 1 were dropped. (Our simple example assumes that the fixed administrative expenses are *truly* fixed—that none of them would be eliminated if this department were dropped.)

A contribution-margin income statement shows the contribution of each department more clearly, including its contribution to both fixed costs and profit. As long as a department has some contribution-margin, and as long as there is no better use for the resources it uses, the department should be retained.

Contribution-margin versus full-cost—choose your side

Using the full-cost approach often leads to arguments within a company. Any method of allocation can make some products or customers appear less profitable.

For example, it's logical to assign all common advertising costs to customers based on their purchases. But this approach can be criticized on the grounds that it may make large-volume customers appear less profitable than they really are—especially if the marketing mix aimed at the larger customers emphasizes price more than advertising.

Those in the company who want the smaller customers to look more profitable usually argue *for* this allocation method on the grounds that general advertising helps build good customers because it affects the overall image of the company and its products.

Arguments over allocation methods can be deadly serious. The method used may reflect on the performance of various managers—and it may affect their salaries and bonuses. Product managers, for example, are especially interested in how the various fixed and common costs are allocated to their products. Each, in turn, might like to have costs shifted to others' products.

Arbitrary allocation of costs also may have a direct impact on sales reps' morale. If they see their variable costs loaded with additional common or fixed costs over which they have no control, they may ask, "What's the use?"

To avoid these problems, firms often use the contribution-margin approach. It's especially useful for evaluating alternatives and for showing operating managers and salespeople how they're doing. The contribution-margin approach shows what they've actually contributed to covering general overhead and profit.

Top management, on the other hand, often finds full-cost analysis more useful. In the long run, some products, departments, or customers must pay for the fixed costs. Full-cost analysis has its place too.

Planning and Control Combined

We've been treating sales and cost analyses separately up to this point. But management often combines them to keep a running check on its activities—to be sure the plans are working—and to see when and where new strategies are needed.

Sales + Costs + Everybody helps = $163,000

Let's see how this works at Cindy's Fashions, a small-town apparel retailer. This firm netted $155,000 last year. Cindy Reve, the owner, expects no basic change in competition and slightly better local business conditions. So she sets this year's profit objective at $163,000—an increase of about 5 percent.

Next she develops tentative plans to show how she can make this higher profit. She estimates the sales volumes, gross margins, and expenses—broken down by months and by departments in her store—that she would need to net $163,000.

Exhibit 19-14 is a planning and control chart Reve developed to show the contribution each department should make each month. At the bottom of Exhibit 19-14, the plan for the year is summarized. Note that space is provided to insert the actual performance and a measure of variation. So this chart can be used to do both planning and control.

Exhibit 19-14 shows that Reve is focusing on the monthly contribution to overhead and profit by each department. The purpose of monthly estimates is to get more frequent feedback and allow faster adjustment of plans. Generally, the shorter

Exhibit 19-14 Planning and Control Chart for Cindy's Fashions

	Contribution to Store							Cumulative
						Store	Operating	Operating
	Dept. A	Dept. B	Dept. C	Dept. D*	Total	Expense	Profit	Profit
January								
Planned	27,000	9,000	4,000	−1,000	39,000	24,000	15,000	15,000
Actual								
Variation								
February								
Planned	20,000	6,500	2,500	−1,000	28,000	24,000	4,000	19,000
Actual								
Variation								
November								
Planned	32,000	7,500	2,500	0	42,000	24,000	18,000	106,500
Actual								
Variation								
December								
Planned	63,000	12,500	4,000	9,000	88,500	32,000	56,500	163,000
Actual								
Variation								
Total								
Planned	316,000	70,000	69,000	−4,000	453,000	288,000	163,000	163,000
Actual								
Variation								

*The objective of minus $4,000 for this department was established on the same basis as the objectives for the other departments—that is, it represents the same percentage gain over last year when Department D's loss was $4,200. Plans call for discontinuance of the department unless it shows marked improvement by the end of the year.

the planning and control period, the easier it is to correct problems before they become emergencies.

In this example, Reve uses a modified contribution-margin approach—some of the fixed costs can be allocated logically to particular departments. On this chart, the balance left after direct fixed and variable costs are charged to departments is called Contribution to Store. The idea is that each department will contribute to covering *general* store expenses—such as top-management salaries and holiday decorations—and to net profits.

In Exhibit 19-14, we see that the whole operation is brought together when Reve computes the monthly operating profit. She totals the contribution from each of the four departments, then subtracts general store expenses to obtain the operating profit for each month.

As time passes, Reve can compare actual sales with what's projected. If actual sales were less than projected, corrective action could take either of two courses: improving implementation efforts or developing new, more realistic strategies.

The Marketing Audit

While crises pop up, planning and control must go on

The analyses we've discussed so far are designed to help a firm plan and control its operations. They can help a marketing manager do a better job. Often, however, the control process tends to look at only a few critical elements, such as sales variations by product in different territories. It misses such things as the effectiveness of present and possible marketing strategies and mixes.

The marketing manager usually is responsible for day-to-day implementing as well as planning and control and may not have the time to evaluate the effectiveness of the firm's efforts. Sometimes crises pop up in several places at the same time. Attention must focus on adjusting marketing mixes or on shifting strategies in the short run.

To make sure that the whole marketing program is evaluated *regularly*, not just in times of crisis, marketing specialists developed the marketing audit. A marketing audit is similar to an accounting audit or a personnel audit, which businesses have used for some time.

The **marketing audit** is a systematic, critical, and unbiased review and appraisal of the basic objectives and policies of the marketing function and of the organization, methods, procedures, and people employed to implement the policies.[12]

A marketing audit requires a detailed look at the company's current marketing plans to see if they are still the best plans the firm can offer. Customers' needs and attitudes change—and competitors continually develop new and better plans. Plans more than a year or two old may be out-of-date or even obsolete. Sometimes marketing managers are so close to the trees that they can't see the forest. An outsider can help the firm see whether it really focuses on some unsatisfied needs and offers appropriate marketing mixes. Basically, the auditor uses our strategy planning framework. But instead of developing plans, the auditor works backward and evaluates the plans being implemented. The consultant-auditor also evaluates the quality of the effort—looking at who is doing what and how well. This means interviewing customers, competitors, channel members, and employees. A marketing audit can be a big job. But if it helps ensure that the company's strategies are on the right track and being implemented properly, it can be well worth the effort.

An audit shouldn't be necessary—but often it is

A marketing audit takes a big view of the business—and it evaluates the whole marketing program. It might be done by a separate department within the company, perhaps by a marketing controller. But to get both expert and objective evaluation, it's probably better to use an outside organization such as a marketing consulting firm.

Ideally, a marketing audit should not be necessary. Good managers do their best in planning, implementing, and control—and they should continually evaluate the effectiveness of the operation. In practice, however, managers often become identified with certain strategies, and pursue them blindly, when other strategies might be more effective. Since an outside view can give needed perspective, marketing audits may be more common in the future.

Conclusion

In this chapter, we've focused on the important role of implementation and control in satisfying customers and the firm's ongoing success. We explained how improvements in information technology are playing a critical role in revolutionizing these areas. Managers should seek new and creative ways to improve implementation, which can often give a firm a competitive advantage in building stronger relationships with customers, even in highly competitive mature markets.

We also went into some detail on how total quality management can help the firm get the type of implementation it needs—implementation that continuously improves and does a better job of meeting customers' needs and at lower cost.

A marketing program must also be controlled. Good control helps the marketing manager locate and correct weak spots and at the same time find strengths that may be applied throughout the marketing program. Control works hand in hand with planning.

Simple sales analysis just gives a picture of what happened. But when sales forecasts or other data showing expected results are brought into the analysis, we can evaluate performance—using performance indexes.

Cost analysis also can be useful. There are two basic approaches to cost analysis—full-cost and contribution-margin. Using the full-cost approach, all costs are allocated in some way. Using the contribution-margin approach, only the variable costs are allocated. Both methods have their advantages and special uses.

Ideally, the marketing manager should arrange for a constant flow of data that can be analyzed routinely, preferably by computer, to help control present plans and plan new strategies. A marketing audit can help this ongoing effort. Either a separate department within the company or an outside organization may conduct this audit.

Questions and Problems

1. Give an example of how a firm has used information technology to improve its marketing implementation and do a better job of meeting your needs.
2. Should marketing managers leave it to the accountants to develop reports that the marketing manager will use to improve implementation and control? Why or why not?
3. Give an example of a firm that has a competitive advantage because of the excellent job it does with implementation activities that directly impact customer satisfaction. Explain why you think your example is a good one.
4. What are the major advantages of total quality management as an approach for improving implementation of marketing plans? What limitations can you think of?
5. If you were asked to recommend a firm (with which you have dealt) as a benchmark for good customer service after the sale, what firm would you recommend? What does this firm do that other firms do not do as well?

6. Various breakdowns can be used for sales analysis depending on the nature of the company and its products. Describe a situation (one for each) where each of the following breakdowns would yield useful information. Explain why.
   a. By geographic region.
   b. By product.
   c. By customer.
   d. By size of order.
   e. By size of sales rep commission on each product or product group.
7. Distinguish between a sales analysis and a performance analysis.
8. Carefully explain what the iceberg principle should mean to the marketing manager.
9. Explain the meaning of the comparative performance and comparative cost data in Exhibits 19-4 and 19-5. Why does it appear that eliminating sales areas D and E would be profitable?
10. Most sales forecasting is subject to some error (perhaps 5 to 10 percent). Should we then expect variations in sales performance of 5 to 10 percent above or below quota? If so, how should we treat such variations in evaluating performance?
11. Why is there controversy between the advocates of the full-cost and the contribution-margin approaches to cost analysis?
12. The June profit and loss statement for the Browning Company is shown. If competitive conditions make price increases impossible and management has cut costs as much as possible, should the Browning Company stop selling to hospitals and schools? Why?

Browning Company Statement

	Retailers	Hospitals and Schools	Total
Sales:			
80,000 units at $0.70	$56,000		$56,000
20,000 units at $0.60		$12,000	12,000
Total	56,000	12,000	68,000
Cost of sales	40,000	10,000	50,000
Gross margin	16,000	2,000	18,000
Sales and administrative expenses:			
Variable	6,000	1,500	7,500
Fixed	5,600	900	6,500
Total	11,600	2,400	14,000
Net profit (loss)	$ 4,400	$ (400)	$ 4,000

13. Explain why a marketing audit might be desirable, even in a well-run company. Who or what kind of an organization would be best to conduct a marketing audit? Would a marketing research firm be good? Would the present CPA firms be most suitable? Why?

Suggested Cases

33. Huntoon & Balbiera, P.C.

35. Romano's Take-Out, Inc.

Computer-Aided Problem

19. **Marketing Cost Analysis**

This problem emphasizes the differences between the full-cost approach and contribution-margin approach to marketing cost analysis.

Tapco, Inc., currently sells two products. Sales commissions and unit costs vary with the quantity of each product sold. With the full-cost approach, Tapco's administrative and advertising costs are allocated to each product based on its share of total sales dollars. Details of Tapco's costs and other data are given in the spreadsheet. The first column shows a cost analysis based on the full-cost approach. The second column shows an analysis based on the contribution-margin approach.

a. If the number of Product A units sold were to increase by 1,000 units, what would happen to the allocated administrative expense for Product A? How would the change in sales of Product A affect the allocated administrative expense for Product B? Briefly discuss why the changes you observe might cause conflict between the product managers of the two different products.

b. *What would happen to total profits if Tapco stopped selling Product A but continued to sell 4,000 units of Product B? What happens to total profits if the firm stops selling Product B but continues to sell 5,000 units of Product A? (Hint: To stop selling a product means that the quantity sold would be zero.)*

c. *If the firm dropped Product B and increased the price of Product A by $2.00, what quantity of Product A would it have to sell to earn a total profit as large as it was originally earning with both products? (Hint: Change values in the spreadsheet to reflect the changes the firm is considering, and then use the What If analysis to vary the quantity of Product A sold and display what happens to total profit.)*

For additional questions related to this problem, see Exercise 19-3 in the *Learning Aid for Use with Basic Marketing,* 14th edition.

