

Chapter 8

Evaluation and Control of Marketing Activities

In Chapter 8 we come to the final stage of the effective management process model: connecting with customers (see Figure 8.1).

As the previous seven chapters have demonstrated, connecting with customers does not happen by chance or just because the marketer wants it to. Connecting is the final result of a series of demanding steps, carefully and expertly executed. It begins with a firm commitment on the part of all employees that their jobs are not well done unless they contribute to this connection. When a firm achieves excellence in making this connection, it results in the kind of mutually beneficial exchange relationships that customers find so satisfying; competition is irrelevant. That is, customer loyalty is so firmly entrenched

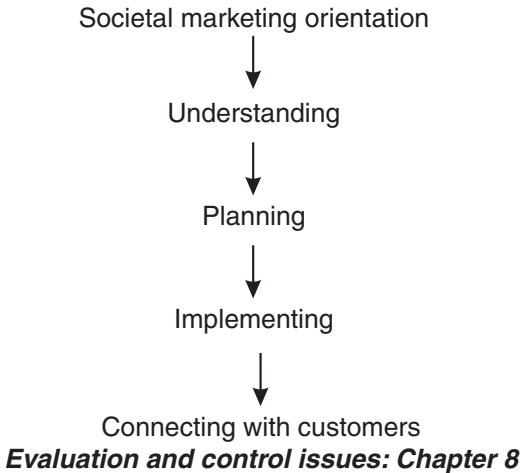


FIGURE 8.1. The Effective Marketing Management Process

that they do not evaluate competitors' products when making purchase decisions. When they decide to make a purchase—you are it. This is a rare kind of connection. Yet as difficult as it is to achieve, it is a worthy goal for marketers and can be the ultimate result of following the effective marketing management process. Evidence has shown the power of such connections, but also the difficulty in achieving them. Research results indicate that if customer satisfaction is measured on a 1-to-5 scale, with 5 representing “completely satisfied,” those customers who are at a 5 are *six times* less likely to defect to competitors (i.e., are six times more brand loyal) than customers who are at a 4 on the scale.¹

Achieving such a level of satisfying performance is obviously rewarding for both customers and companies. Organizations who are not satisfied with lesser performance devote considerable attention to the subject of this chapter. Establishing evaluation and control procedures keeps marketing managers informed of how well an organization has achieved connections with customers and where corrective action is needed.

INTEGRATION OF PLANNING AND CONTROL

Planning and control should be integrated processes. In fact, planning is defined as a process that includes establishing a system for feedback of results. This feedback reflects a company's performance in reaching its objectives through implementation of the strategic marketing plan. The relationship between planning and control is depicted in Figure 8.2.

The planning process results in a specific plan being developed for a product or service. This plan is then implemented (marketing activities are performed in the manner described in the plan) and results are produced. These results are sales revenues, costs, profits, and accompanying consumer attitudes, preferences, and behaviors. Information on these results is given to managers who compare them with objectives to evaluate performance. This performance evaluation identifies the areas where decisions must be made. The actual decision making controls the plan by altering it to accomplish stated objectives, and a new cycle begins. The information flows are the key to a good control system. Deciding what information is provided to which managers in what time periods is the essence of a control system.

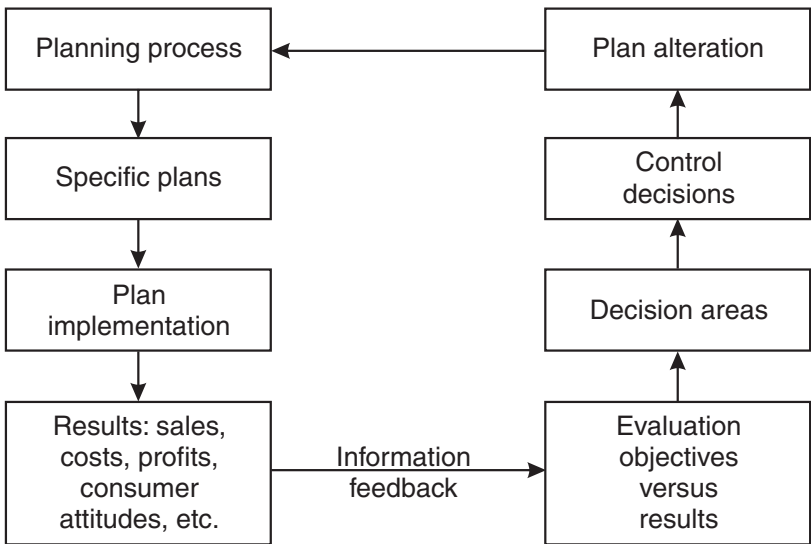


FIGURE 8.2. Planning and Control Model

The need for better control systems was clearly pointed out in a study of seventy-five companies of various sizes in several industries. The findings were as follows:

Smaller companies had poorer control procedures than larger ones.