When You Finish This Chapter, You Should

1. Understand why turning a marketing plan into a profitable business requires money, information, people, and a way to get or produce goods and services.

2. Understand the ways that marketing strategy decisions may need to be adjusted in light of available financing.

3. Understand how a firm can implement and expand a marketing plan using internally generated cash flow.

4. Understand how different aspects of production capacity and flexibility should be coordinated with marketing strategy planning.

5. Understand the ways that the location and cost of production affect marketing strategy planning.

6. Know how marketing managers and accountants can work together to improve analysis of the costs and profitability of specific products and customers.

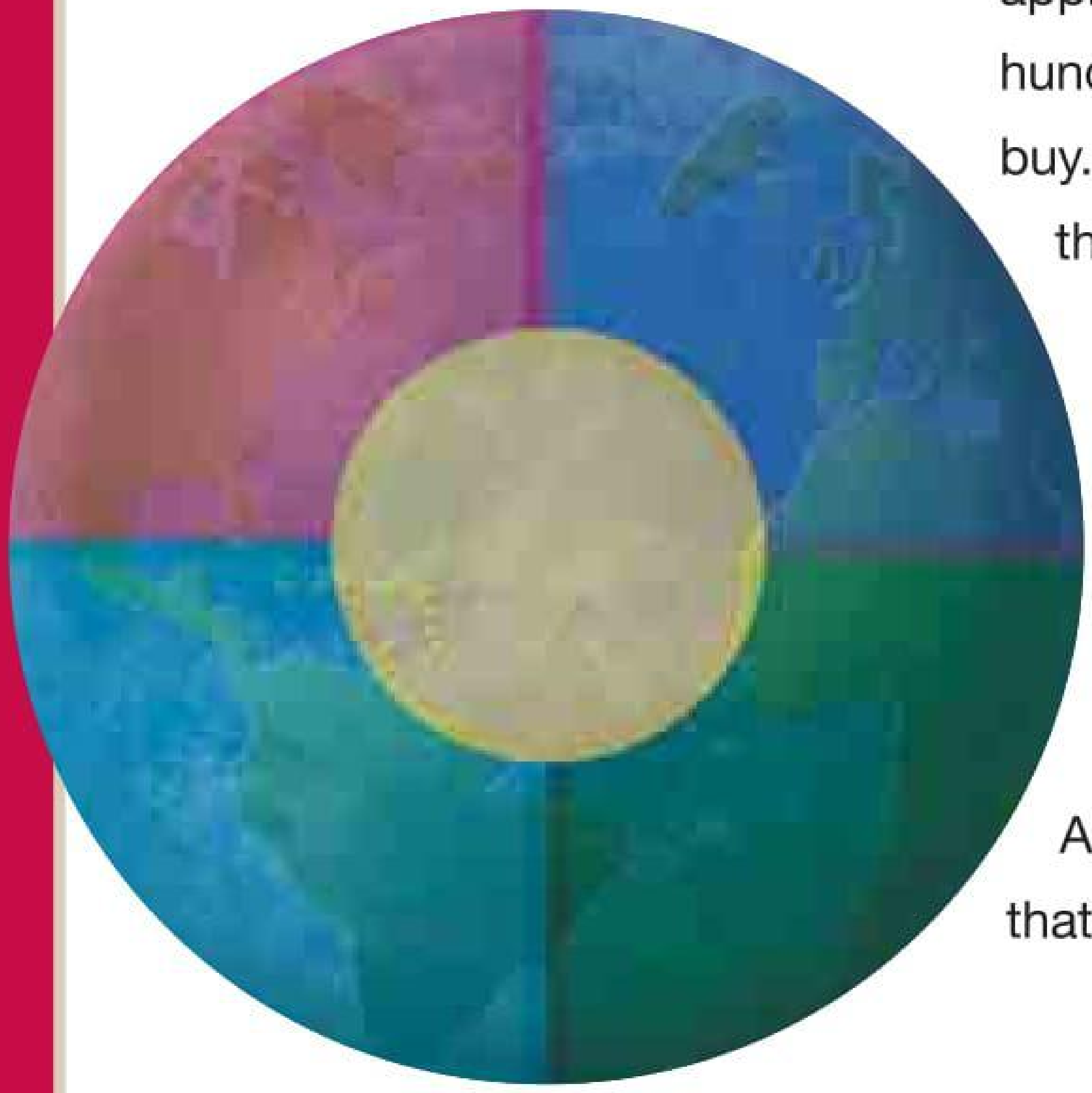
7. Know some of the human resource issues that a marketer should consider when planning a strategy and implementing a plan.

8. Understand the important new terms (shown in red).

Chapter Twenty

Managing Marketing's Link with Other Functional Areas

Illinois Tool Works, Inc. (www.itwinc.com) produces and sells thousands of products—ranging from nuts, bolts, screws, nails, and plastic fasteners to sophisticated equipment—like its new robot that automates the manufacture of picture frames by taking molding directly from a high-speed saw and then automatically joining the pieces into a complete picture frame with virtually no labor required. ITW's fasteners are hidden inside or attached to appliances, cars, computers, and hundreds of other products you buy. One key to ITW's success is that it is fast and creative in identifying target markets with specific needs, developing products—actually whole marketing mixes—and then implementing plans to meet the target market's needs.



Another key to ITW's success is that managers from different

price

place

produc

promotion

areas—such as production, finance, accounting, and human resources—work closely with the marketing people to be certain that market opportunities are turned into profitable strategies.

Some competing firms make the mistake of defining their markets in terms of the products they've always produced (for example, the "screw market" or the "bolt market"). By contrast, ITW defines markets in terms of customer needs. And often ITW finds that what a customer needs is not a screw or a bolt but something entirely new. As one simple example, factories assemble millions of panels that enclose electronic products like computers and medical equipment. The tiny nuts and bolts typically used to fasten the panels require tools, and users often drop them when they need to open a panel. So ITW created the perfect one-piece plastic fastener. It costs less and simplifies production because it pops into place and there's only one piece to inventory. Users can release it with a twist of their fingers, and it stays attached to the panel so it can't get lost.

The ITW approach of starting with customer needs often requires more than a marketing plan. It often requires new resources—new production capabilities, money to put the plan into operation, and people with new skills.

You can appreciate ITW's approach if you consider the origin of the now-common plastic buckle. The start was simple. A firm that produces life jackets needed a better way to fasten them. ITW's salespeople and R&D people teamed up to develop just the right product for this customer. The result: a durable, safety-rated plastic buckle. ITW had the money to quickly set up new production facilities for the buckle because its other established products were producing profits that ITW could reinvest. With production capacity in place, ITW targeted marketing mixes at other firms with similar needs. Today, there are hundreds of different types of ITW's Nexus brand buckles. To get a sense for the variety, check out ITWNexus.com. Millions of them are used not only in life jackets but in hundreds of other products, ranging from belts on swimsuits to straps on backpacks and safety helmets. Adding a wide variety of special buckles for these different markets quickly contributed to profits because most of the major fixed costs had already been covered.

ITW has developed many other innovative products and marketing mixes focused on the needs of specific market segments. For example, ITW makes Kiwi-Lok, a nylon fastener that New Zealand farmers use to secure their kiwi plants. It's not a fluke that ITW saw this unusual fastening need. As one ITW executive put it, "We try to sell where our competitors aren't"—one reason why ITW now serves customers from operations in more than 35 countries. Although ITW is a very large company with many different product lines, it is able to stay in close contact with its customers because all of its businesses are locally managed. At the same time, it expands its reach by maintaining more than 90 different websites for product lines focused at different sets of business customers (but you can link to any of the websites from ITW's home page at www.itwinc.com).

ITW organizes all of its activities, including how it sets up its factories, to adjust to the needs of distinct target markets. ITW serves large-volume segments with "focused factories" that concentrate on quickly producing large quantities of a single product line at a low cost. It handles limited production for small segments in special "batches" on equipment dedicated to short runs. This flexible approach helps ITW fill customers' orders faster than competitors—which is yet another reason for the company's success.[1]

Marketing in the Broader Context

The marketing concept says that everyone in a firm should work together to satisfy customer needs at a profit. Once a marketing strategy has been developed and turned into a marketing plan, the blueprint for what needs to be done is in place. So throughout the text we've developed concepts and how-to approaches relevant to marketing strategy planning, implementation, and control.

From the outset, we've emphasized that what is a good marketing strategy—selection of a target market and a marketing mix to meet target customers' needs—depends on the fit with the specific firm and its market environment—what it's able to do and what it wants to do. Now we'll broaden our view to take a closer look at some of the important ways that marketing links to other functional areas.

Cross-functional links affect strategy planning

Our emphasis is not on the technical details of other functional areas but rather on the most important ways that cross-functional links impact your ability to develop marketing strategies and plans that really work. See Exhibit 20-1.

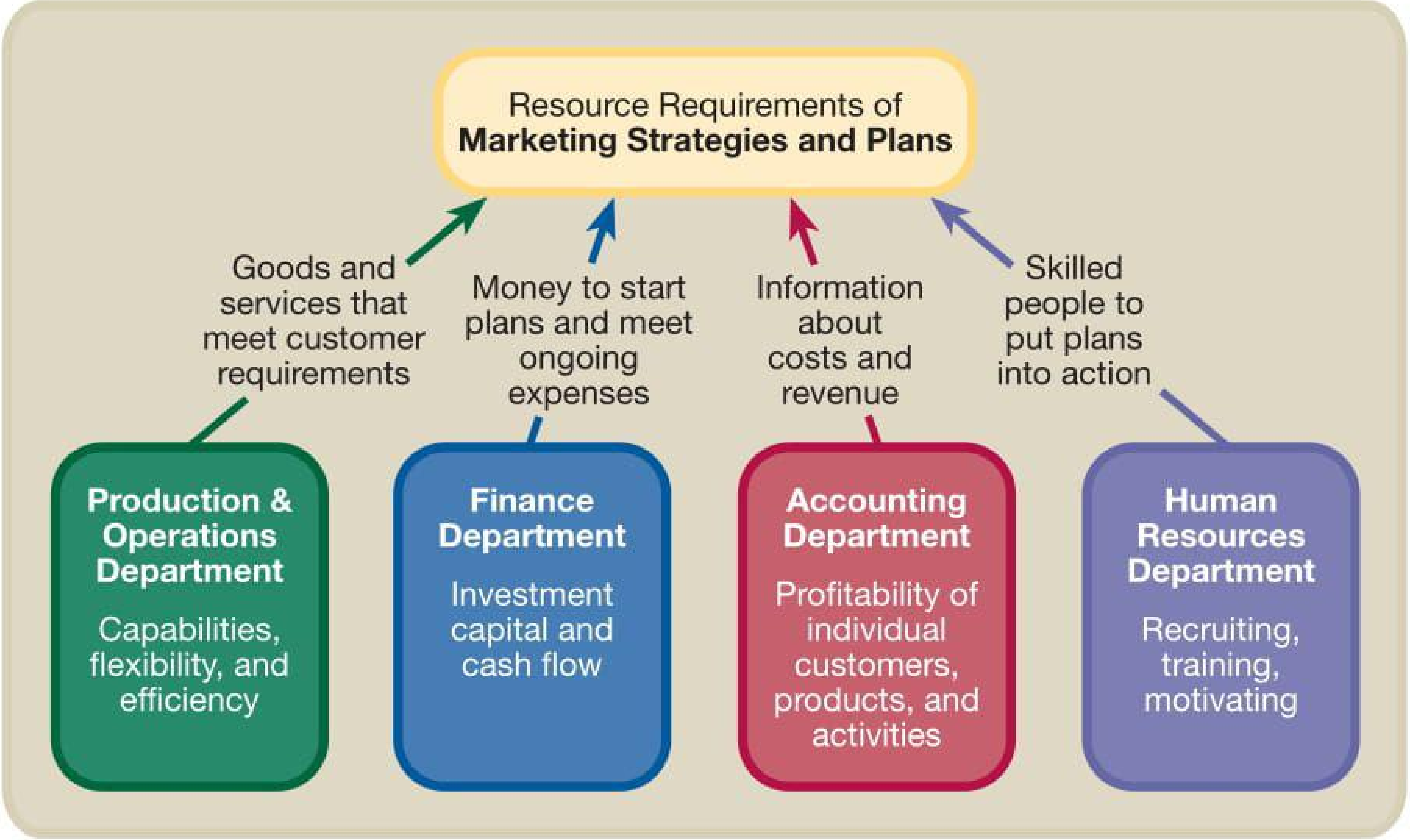
In firms with a marketing orientation, people from different functional areas work together to make certain that they satisfy the customer.