Fewer than one-half of the companies knew the profitability of individual products, and, one-third had no system set up to spot weak products.

Almost half failed to analyze costs, evaluate advertising or sales force call reports, or compare their process to competitors.

Many managers reported long delays in getting control reports, and many of their reports were inaccurate.²

TIMING OF INFORMATION FLOWS

A strategic plan is comprised of many annual operating plans. An economist once noted that “we plan in the long run but live in the

short run.” If each annual operating plan is controlled properly, the long-run plans are more likely to be controlled. A planner cannot afford to wait for the time period of a plan to pass before control information is available. The information must be available within a time frame that is long enough to allow results to accrue but short enough to allow actions to align results with objectives. Although some types of businesses may find weekly or bimonthly results necessary, most companies can adequately control operations with monthly or quarterly reports. Cumulative monthly or quarterly reports become annual reports, which in turn become the feedback needed to control the plan.

PERFORMANCE EVALUATION AND CONTROL

Performance should be evaluated in many areas to provide a complete analysis of what the results are and what caused them. The four key control areas are sales, profits, consumers, and costs. Objectives have been established in three of these areas for the operating and strategic plans. The fourth area, costs, is a measure of marketing effort and is directly tied to profitability analysis.

Sales Control

Sales control data are provided from an analysis of sales by individual segments (products, territories, etc.), market share data, and data on sales inputs (sales force, advertising, and sales promotion).

Sales by Segment

Sales performance can be evaluated per segment by developing a sales performance report as shown in Table 8.1. Using this format, the

TABLE 8.1. Sales Performance by Product—Quarter 1

Product	\$ Objective	\$ Actual sales	\$ Variation	% Variation	Sales index
A	100,000	90,000	-10,000	-10.0	.90
B	95,000	102,000	+7,000	+7.4	1.07
C	120,000	92,000	-28,000	-23.0	.77
D	200,000	203,000	+3,000	+1.5	1.02

sales objectives stated in the annual operating plan are broken down on a quarterly basis and become the standard against which actual sales results are compared. Dollar and percentage variations are calculated because in some instances a small percentage can result in a large dollar variation.

A performance index can be calculated by dividing actual sales by the sales objective. Index numbers of about 1.00 indicate that expected and actual performance are about equal. Numbers larger than 1.00 indicate above-expected performance, and numbers below 1.00 reveal below-expected performance. Index numbers are especially useful when a large number of products is involved because they enable managers to identify those products that need immediate attention.

Analysis of net sales can provide some insight into a firm's sales pattern and historical market share, but more specific information is needed. This information can be obtained through analyses of sales by segments—products, product groups, customers, divisions, geographical areas, and so on. An example of this type of analysis is shown in Table 8.2 for a manufacturer of industrial parts. In this table, a two-way classification of sales is presented: by product and by region. This analysis provides data of three different types. First, it shows the contribution of each product to total sales volume; second, it shows the contribution of each region's sales to total sales; and finally, it shows the contribution of each product in each region.

This type of analysis is most revealing when it is first completed because it shows the composition of the total sales volume. This detailed information is needed because decisions are made on the basis of individual products, territories, customers, etc., and not on the basis of totals. In fact, the good performance of one product may offset

TABLE 8.2. Sales Analysis by Product and Region for Industrial Parts

Product	Total sales	\$ Sales by region			
		Southwest	Southeast	Northwest	Northeast
Grinders	127,806	34,606	27,901	48,600	16,699
Drills	238,700	58,731	62,800	54,601	62,568
Drill bits	158,208	39,653	47,288	34,046	37,221
Buffers	252,900	63,985	65,126	54,631	69,158
Sanders	328,500	75,858	84,720	85,952	81,970
Total sales	1,106,114	272,833	287,835	277,830	267,616

the bad performance of another product, which could be unnoticed if only total net sales were examined. This has been called the “iceberg principle” in that total sales (the top of the iceberg), can cover up the sales by segments (the hidden part of the iceberg). Usually, the submerged part of the iceberg causes the problems.