TO A NINE YEAR OLD, "OUT OF STOCK" MEANS "NO BIRTHDAY PRESENT."
GREAT PLAINS
www.greatplains.com

Implementing a marketing plan usually requires a financial investment—so we'll consider both money required to start up a new plan and the money needed to meet ongoing expenses. Then we'll look at production and operations and review how available production capacity, production flexibility, and operating issues impact marketing planning. We'll also take a closer look at how accounting people and marketing managers work together to get a better handle on marketing costs. We'll conclude with a discussion of human resource issues—because it's people who put plans into action.

How important the linkages with production, finance, accounting, and human resources are for the marketing manager depends on the situation. In an entrepreneurial dot-com start-up, the same person may be making all of the decisions. In a big company, managing the linkages among many specialists may be much more complicated.

Exhibit 20-1
Some Important Links between Marketing and Other Functional Areas


Resource Requirements of **Marketing Strategies and Plans**

Goods and services that meet customer requirements

Money to start plans and meet ongoing expenses

Information about costs and revenue

Skilled people to put plans into action

Production & Operations Department
Capabilities, flexibility, and efficiency

Finance Department
Investment capital and cash flow

Accounting Department
Profitability of individual customers, products, and activities

Human Resources Department
Recruiting, training, motivating

Cross-functional challenges are greatest with new efforts

Our emphasis will be on new efforts. When a new strategy involves only minor changes to a plan that the firm is already implementing, the specialists usually have a pretty good idea of how their activities link to other areas. However, when a potential strategy involves a more significant change—like the introduction of a totally new product idea—understanding the links between the different functional areas is usually much more critical.

The Finance Function: Money to Implement Marketing Plans

Chief financial officer handles money matters

Bright marketing ideas for new ways to satisfy customer needs don't go very far if there isn't enough money to put a plan into operation. Finding and allocating **capital**—the money invested in a firm—is usually handled by a firm's chief financial officer. Entrepreneurs and others who own their own companies may handle this job themselves. In most firms, however, there is a separate financial manager who works with the chief executive to make major finance decisions.

A firm's marketing manager and financial manager must work together to ensure that the firm can successfully implement its marketing plans with the money that is or will be available. Further, a successful strategy should ultimately generate profit. And the financial manager needs to know how much money to expect and when to expect it to be able to plan for how it will be used.

Opportunities compete for capital and budgets

Within an organization, different possible opportunities compete for capital. There's usually not enough money to do everything, so strategies that are inconsistent with the firm's financial objectives and resources are not likely to be funded. It's often best for the marketing manager to use relevant financial measures as quantitative screening criteria when evaluating various alternatives in the first place.

Marketing plans that *are* funded usually must work within a budget constraint. Ideally, the marketing manager should have some inputs on what that budget is—to get the marketing tasks done. Further, some strategy decisions may need to be adjusted, either in the short or long run, to work within the available budget. For example, a marketing manager might prefer to have control over the selling effort for a new product by hiring new people for a separate sales force. However, if there isn't enough money available for salesperson salaries, then the best alternative might be to start with manufacturers' agents. They work for a commission and aren't paid until after they generate a sale and some sales revenue. Then after the market develops and the plan becomes profitable, the firm might expand its own sales force.

When evaluating new opportunities, Unilever brings together a team of managers with experience around the world to be certain that marketing plans that the firm implements will give it a competitive advantage and earn a return that will be attractive to investors.

Working capital pays for short-term expenses

Financial managers usually think about two different uses of capital. First, capital may be required to pay for investments in facilities, equipment, computer networks, and other "fixed assets." These installations are usually purchased and then used, and depreciated, over a number of years. In addition, a firm needs **working capital**—money to pay for short-term expenses such as employee salaries, advertising, marketing research, inventory storing costs, and what the firm owes suppliers. A firm usually must pay for these ongoing expenses as they occur. As a result there is usually a continuing need for working capital.

Capital is usually a critical resource when a marketing plan calls for rapid growth—especially if the growth calls for expensive new facilities. Clearly, a plan to build a chain of 15 hotels requires more money for buildings and equipment, as well as more money for salaries, food, and supplies, than a plan for a single hotel. Such a plan might require that the firm borrow money from a commercial lender. In contrast, a plan that simply calls for improving the service in an existing hotel, perhaps by adding several people to handle room service, would require much less money. In fact, increased food sales from room service might quickly generate more than enough earnings to pay for the added people.

Capital comes from internal and external sources

As these examples imply, there are a number of different possible sources of capital. However, it's useful to boil them down to two categories: *external sources*, such as loans or sales of stocks or bonds, and *internal sources*, such as cash accumulated from the firm's profits. A firm usually seeks outside funding in advance of when it is needed to invest in a new strategy. Internally generated profits may be accumulated and used in the same way, but often internal money is used as it becomes available. In other words, with internally generated funding a firm's marketing program may be expected to "pay its own way."

The timing of when financing is available has an important effect on marketing strategy planning, so we'll look at this topic in more detail. We'll start by looking at external sources of funds.

External funding—investors expect a return

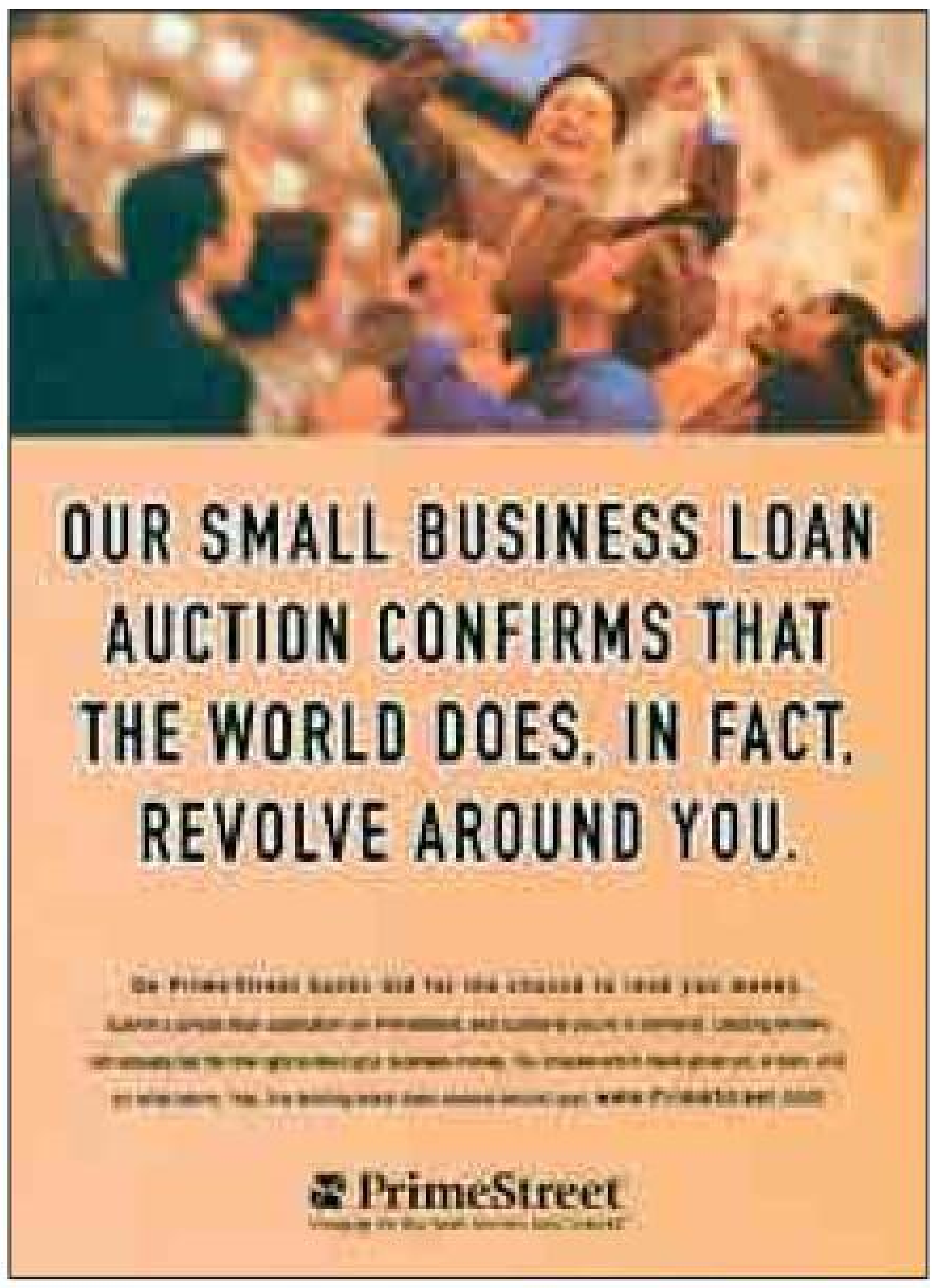
While a firm might like to fund its marketing program from rapid growth in its own profits, that is not always possible. New companies often don't have enough money to start that way. An established company with some capital may not have as much as it needs to make long-term investments and still have enough working capital for the routine expenses of implementing a plan. Getting started may also involve losses, perhaps for several years, before earnings come in. In these circumstances, the firm may need to turn to one of several sources of external capital.

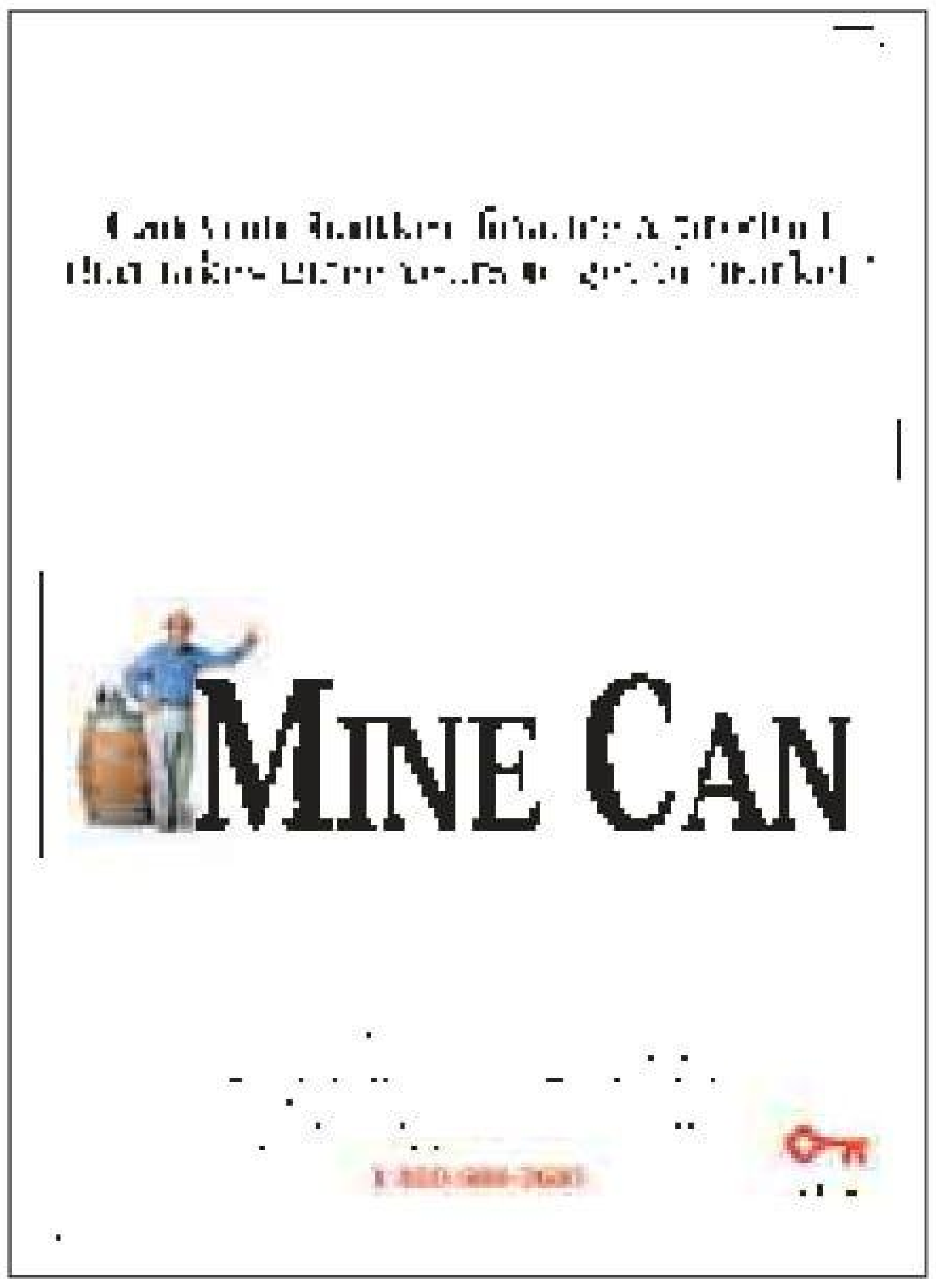
A firm may be able to raise money by selling **stock**—a share in the ownership of a company. Stock sales may be public or private, and the buyers may be individuals, including a firm's own employees, or institutional investors (such as a pension fund or venture capital firm).

People who own stock in a firm want a good return on their investment. That can happen if the company pays owners of its stock a regular dividend. It also happens if the value of the stock goes up over time. Neither is likely if the firm isn't consistently earning profits. Further, the value of a firm's stock typically doesn't increase unless its profits are *growing*. This is one reason that marketing managers are always looking for profitable new growth opportunities. Profits can also improve by being more efficient—getting the marketing jobs done at lower cost, doing a better job holding on to customers, and the like. Ultimately, a firm that doesn't have a successful or at least promising marketing strategy can't attract and keep investors.

On the other hand, it's a sad reality that a firm with a great strategy can't always attract investors. As in other aspects of business, investors sometimes get caught up in a current fad. One week they want to invest in *any* new biotech firm, and then the next week the only thing that gets their attention is the stock, say, for a dot-com

A firm that has a promising marketing plan will usually have more success in obtaining financial resources from external lenders or investors.


OUR SMALL BUSINESS LOAN AUCTION CONFIRMS THAT THE WORLD DOES, IN FACT, REVOLVE AROUND YOU.
On PrimeStreet banks bid for the chance to lend you money.
PrimeStreet


Can your banker finance a product that takes [illegible] years to get to market?
MINE CAN

business. They don't even stop to figure out if the firm's specific plan makes sense—because it's the Internet label that makes it hot. Oddly, by the time a type of business has attracted enough attention to have fad value to investors there's already likely to be a lot of competition. Then it's usually too late to have an innovative strategy.

Investors' time horizon is important

The time horizon for profit and growth that investors have in mind can be very important to the marketing manager. If investors are patient and willing to wait for a new strategy to become profitable, a marketing manager may have the luxury of developing a plan that will be very profitable in the long run even if it racks up short-term losses. Many Japanese firms take this approach. However, most marketing managers face intense pressure to develop plans that will generate profits quickly; there's more risk for investors if potential profits are off in the future.

It is often a challenge to develop a plan that produces profit in the short term and also positions the firm for long-run success. For example, a low penetration price for a new product may help to prevent competition and to attract repeat purchasers long into the future. Yet a skimming price may be better for profits in the short term. Even so, the marketing manager's plans must take the investors' time horizon into consideration. Unhappy investors can demand new management or put their money somewhere else.

Forecasts may become an ethical issue

Investors usually want detailed information about a firm's plans before they invest money in the firm's stock. The firm's financial people usually provide this information, but financial estimates don't mean much unless they're based on realistic estimates of demand, revenue, and marketing expenses from the marketing manager. An optimistic marketing manager may be hesitant to lay out the potential limitations of a plan or its forecasts—especially if the full story might scare off needed investors. However, this is an important ethical issue. While investors know that there is always some uncertainty in forecasts, they have a right to information that is as accurate as possible. Put another way, just as a marketing manager shouldn't mislead a buyer of the firm's products, it's not appropriate to mislead investors who are buying into the firm's marketing plan.

Debt financing involves an interest cost

Rather than sell stock, some firms prefer **debt financing**—borrowing money based on a promise to repay the loan, usually within a fixed time period and with a specific interest charge. This might involve a loan from a commercial bank or the use of corporate bonds. People or institutions that loan the money typically do not get an ownership share in the company, and they are usually even less willing to take a risk than are investors who buy stock.

Most commercial banks are conservative. They usually won't loan money to a firm that doesn't have some valuable asset to put up as a guarantee that the lender will get its money. Investors who buy a firm's bonds are also very concerned about security—but they often don't have a legal right to some specific assets if the firm can't repay the borrowed money when it's due. In general, the greater the risk that the lender takes on to provide the loan, the greater the interest rate charge will be.

Interest expense may impact prices

The cost of borrowing money can be a real financial burden. Just as a firm's selling price must cover all of the marketing expenses and the other costs of doing business before profits begin to accumulate, it must also cover the interest charge on borrowed money. The impact of interest charges on prices can be significant. For example, the spread between the prices charged by fast-growing, efficient supermarket chains and individual grocery stores would be even greater if the chains weren't paying big interest charges on loans to fund new facilities.

While the cost of borrowing money can be high, it may still make sense if the money is used to implement a marketing plan that earns an even greater return. In that way, the firm leverages the borrowed money to make a profit. Even so, there are often advantages if a firm can pay for its plans with internally generated capital.[2]

Winning strategies generate capital

A company with a successful marketing strategy has its own internal source of funds—profits that become cash in the bank!

For example, the building-supply company, Home Depot, reported a profit of just over $600 million from running its businesses in 1994. The company only paid out about 11 percent of that money as dividends to its stockholders. The stockholders liked it that way because Home Depot used the remaining half a billion dollars to open 126 new stores. And by financing stores in this fashion its profits grew to about $940 million by the beginning of 1997.[3]

Reinvesting cash generated from operations is usually less expensive than borrowing money because no interest expense is involved. So internal financing often helps a firm earn more profit than a competitor that is operating on borrowed money—even if the internally financed company is selling at a lower price.

Expanding profits may support expanded plan

Firms that can't get a loan or that don't want the expense of borrowed money often start with a less costly strategy and a plan to expand it as quickly as is allowed by earnings. Consider the case of Sorrell Ridge, a small company that wanted to compete with the jams and jellies of big competitors like Welch's and Smucker's. Sorrell Ridge started small with a strategy that focused on a better product—"spreadable fruit" with no sugar added—that was targeted at health-conscious consumers. After paying to update its production facilities, Sorrell Ridge didn't have much working capital to pay for promotion and other marketing expenses. So it turned to health-food wholesalers and retailers to give the product a promotion push in the channel. As profits from the health-food channel started to grow, Sorrell Ridge used some of the money for local TV and print ads in big cities in the Northeast. The ads increased consumer demand for Sorrell Ridge's spreads and helped get shelf space from supermarkets in that region. Success from selling through supermarkets in the Northeast generated more volume and profit, which provided Sorrell Ridge with the financial base to enter the big California market. The big supermarket chains there wouldn't consider carrying a new fruit spread without a lot of trade promotion, including hefty stocking allowances. Sorrell Ridge had the money to pay for a coupon program to stimulate consumer trial, but that didn't leave enough money for the stocking allowance. However, the marketing manager had a creative idea that involved giving retailers the stocking allowance in the form of a credit against future purchases rather than cash up front. With a plan for that blend of trade and consumer promotion in place, one of the best food brokers in California agreed to take on the line. And expanding into the new market resulted in profitable growth.[4]

As the Sorrell Ridge case shows, a firm with limited resources can sometimes develop a plan that allows for growth through internally generated money. On the other hand, a company with a mature product that has limited growth potential can invest the earnings from that product in developing a new opportunity that is more profitable. Lotus Development, the software company, is a good example. It used profits from its Lotus 1-2-3 spreadsheet, which faced tough competition from Microsoft's Excel, to fund the development of Lotus Notes, an innovative product for the fast-growing segment of computer users who wanted an easy way to communicate with other networked members of their work group.

Cash flow looks at when money will be available

A marketing manager who wants to plan strategies based on the expected flow of internal funding needs a good idea of how much cash will be available. A **cash flow statement** is a financial report that forecasts how much cash will be available after paying expenses. The amount that's available isn't always just the bottom line or net profit figure shown on the firm's operating statement. Some expenses, like depreciation of facilities, are subtracted from revenue for tax and accounting purposes but do not actually involve writing a check. So in determining cash flow, managers often look at a company's earnings *before* subtracting out these noncash expenses.[5]

Adjusting the strategy to money that's available

Most firms rely on a combination of internal and external capital. An adequate overall amount of capital makes it possible to expand more rapidly or to implement a more ambitious plan from the outset. However, when a marketing manager must rely, at least in part, on internally generated funds to make a strategy self-supporting, that may need to be considered in selecting between alternative strategies or in specific marketing mix decisions for a given strategy.