Another basic finding in this type of analysis has been referred to as the 80/20 principle or rule. This generalization states that 80 percent of the business is accounted for by 20 percent of the products, customers, or territories. The percentages, of course, will vary, but the point is that there will be an uneven proportionate contribution to total sales by certain segments. In Table 8.1, for example, two products, buffers and sanders, account for 52 percent of sales, and for grinders, three regions account for 87 percent of sales. If a manager is aware of these types of situations, attention and marketing effort can be allocated appropriately. However, unless this type of analysis is made, a misallocation of effort can occur. This means more effort is directed at a part or a segment—a specific region, for example—than its potential contribution would warrant. If, in the example, 25 percent of the marketing budget and effort for grinders were directed at the Northeast region, too much effort would probably have been exerted in that region. Its contribution to sales is only 13 percent.

This type of analysis begins to provide a clear picture of “where we are” for specific products and services and for any other segments that are analyzed. It offers a much more solid basis for planning than merely a general analysis of sales volume. Since these data are not part of a regular accounting system, they must be requested and sometimes generated by the marketing planner. Computer manipulation would facilitate detailed analysis of sales volume.

The same procedures can be followed to analyze sales performance by customers or territories. They could also be combined to check performance of products in various territories or sales to various customer types.

Market Share Data

Other important types of sales control data are provided through a market share analysis. A firm’s performance should be compared to competitors’. A common method is to calculate a firm’s share of a market. External forces do not affect all firms in the same way, and their impact can be analyzed through market share analyses. To cal-

culate market share, the relevant market must be identified. Market share can be analyzed on at least two bases.

1. *Share of total market:* This is the firm's sales divided by the total sales in the markets in which the firm is exerting marketing effort.
2. *Relative market share:* This is one firm's share of the market held by the top two, three, or four firms. It reflects the firm's share of the market captured by the major competitors.

Unless some effort is made to understand why a firm's market share has changed or failed to change, this analysis is more of a scorekeeping task. If the components of market share are analyzed—such as the number of customers reached, product loyalty, repeat purchases—meaningful control decisions can be made.

Sales Input Data

A great deal of analyses of performance can be done on sales inputs. For the sales force these inputs can be divided into qualitative and quantitative inputs.

Qualitative inputs:

1. Time management
2. Planning effort
3. Quality of sales presentation
4. Product knowledge
5. Personal appearance and health
6. Personality and attitudes

Quantitative inputs:

1. Days worked
2. Calls per day
3. Proportion of time spent selling
4. Selling expenses
5. Nonselling activities
 - a. Calls to prospects
 - b. Display setups
 - c. Service calls
6. Miles traveled per call

Analysis of these factors will help a sales manager evaluate the efficiency of the sales effort. For many of these factors, a sales force average can be computed to serve as a standard for analyzing individual salespersons. For example, if the number of sales calls per day for one salesperson is three and the company average is six, this case warrants attention. The low calls per day could be caused by a large, sparsely populated territory or it could be that the salesperson is spending too much time with each customer. Whatever the problem, management must be alerted to its existence.

Advertising inputs are difficult to evaluate but must be dealt with nonetheless. Several factors can be evaluated to help determine the efficiency of advertising:

1. Competitive level of advertising
2. Readership statistics
3. Cost per thousand
4. Number of sales inquiries stimulated by an ad
5. Number of conversions of inquiries to sales
6. Changes in store traffic generated by an ad campaign

Tracking these data over several years can help identify successful appeals, ads, or media.

Many promotional sales tools can be directly evaluated if objectives are set before their use. For example, if a firm is going to enclose a cents-off coupon in a packaged product, the number of coupons redeemed is one measure of the results. The number of people who visit a trade show, the number of customers who try a product through in-store demonstrations, etc., are all examples of how data can be used.

The key to evaluating sales input performance is the setting of objectives, which become the standards by which actual performance can be evaluated.