Improve return of current investment

When finances are tight, it's sensible to look for strategy alternatives that help get a better return on money that's already invested. A firm that sells diagnostic equipment to hospitals might look for another related product for its current salespeople to sell while calling on the same customers. Similarly, a firm that has a successful domestic product might look for new international markets where little or no modification of the product would be required. A firm that is constantly fighting to rewin customers might be better off with a program that offers loyal customers a discount; the increase in the number of customers served might more than offset the lost revenue per sale. Any increase in revenue and profit contribution that the strategy generates—without increasing fixed costs and capital invested—increases profit and the firm's return on investment.

Market mix decisions affect capital needed

Strategy decisions within each of the marketing mix areas often have significantly different capital requirements. For example, offering more models, package sizes, flavors, or colors of a product will almost certainly increase front-end capital needs and increase costs.

Place decisions often have significant financial implications, depending on how responsibilities are shifted and shared in the channel. Indirect distribution usually requires less investment capital than direct approaches. Merchant wholesalers and retailers who pay for products when they purchase them, and who pay the costs of carrying inventory, help a producer's cash flow. Working with public warehousers and transportation firms may help reduce the capital requirements for logistics facilities.

Promotion blends that focus on stimulating consumer pull usually require a big front-end investment in advertising and consumer promotions. For example, it's not unusual for a consumer packaged goods producer to spend half of a new product's first-year sales revenue on advertising. Thus, it may be less risky for a firm with limited capital to put more emphasis on a strategy that relies on push rather than pull. Similarly, capital requirements are less when intermediaries take on much of the responsibility for promotion in the channel.

Production Must Be Coordinated with the Marketing Plan

Production capacity takes many forms

In screening product-market opportunities, a marketing manager needs to have a realistic understanding of what is involved in turning a product concept into something the firm can really deliver. If a firm is going to pursue an opportunity, it's also critical that there be effective coordination between marketing planning and **production capacity**—the ability to produce a certain quantity and quality of specific goods or services.

Different aspects of production capacity have different impacts on marketing planning, so we'll consider this topic in more depth.[6]

Use excess capacity to improve profits

If a firm has unused production capacity, it's sensible for a marketing manager to try to identify new markets or new products that make more effective use of that investment. For example, a company that produces rubber floor mats for automobiles might be able to add a similar line of floor mats for pickup trucks. Expanded production might result in lower costs and better profits for the mats the firm was already producing—because of economies of scale. In addition, revenue and profit contribution from the new products could improve the return on investment the firm had already made.

If a firm's production capacity is flexible, many different marketing opportunities might be possible. For example, in light of growing consumer interest in fancy sport utility vehicles, the marketing manager for the firm above might see even better profit potential in color-coordinated rubber cargo area liners than in commodity floor mats. Opportunities further away from its current markets might be relevant too. For example, there might be better growth and profits in static-electricity-free mats for Internet server equipment than for auto accessories.

Excess capacity may be a safety net

While excess capacity can be costly, it can also serve as a safety net if demand suddenly picks up. For example, many firms that make products for the construction industry faced costly excess capacity during the early 1990s. However, many of those firms were glad that they had that capacity when construction turned into a booming market a few years later. Whether excess capacity is a wasteful cost or a safety net for handling unexpected demand depends on the opportunity costs and likelihood of the two situations.

Or it may be a signal of problems

Excess capacity may exist because the market for what a firm can produce never really materialized or has moved into long-term decline. Excess capacity may also indicate that there's too much competition—with many other firms all fighting for the same fixed demand. In situations like these, rather than struggling to find minor improvements in capacity use, it might be better for the marketing manager to lead the firm toward other, more profitable alternatives.

Slow adjustments result in stock-outs

Another aspect of flexibility concerns how quickly and easily a firm can adjust the quantity of a product it produces. This can be especially important when demand is uncertain. If a new marketing mix is more successful than expected, demand can quickly outstrip supply. This happened to Frito-Lay when it developed WOW! fat-free snack chips using its Olestra fat substitute. It was hard to predict how people would react to the chips because the FDA required a warning label that the chips might cause abdominal cramping and diarrhea. That's not exactly the message the brand manager wanted the package to send! Even so, diet-conscious chip lovers were so enthusiastic about the chips that they were quickly out-of-stock at most supermarkets.[7]

Scarce supply wastes marketing effort

This kind of problem can be serious. Promotion spending is wasted if supply can't keep up with demand. Further, stock-outs frustrate both consumers and channel members. This may give a more nimble competitor the opportunity to introduce an imitation product. By the time the original innovator is able to increase production, consumers may already be loyal to the other brand.

Staged distribution may match capacity

Problems of matching supply and demand are likely to be greatest when a marketing plan calls for quick expansion into many different market areas all at once. That's one reason a marketing manager may plan a regional rollout of a new product. Similarly, initial distribution may focus on certain types of channels—say, drugstores alone rather than drugstores and supermarkets. Experience with the early stages of the implementation effort can help the marketing manager determine how much promotion effort is required to keep distribution channels full and avoid stock-outs.

Virtual corporations may not make anything at all

Many firms are finding that they can satisfy customers and build profits without doing any production in house. Instead, they look for capable suppliers to produce a product that meets the specs laid out in the firm's marketing plan. This is the

OK.
WHO
TOOK
THE
LAST
ONE
?
Kellogg's

Finally,
there's more
where this
came from.
Kellogg's

When Kellogg's introduced Rice Krispies Treats Squares, production couldn't keep up with the unexpectedly high demand. So Kellogg's used advertising to tell consumers and retailers about the shortages and to ask them to be patient. When the squares were back in stock, Kellogg's again used advertising to communicate with consumers.

A firm that outsources some or all of its production may have more flexibility to enter attractive new product-markets.

36
Diapers
Pañales
over 27 lbs
over 12 kg
UNITED COLORS
OF BENETTON
5
5

approach that Sara Lee is taking. It's selling off the factories that make its apparel products—brands like Champion and Hanes and Playtex. The idea is that Sara Lee will just buy the goods that it wants from independent manufacturers who will produce to its specs. The company thinks that this is attractive to investors because it moves the company away from running knitting machines, which "is a business of yesterday," and into the knowledge business of building its brands. However, this could be risky. Sara Lee will still be competing in a low-growth, mature market whether it does the manufacturing or someone else does. Further, the reputation of a brand often depends on the quality of the manufacturing behind it.

Of course, some firms are making this work and work well. At the extreme, a firm may even act like a **virtual corporation**—where the firm is primarily a coordinator—with a good marketing concept. Consider the case of Calvin Klein fashions. At one time Calvin Klein was a large manufacturer of underwear and jeans. However, the company was better at analyzing markets, designing fashions, and marketing them than it was at production. So the firm sold its factories and arranged for other companies to make the products that carry the Calvin Klein brand.[8]

Outsourcing production may increase a firm's flexibility in some ways, but costs are often higher, and it may be difficult or even impossible to control quality. Similarly, product availability may be unpredictable. If several firms are involved in producing the final product, coordination and logistics problems may arise.

A company with a line of accessories for bicycle riders faced this problem when it decided to introduce a water bottle. Its other products were metal, so it turned to outside suppliers to produce the plastic bottles. However, getting the job done required three suppliers. One made the bottles, another printed the colorful designs on them, and the third attached a clip to hold the bottle to a bike.

Moving the product from one specialist to another added costs, and whenever one supplier hit a snag, all of the others were affected. The firm was constantly struggling to fill orders on time, and too often it was losing the battle. To avoid these problems, the firm invested in its own production facilities.[9]

Design flexibility into operations

Because production flexibility can give a firm a competitive advantage in meeting a target market's needs better or faster, many firms are trying to design more flexibility into their operations. In fact, without flexible production it may not be possible for a firm to provide business customers with just-in-time delivery or rapid response to orders placed by EDI or some other type of e-commerce reorder system.

Producing to order requires flexibility too

By contrast, flexible manufacturing systems may make it possible for a firm to better respond to customer needs. This is a key advantage of Dell Computer's Internet order approach. Early on, most other computer firms produced large quantities of standardized computers and then shipped them to dealers for resale. If the dealer didn't have the right model in stock, it often took weeks to get it. Dell's approach allowed customers to order whatever computer configuration they wanted—then the parts were assembled to match the order. This reduced the cost of finished goods inventories, precisely matched output to customer needs, and kept everyone focused on satisfying each customer. It's been hard for firms like Compaq to directly copy this approach without alienating the dealers that it relies on. But it's trying a variation of the same idea. Compaq ships bare-bones computers to the dealer, and the dealer's service department installs the accessories that the customer wants. Here flexibility is achieved by combining efforts at different levels of the channel.[10]

Mass customization—serves individual needs

Of course, automobile companies, producers of specialized machine tools, and other types of manufacturers, as well as many service firms, have been creating products based on specific orders from individual customers for a long time. However, a wide variety of companies are now looking for innovative ways to serve smaller segments of customers by using **mass customization**—tailoring the principles of mass production to meet the unique needs of individual customers.

Note that using the principles of mass production is not the same thing as trying to appeal to everyone in some mass market. With the mass-customization approach, a firm may still focus on certain market segments within a broad product-market. However, in serving individuals within those target segments it tries to get a competitive advantage by finding a low-cost way to give each customer more or better choices.

The changes that are coming with mass customization are illustrated by Levi's Personal Pair personalized jeans program for women, which is offered in select Levi's stores. With this program, a woman goes to a participating retail store and is carefully measured by a trained fit consultant. These measurements are entered into a computer that generates a pair of prototype trial jeans with these measurements. The customer tries on that prototype for fit; if necessary, other prototypes or modifications of measurements may be tried. When the customer is satisfied, the measurements are sent via computer to the Levi's factory, where sewing operators construct the jeans. In about three weeks, the jeans are ready at the store, or they can be shipped directly to the customer via express mail. The customer's measurements are kept in a database to make it easy to place future orders—perhaps in a different color, finish, or style.

Mass customization is not limited to consumer products. Andersen gives builders and architects a software disk that they use to design their own custom windows. Similarly, sales reps for ChemStation, a firm that produces industrial detergents, work closely with customers to understand their special cleaning needs—a car wash wants something very different from a metal-working plant. Then scientists in ChemStation develop just the right product—with the correct amount of foam,

Lear Corp. has designed modular, interchangeable components that make it possible for car buyers to customize their car interiors. This sort of mass customization could become available in the near future.

Baldor Electric Gets Wired for Worldwide Profits

Baldor Electric Company produces and markets electric motors. While sales in recent times have been depressed by a weak economy, Baldor has weathered bad markets in the past. One of the worst times was about 15 years ago. Back then, demand for electric motors was in a slump. Worse, producers in Asia were pumping out low-cost commodity-type motors from automated factories. The market was so tough that Westinghouse, the original developer of the electric motor, got out of the business altogether. Yet Baldor's sales have increased five times over since that time, and its profits have been on an upward trend. So how has Baldor, an old company in a mature market, achieved profitable growth?

Rather than trying to compete with motors like those available from many suppliers, Baldor focused on specific target markets. It came out with special motors, like the one to run heart pumps in hospitals or the 500-horsepower unit for rolling steel. The R&D group also added computer controllers to motors to improve their value to the customer and to work with factory automation systems that are replacing old approaches. In fact, Baldor's innovations recently earned a "Product of the Year" Gold Award from a major trade magazine. That kind of publicity brings in inquiries and gives Baldor's knowledgeable sales reps the chance to work with individual customers to help them increase their productivity. For example, in a recent sale Baldor's drive doubled the output from the equipment in a customer's factory. Individually, these specialized motors are not big sellers. Rather, Baldor's strategy takes advantage of flexible production to focus on getting higher margins on each motor.

Baldor also expanded distribution into 55 countries. And to make it easy for customers worldwide to get information, Baldor supplements its website (www.baldor.com) with an electronic catalog on a CD. Its CD includes CAD drawings, performance data, and installation manuals for over 2,500 Baldor motors. Product designers in customer-firms use it to pick the right motor, and it also helps the customer-firm train its employees. All of these innovations mean that Baldor can command a premium price.[11]

grease cutting, grit, and the like. After starting this program, ChemStation's profit margins doubled.[12]

Internet

Internet Exercise Nike offers an online service in which customers can design their own shoes. Go to the Nike website (www.nike.com), select *USA,* then select *Nike iD,* and check out this feature. What do you think are the major (1) strengths and (2) weaknesses of Nike's service?

Batched production requires inventories

If it is expensive for a firm to switch from producing one product (or product line) to another, it may have no alternative but to produce in large batches and maintain large inventories. Then it can supply demand from inventory while it is producing some other product. However, a firm that must pay the costs of carrying extra inventory to avoid stock-outs may not be able to compete with a firm that has more flexible production.

Excess inventory that can't be sold using the firm's normal strategy can become a big problem. In some industries there are specialized middlemen whose primary job is to buy and liquidate excess inventories. There has been a significant increase in the buying and selling of excess, surplus, or obsolete inventory during the past few years, mainly because the Internet makes it possible for buyers to locate sellers and vice versa. Sometimes the inventory is sold with an online auction. The selling price may be high or low, depending on demand at that particular time.

Where products are produced matters

A marketing manager also needs to carefully consider the marketing implications of where products are produced. It often does make sense for a firm to produce where it can produce most economically, if the cost of transporting and storing products to match demand doesn't offset the savings. On the other hand, production in areas distant from customers can make the distribution job much more complicated.

(ALIEN W P)
(ALIEN WORKSHOP)

Alien Workshop, which markets skateboarding and snowboarding equipment and apparel, was growing rapidly and needed to move into larger facilities. Key Corp, a provider of financial services, helped the firm develop a plan that made its growth objectives achievable.

Offshore operations may complicate marketing

As an interesting example, consider the marketing implications of Hanes' decision to use offshore production for many of its men's underwear products. Buyers for mass-merchandiser chains, like Wal-Mart and Kmart, put constant pressure on Hanes to find ways to cut prices. That's why much of the sewing work on Hanes underwear is done in the Caribbean Islands where labor costs are low.

However, the only practical way to transport the bulky and inexpensive finished products back to the U.S. market is by boat. Boats are slow, and clearing customs can add further delays. At the port, the bulk cases of underwear must be handled again and broken down into quantities and assortments for shipping to the retailers' distribution centers. And at the distribution centers the cases need to be grouped with other products going to a specific store. All of these steps are necessary to meet customers' needs, but they also make it difficult to quickly adjust supply.[13]

Some critics object to overseas production

Marketing managers must be aware of and sensitive to criticisms that may arise concerning overseas production. Some of these concerns relate to nationalism. But other issues are sometimes at stake.

Although overseas production may reduce prices for domestic consumers, some critics argue that the costs are only lower because the work is handled in countries with lower workplace safety standards and fewer employee protections. At the extreme, some firms have been boycotted for relying on Chinese suppliers who were accused of using political prisoners as slave labor.

Marketing managers can't ignore such concerns. Just as a firm has a social responsibility in the country where it sells products, it also has a social responsibility to the people who produce its products. However, pay or safety standards that seem low in developed nations may make it possible for workers in an undeveloped nation to have a better, healthier life.[14]

Service firms may transfer some tasks

Firms that produce services often must locate near their customers. However, some service firms are finding ways to reduce the cost of some of their production work with **task transfer**—using telecommunications to move service operations to places where there are pools of skilled workers. For example, Bank of America puts its automatic teller machines and branch offices where they're convenient for customers, but many of the programmers who do its backroom computer work are in India.

Price must cover production costs

In Chapter 18, we analyzed various cost curves and how they fit, along with demand curves, into the pricing puzzle. Production costs are usually an important part of the overall costs that must be considered in pricing, so a marketing manager needs to have a reasonable understanding of the costs associated with production—especially when product features called for in the marketing plan drive costs.

Cut costs that don't add value for customers

A well-informed marketing manager can play an important role in working with production people to decide which costs are necessary to add value that meets customer needs and which are just added expense with little real benefit. For example, a software firm was providing a very detailed instruction book along with the disks in its distribution package. The book was running up costs and causing delays because it needed to be changed and reprinted every time the firm came out with a new version of its software. The marketing manager realized that most of the detail in the book wasn't necessary. When users of the software had a problem, they didn't want to search for the book but instead wanted the information on the computer screen. Providing the updated information on the disk was faster and cheaper than printing the book. Further, packaging costs were lower without the book. And as icing on the cake, customers were more satisfied with the online help.

In a situation like this, it is easy to identify specific costs associated with the production job. However, often it's difficult to get a good handle on all of the costs associated with a product without help from the firm's accountants.

Accounting Data Can Help in Understanding Costs and Profit

Accounting data that helps managers track where costs and profit are coming from is an important aid for strategy decisions. Unfortunately, accounting statements that are prepared for tax purposes and for outside investors often aren't helpful for managers who need to make decisions about marketing strategy.

Understanding profitability depends on being able to identify the specific costs of different goods and services. You saw this in the last chapter when two basic approaches to handling costs—the full-cost approach and the contribution-margin approach—resulted in different views of profitability. At that point, however, we didn't go into any detail about how marketing managers and accountants can work together to get a better understanding of costs—especially how to allocate costs that seem to be *common* to several products or customers making allocation of costs difficult. In recent years, some accountants have devoted more attention to approaches to this problem and given it the name "activity-based accounting." In spite of the new name, the basic ideas behind marketing cost analysis were developed years ago by a marketing specialist.[15]

Marketing cost analysis usually requires a new way of classifying accounting data. Instead of using the type of accounts typically used for financial analysis, we have to use functional accounts.

Natural versus functional accounts—what is the purpose?

Natural accounts are the categories to which various costs are charged in the normal financial accounting cycle. These accounts include salaries, wages, social security, taxes, supplies, raw materials, auto, gas and oil expenses, advertising, and others. These accounts are called natural because they have the names of their expense categories.

However, factories don't use this approach to cost analysis—and it's not the one we will use. In the factory, **functional accounts** show the *purpose* for which expenditures are made. Factory functional accounts include shearing, milling, grinding, floor cleaning, maintenance, and so on. Factory cost accounting records are organized so that managers can determine the cost of particular products or jobs and their likely contribution to profit.

Marketing managers often need to assign costs to specific products or customers to be able to understand the profitability of different possible strategies.

in progress

Marketing jobs are done for specific purposes too. With some planning, the costs of marketing can also be assigned to specific categories, such as customers and products. Then their profitability can be calculated.

Internet

Internet Exercise ITW, Inc., has a variety of different businesses that produce different products. ITW mainly targets business markets, but its ITW Brands division sells through home improvement retailers. Go to the ITW website (www.itwinc.com) and then select the list of other ITW websites. After you briefly review the descriptions of ITW's different websites, select *ITW Brands* and study it in more detail. From a cost standpoint, does it make sense to have a unit like ITW Brands? Why or why not?

First, get costs into functional accounts

The first step in marketing cost analysis is to reclassify all the dollar cost entries in the natural accounts into functional cost accounts. For example, the many cost items in the natural *salary* account may be allocated to functional accounts with the following names: storing, inventory control, order assembly, packing and shipping, transporting, selling, advertising, order entry, billing, credit extension, and accounts receivable. The same is true for rent, depreciation, heat, light, power, and other natural accounts.

The way natural account amounts are shifted to functional accounts depends on the firm's method of operation. It may require time studies, space measurements, actual counts, and managers' estimates.

Then reallocate to evaluate profitability of profit centers

The next step is to reallocate the functional costs to those items—or customers or market segments—for which the amounts were spent. The most common reallocation of functional costs is to products and customers. After these costs are allocated, the detailed totals can be combined in any way desired—for example, by product or customer class, region, and so on.

The costs allocated to the functional accounts equal, in total, those in the natural accounts. They're just organized differently. But instead of being used only to show *total* company profits, the costs can now be used to calculate the profitability of territories, products, customers, salespeople, price classes, order sizes, distribution methods, sales methods, or any other breakdown desired. Each unit can be treated as a profit center.

Exhibit 20-2
Profit and Loss Statement, One Month

Sales		$17,000
Cost of sales		11,900
Gross margin		5,100
Expenses:		
Salaries	$2,500	
Rent	500	
Wrapping supplies	1,012	
Stationery and stamps	50	
Office equipment	100	
		4,162
Net profit		$ 938

Cost analysis helps track down the loser

The following example illustrates these ideas. This case is simplified, and the numbers are small, so you can follow each step. However, you can use the same basic approach in more complicated situations.

In this case, the usual financial accounting approach, with natural accounts, shows that the company made a profit of $938 last month (Exhibit 20-2). But such a profit and loss statement doesn't show the profitability of the company's three customers. So the managers decide to use marketing cost analysis because they want to know whether a change in the marketing mix will improve profit.

First, we distribute the costs in the five natural accounts to four functional accounts—sales, packaging, advertising, and billing and collection (see Exhibit 20-3)—according to the functional reason for the expenses. Specifically, $1,000 of the total salary cost is for sales reps who seldom even come into the office since their job is to call on customers; $900 of the salary cost is for packaging labor; and $600 is for office help. Assume that the office force split its time about evenly between addressing advertising material and billing and collection. So we split the $600 evenly into these two functional accounts.

The $500 for rent is for the entire building. But the company uses 80 percent of its floor space for packaging and 20 percent for the office. Thus $400 is allocated to the packaging account. We divide the remaining $100 evenly between the advertising and billing accounts because these functions use the office space about equally. Stationery, stamps, and office equipment charges are allocated equally to the latter two accounts for the same reason. Charges for wrapping supplies are allocated to the packaging account because these supplies are used in packaging. In another

Exhibit 20-3 Spreading Natural Accounts to Functional Accounts

		Functional Accounts			
Natural Accounts		Sales	Packaging	Advertising	Billing and Collection
Salaries	$2,500	$1,000	$ 900	$300	$300
Rent	500		400	50	50
Wrapping supplies	1,012		1,012		
Stationery and stamps	50			25	25
Office equipment	100			50	50
Total	$4,162	$1,000	$2,312	$425	$425

Exhibit 20-4 Basic Data for Cost and Profit Analysis Example

Products	Cost/Unit	Selling Price/Unit	Number of Units Sold in Period	Sales Volume in Period	Relative "Bulk" per Unit	Packaging "Units"
A	$ 7	$ 10	1,000	$10,000	1	1,000
B	35	50	100	5,000	3	300
C	140	200	10	2,000	6	60
			1,110	$17,000		1,360

			Number of Each Product Ordered in Period		
Customers	Number of Sales Calls in Period	Number of Orders Placed in Period	A	B	C
Smith	30	30	900	30	0
Jones	40	3	90	30	3
Brown	30	1	10	40	7
Total	100	34	1,000	100	10

situation, different allocations and even different accounts may be sensible—but these work here.

Allocating functional cost to customers

Now we can calculate the profitability of the company's three customers. But we need more information before we can allocate these functional accounts to customers or products. It is presented in Exhibit 20-4.

Exhibit 20-4 shows that the company's three products vary in cost, selling price, and sales volume. The products also have different sizes, and the packaging costs aren't related to the selling price. So when packaging costs are allocated to products, size must be considered. We can do this by computing a new measure—a packaging unit—which is used to allocate the costs in the packaging account. Packaging units adjust for relative size and the number of each type of product sold. For example, Product C is six times larger than A. While the company sells only 10 units of Product C, it is bulky and requires 10 times 6, or 60 packaging units. So we must allocate more of the costs in the packaging account to each unit of Product C.

Exhibit 20-4 also shows that the three customers require different amounts of sales effort, place different numbers of orders, and buy different product combinations.

Jones seems to require more sales calls. Smith places many orders that must be processed in the office, with increased billing expense. Brown placed only one order—for 70 percent of the sales of high-valued Product C.

Exhibit 20-5 shows the computations for allocating the functional amounts to the three customers. There were 100 sales calls in the period. Assuming that all calls took the same amount of time, we can figure the average cost per call by dividing the $1,000 sales cost by 100 calls—giving an average cost of $10. We use similar reasoning to break down the billing and packaging account totals. Advertising during this period was for the benefit of Product C only—so we split this cost among the units of C sold.

Calculating profit and loss for each customer

Now we can compute a profit and loss statement for each customer. Exhibit 20-6 shows how each customer's purchases and costs are combined to prepare a statement

Exhibit 20-5
Functional Cost Account Allocations

Sales calls	$1,000/100 calls	=	$10/call
Billing	$425/34 orders	=	$12.50/order
Packaging units costs	$2,312/1,360 packaging units	=	$1.70/packaging unit or $1.70 for Product A $5.10 for Product B $10.20 for Product C
Advertising	$425/10 units of C	=	$42.50/unit of C

for each customer. The sum of each of the four major components (sales, cost of sales, expenses, and profit) is the same as on the original statement (Exhibit 20-2)—all we've done is rearrange and rename the data.

For example, Smith bought 900 units of A at $10 each and 300 units of B at $50 each—for the respective sales totals ($9,000 and $1,500) shown in Exhibit 20-6. We compute cost of sales in the same way. Expenses require various calculations. Thirty sales calls cost $300—30 × $10 each. Smith placed 30 orders at an average cost of $12.50 each for a total ordering cost of $375. Total packaging costs amounted to $1,530 for A (900 units purchased × $1.70 per unit) and $153 for B (30 units purchased × $5.10 per unit). There were no packaging costs for C because Smith didn't buy any of Product C. Neither were any advertising costs

Exhibit 20-6 Profit and Loss Statements for Customers

		Smith		Jones		Brown	Whole Company
Sales							
Product A	$9,000		$ 900		$ 100		
Product B	1,500		1,500		2,000		
Product C			600		1,400		
Total sales		$10,500		$ 3,000		$ 3,500	$17,000
Cost of Sales							
Product A	6,300		630		70		
Product B	1,050		1,050		1,400		
Product C			420		980		
Total cost of sales		7,350		2,100		2,450	11,900
Gross margin		3,150		900		1,050	5,100
Expenses							
Sales calls ($10 each)	300		400.00		300.00		
Order costs ($12.50 each)	375		37.50		12.50		
Packaging costs							
Product A	1,530		153.00		17.00		
Product B	153		153.00		204.00		
Product C			30.60		71.40		
Advertising			127.50		297.50		
		2,358		901.60		902.40	4,162
Net profit (or loss)		$ 792		$ (1.60)		$147.60	$ 938

charged to Smith—all advertising costs were spent promoting Product C, which Smith didn't buy.

Analyzing the results

We now see that Smith was the most profitable customer, yielding over 75 percent of the net profit.

This analysis shows that Brown was profitable too—but not as profitable as Smith because Smith bought three times as much. Jones was unprofitable. Jones didn't buy very much and received one-third more sales calls.

The iceberg principle is operating again here. Although the company as a whole is profitable, customer Jones is not. But before dropping Jones, the marketing manager should study the figures and the marketing plan very carefully. Perhaps Jones should be called on less frequently. Or maybe Jones will grow into a profitable account. Now the firm is at least covering some fixed costs by selling to Jones. Dropping this customer may only shift those fixed costs to the other two customers, making them look less attractive. (See the discussion on contribution margin in Chapter 19.)

The marketing manager may also want to analyze the advertising costs against results—since a heavy advertising expense is charged against each unit of Product C. Perhaps the whole marketing plan should be revised.

Cost analysis is not performance analysis

Such a cost analysis is not a performance analysis, of course. If the marketing manager budgeted costs to various jobs, it would be possible to extend this analysis to a performance analysis. This would be logical and desirable, but many companies have not yet moved in this direction.

Now that more accounting and marketing information is routinely available on computers, and software to analyze it is easier to use, many managers are seizing the opportunity to do marketing cost and performance analysis—just like factory cost accounting systems develop detailed cost estimates for products. These changes also mean that more managers are able to compare marketing cost and performance figures with expected figures to evaluate and control their marketing plans.

COLGATE / HUBER SUPPLY CHAIN ANALYSIS

J.M. Huber is a company that supplies Colgate with a key ingredient for toothpaste. A multidisciplinary team from Colgate and Huber worked together to understand all of the costs in the supply process. Their efforts reduced the total delivered costs of Colgate's finished products by hundreds of thousands of dollars.

People Put Plans into Action

People are an important resource

A great marketing plan may fail if the right people aren't available to implement it. Large firms usually have a separate human resources department staffed by specialists who work with others in the firm to ensure that good people are available to do jobs that need to be done. A small firm may not have a separate department—but somebody (perhaps the owner or other managers) must deal with people-management matters, like recruiting and hiring new employees, deciding how people will be compensated, and what to do when a job is not being performed well or is no longer necessary. Human resource issues are often critically important both in a marketing manager's choice among different possible marketing opportunities and in the actual implementation of marketing plans.

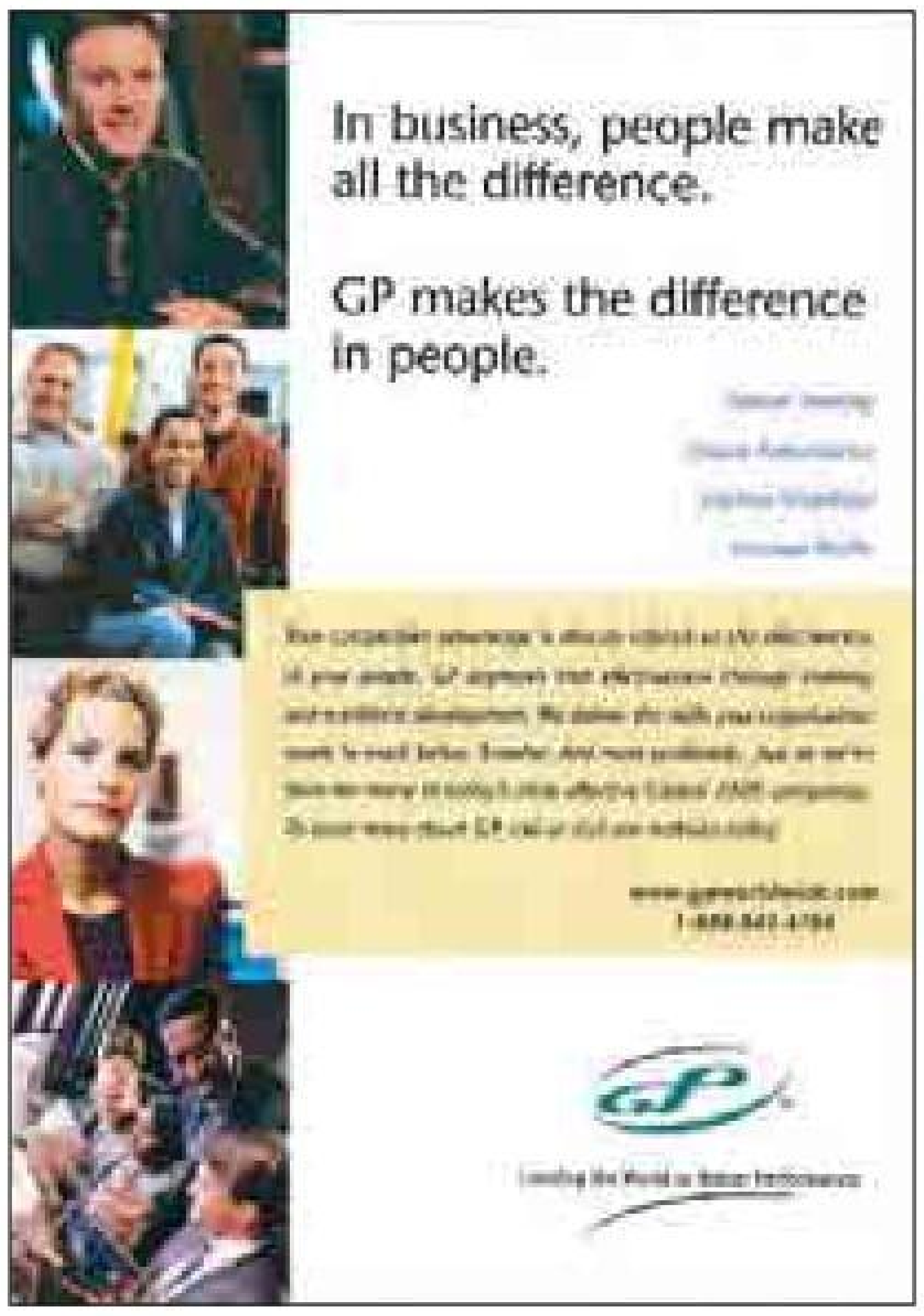
In this section, we'll briefly consider how and why these issues need to be considered in planning new strategies and implementing plans—especially plans that involve major change.

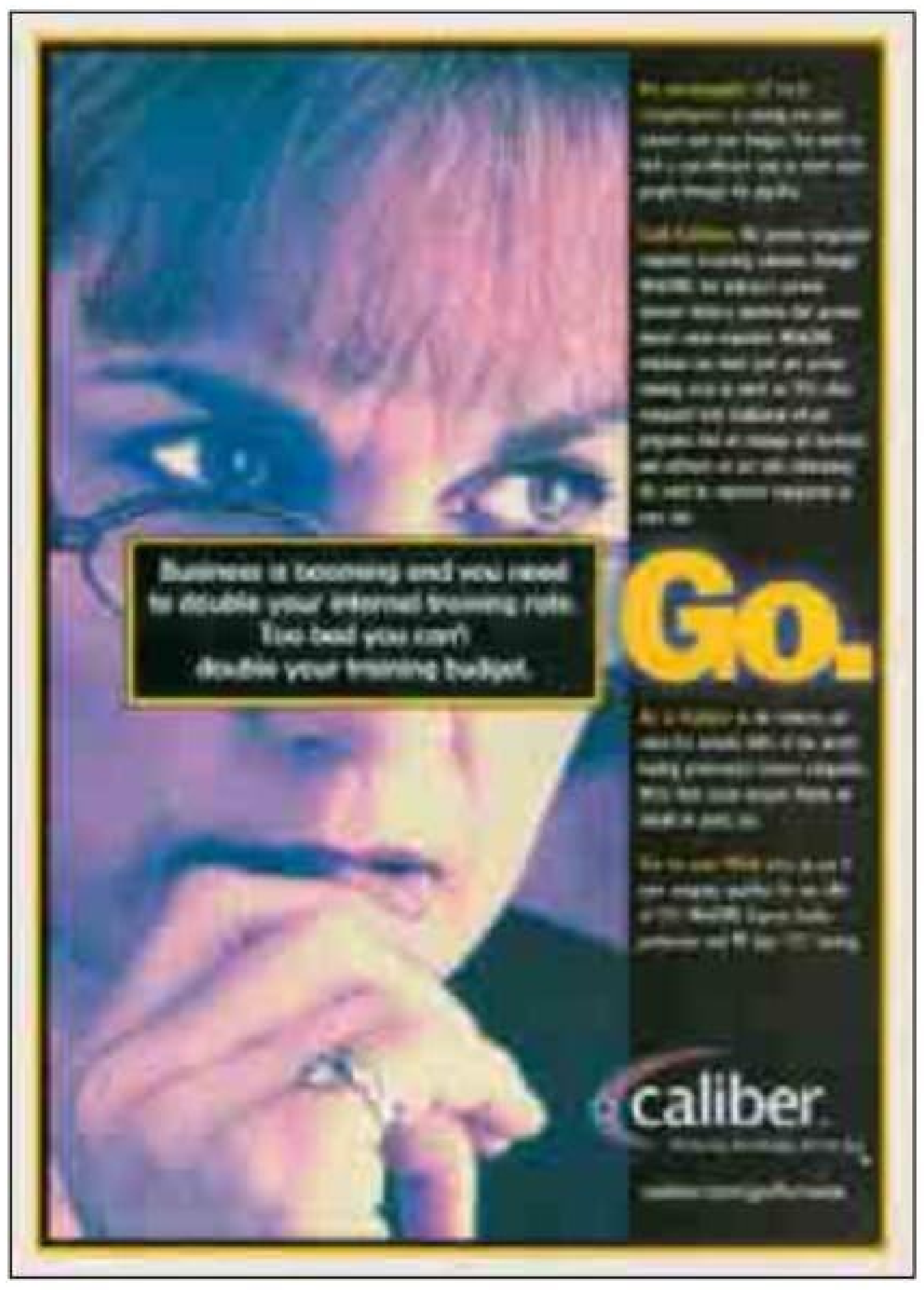
New strategies usually require people changes

New strategies often involve new and different ways of doing things. Even if such changes are required to ensure that the firm will survive, changes often upset the status quo and long-established vested interests of its current employees. A production manager who has spent a career becoming an expert in producing fine wood furniture may not like the idea of switching to an assemble-it-yourself line—even if that's what customers want. And when the market maturity stage of the product life cycle hits, a financial manager who looked like a hero during the profitable growth stage may not see that the picnic is over and that profit growth will resume only if the firm takes some risk and invests in a new product concept.

As these examples suggest, many of the people affected by a new strategy may not be under the control of the marketing manager. And acting alone, the marketing manager may not be the change agent who can instantly turn everyone in the organization into an enthusiastic supporter of the plan. However, if the marketing manager doesn't think about how a new strategy will affect people, and how what people do will affect the success of the strategy, even the best strategy may fail.

New marketing strategies often require new people or new skills or both. Firms like GP and Caliber help other companies develop training programs so that they have the people they need to implement their strategies.


In business, people make all the difference.
GP makes the difference in people.
GP


Business is booming and you need to double your internal training rate. Too bad you can't double your training budget.
Go.
caliber

" เจาะใจ ผู้บริโภ
INSIGHT

To keep employees up-to-date on the latest information available, Colgate runs training programs all over the world. This session, in Thailand, focuses on research insights about consumers of personal care products.

Communication helps promote change

Good communication is crucial. The marketing manager must find ways to explain the new strategy, what needs to happen, and why. You can't expect people to pull together in an organizationwide effort if they don't know what's going on. Such communication might be handled in meetings, memos, casual discussions, internal newsletters, or any number of other ways, depending on the situation. However, the communication should occur. At a minimum, the marketing manager needs to have clear communication with other managers who will participate in preparing the firm's personnel for a change.

Rapid growth strains human resources

When developing a marketing plan, a pragmatic marketing manager must take a realistic look at how quickly the firm's personnel can get geared up for the plan or whether it will be possible to get people who can.

Firms that are growing rapidly face special challenges in getting enough qualified people to do what needs to be done. A fast-growing retail chain like Home Depot that opens many new stores doesn't just need money for new land, buildings, and inventory. It also needs new store managers, assistant managers, sales clerks, customer service people, advertising managers, computer operators, and even maintenance people. Not all of these jobs are likely to be filled by internal promotions, so at least some of the "new blood" have to learn about the culture of the company, its customers, and its products at the same time they are learning the nuts and bolts of performing their jobs well. Hiring people and getting them up to speed takes time and energy.

Allow time for training and other changes

Training is important in situations like this; but training, like other organizational changes, takes time. A marketing manager who wants to reorganize the firm's sale force so that salespeople are assigned to specific customers rather than by specific product line may have a great idea, but it can't be implemented overnight. A salesperson who is supposed to be a specialist in meeting the needs of a certain customer won't be able to do a very good job if all he or she knows about is the specific product that was previously the focus. So the plan would need to include time for training to take place.

Each change may result in several others

A change in sales assignments is also likely to require changes in compensation. Someone needs to figure out the specifics of the new compensation system, and accountants need time to adjust their computer programs to make certain that the salespeople actually get paid. Similarly, the changes in the sales force are likely to require changes in who they report to and the structure of sales management assignments.

Our objective in this example is not just to detail the changes that might be required for this specific strategy decision, but rather to highlight the more general point that changing people usually takes time—and only so much change can be absorbed effectively in a limited period.

Plan time for changes from the outset

A marketing manager who ignores the ripple effects of a change in strategy may later expect everyone else in the organization to bend over backward, work overtime, and otherwise do everything possible to meet a schedule that was put together with little, or no, forethought. Certainly there are cases of heroic efforts by people in organizations to turn someone's vision into a reality. Yet it's more typical for such a plan to fall behind schedule, to run up unnecessary costs, or to just plain fail. Marketing managers who work that way are likely to be criticized for "not having the time to do it right the first time, but having the time to do it over again."

Cutbacks need human resource plans too

If rapidly expanding marketing efforts involve human resource challenges, decisions to drop products, channels of distribution, or even certain types of customers can be even more traumatic. In these situations, people always worry that *someone* will lose his or her job—and that isn't easy.

Dropping products or making other changes that would result in a cutback on people doing certain jobs must be planned very carefully and with a good dose of humanity. To the extent possible, it's important to plan a phase-out period so that people can make other plans. During the last decade, too many firms downsized so rapidly that long-time employees were abruptly left with no job. Then when a strong economy required growth and more people, they couldn't understand why it was hard for them to recruit!

If a phase-out is carefully planned—considering not only the implications for production facilities and contracts with outside firms but also the people inside—it may be possible to develop strategies that will create exciting new jobs for those who would otherwise be displaced.[16]

Marketing pumps life into an organization

This line of thinking highlights again that marketing is the heart that pumps the lifeblood through an organization. Marketing managers who create profitable marketing strategies and implement them well create a need for a firm's production workers, accountants, financial managers, lawyers, and—yes—even its human resources people. In this chapter we've talked about marketing links with those other functions; but when you get down to brass tacks, organizations and the various departments within them consist of *individuals*. If the marketing manager makes good strategy decisions—ones that lead to satisfied customers and profits—each of the individuals in the organization has a chance to prosper and grow.

Conclusion

Even when everyone in an entire company embraces the marketing concept, coordinating marketing strategies and plans with other functional areas is a challenge. Yet it's a challenge that marketing managers must address. It doesn't make sense to select a strategy that the firm can't implement. And implementing new plans usually requires money, people, and a way to produce goods or services the firm will sell.

Cooperation between the marketing manager and the finance people helps to ensure that there's enough money available for the initial one-time investments and ongoing working capital needed to implement a marketing plan. If money comes from outside investors, the marketing manager may need to develop a strategy that satisfies them as well as customers. If the money available is limited, the strategy may need to be scaled back in various ways, or the marketing manager may need to find creative ways to phase in a strategy over time so that it generates enough cash flow to "pay its own way."

There also needs to be close coordination between a firm's production specialists and the marketing plan. To get that coordination, the marketing manager needs to consider the firm's production capacity when evaluating alternative strategies. And flexibility in production may allow the firm to pursue different strategies at the same time or to switch strategies more easily when new opportunities develop.

Figuring out the profitability of a strategy, product, or customer often requires a real understanding of costs—production costs, marketing costs, and other costs that may accumulate. Traditional accounting reports are often not very useful in pinpointing these costs. However, marketing managers and accountants are now working together to get more accurate cost information—by developing functional accounts rather than just relying on natural accounts typically used for financial analysis.

Money, facilities, and information are all important in developing a successful strategy, but most strategies are implemented by people. So a marketing manager must also be concerned with the availability and skills of the firm's people—its human resources. New marketing strategies may upset established ways of doing things. Plans need to be clearly communicated so that everyone knows what to expect. Further, plans need to take into consideration the time and effort that will be required to get people up to speed on the new jobs they will be expected to do.

Making the strategic planning decisions that concern how a firm is going to use its overall resources—from marketing, production, finance, and other areas—is the responsibility of the chief executive officer, not the marketing manager. Further, the marketing manager usually can't dictate what a manager in some other department should do. However, it is sensible for the marketing manager to make recommendations on these matters. And marketing strategies and plans that the marketing manager recommends are more likely to be accepted, and then successfully implemented, if the links between marketing and other functional areas have been carefully considered from the outset.

Questions and Problems

1. Identify some of the ways that a firm can raise money to support a new marketing plan. Give the advantages and limitations—from a marketing manager's perspective—of each approach.
2. An entrepreneur who started a chain of auto service centers to do fast oil changes wants to quickly expand by building new facilities in new markets but doesn't have enough capital. His financial advisor suggested that he might be able to get around the financial constraint and still grow rapidly if he franchised his idea. That way the franchisees would invest to build their own centers, but fees from the franchise agreement would also provide cash flow to build more company-owned outlets. Do you think this is a good idea? Why or why not?
3. Explain, in your own words, why investors in a firm's stock might be interested in a firm's marketing manager developing a new growth-oriented strategy. Would it be just as good, from the investors' standpoint, for the manager to just maintain the same level of profits? Why or why not?
4. A woman with extensive experience in home health care and a good marketing plan has approached a bank for a loan, most of which she has explained she intends to "invest in advertising designed to recruit part-time nurses and to attract home-care patients for her firm's services." Other than the furniture in her leased office space, she has few assets. Is the bank likely to loan her the money? Why?
5. Could the idea of mass customization be used by a publisher of college textbooks to allow different instructors to order customized teaching materials—perhaps even unique books made up of chapters from a number of different existing books? What do you think would be the major advantages and disadvantages of this approach?
6. Give examples of two different ways that a firm's production capacity might influence a marketing manager's choice of a marketing strategy.
7. Is a small company's flexibility increased or decreased by turning to outside suppliers to produce the products it sells? Explain your thinking.
8. Explain how a marketing manager's sales forecast for a new marketing plan might be used by
   a. A financial manager.
   b. An accountant.
   c. A production manager.
   d. A human resources manager.

9. Explain the difference between natural accounts and functional accounts.
10. Could the approaches to cost allocation that we discussed in this chapter apply to a firm, like a travel agency, that produces only services? Explain your thinking.
11. What types of human resource issues does a marketing manager face when planning to expand sales operations from a branch office in a new overseas market? Are the problems any different than they would be in a new domestic market?

Suggested Cases

17. Enviro Pure Water, Inc.
35. Romano's Take-Out, Inc.