Cost Control

Several methods are available for establishing cost control procedures. These include budgets, expense ratios, and segment and functional costs analysis. Budgets are a common tool used by most organizations for anticipating expense levels on a yearly basis. The budget is often established by using historical percentages of various expenses as a percent of sales. Thus, once the sales forecast is estab-

lished, expense items can be budgeted as a percent of total sales. If zero-based budgeting is used, the objectives to be accomplished must be specified and the expenditures necessary to accomplish these objectives estimated. The estimates are the budgeted expenses for the time period.

Once the budget is established, an expense variance analysis by line item or expenditure category is used to control costs. Although it is not possible to establish standard costs for marketing expenditures, the budget amounts are the standards used to perform the variance analysis. A typical procedure is to prepare monthly or quarterly budget reports showing the amount budgeted for the time period and the dollar and percentage variation from the budgeted amount, if any exists. Expenditure patterns that vary from the budgeted amounts are then analyzed to determine why the variations occurred.

Expense ratio analysis is another tool used to control costs. An important goal of every plan is to maintain the desired relationship between expenditures and revenues. Calculations of expense ratios provide information on what this relationship is at any time. Monthly, quarterly, and yearly ratio calculations should satisfy most managers' needs for these data.

Common expense ratios are as follows:

1. Profit margins
2. Selling expense ratio
3. Cost per sales call
4. Advertising expense ratio

Many other financial ratios, such as asset turnover, inventory turnover, and accounts receivable turnover, also provide measures that can be used to reduce or maintain cost levels.

Sales analysis, even by segments, is only a part of the information needed to understand the nature of a firm's current marketing operations. Sales analysis, when considered alone, can even be misleading: a product low in sales volume may not be low in its profit contribution. Sales and profitability can be determined only through sales and cost analysis.

There are three basic types of cost analysis: (1) analysis of ledger accounts, (2) functional or activity cost analysis, and (3) segment cost analysis. These analyses are not part of the accounting system, and a

manager must request this information and in most cases work with the information supplier in coordinating the analysis.

The simplest type of cost analysis involves examining costs, over a period of time, as they appear in the accounting system. The interest is in the absolute size and growth of an account, such as the change in sales salaries over time. One tool frequently used in this analysis is the common-size income statement shown in Figure 8.3. This statement shows each item as a percentage of sales. When several years are compared, the actual percentage growth and relative value of a given expense can be evaluated. A manager can then begin to question why a given expense has grown or why it represents such a large

Net sales		100.0%
Cost of sales		<u>-72.0%</u>
Gross profit		28.0%
<i>Selling expenses:</i>		
Sales salaries	5.5%	
Travel and entertainment	.9%	
Sales supplies used	.5%	
Advertising	5.6%	
Other selling expenses	<u>.5%</u>	
Total selling expenses	13.0%	
<i>Administrative expenses:</i>		
Office salaries	4.9%	
Office supplies used	.8%	
Office rent	.8%	
Taxes and insurance	.6%	
Depreciation of equipment	.3%	
Other administrative expenses	<u>.1%</u>	
Total administrative expenses	7.5%	
Total operating expenses		20.5%
Net operating income		7.5%
Less income expense		<u>.5%</u>
Net income		7.0%

FIGURE 8.3. Common-Size Income Statement, 20__

part of total expenses. These analyses help explain why an expenditure pattern exists and enable planners to understand expenditure patterns.

Functional Cost Analysis

Functional or activity cost analysis involves allocating costs from the natural accounts to accounts set up for each marketing function or activity. This analysis serves two purposes. First, it provides information on the total costs of performing the various marketing activities, and, second, it is an intermediate step to segment cost analysis. Knowing the total cost of performing a function or activity is useful in major strategic decisions such as altering the physical distribution system. This type of analysis is illustrated in Table 8.3. When costs are allocated to a category, such as a product, questions about the costs for a specific product can be answered.

Functional costs allocated to a specific category are determined by the nature of the function. For example, storage costs would usually be allocated to products on the basis of the number of square feet of warehouse space used to store each product. If storage costs were allocated to geographical areas, sales volumes in each area would usually be used as the basis for allocation unless there were storage facilities in each area.

Segment Cost Analysis

Segment cost analysis is illustrated in Tables 8.4 and 8.5. The objective in segment cost analysis is to determine the contribution of a segment—products, customers, territories—in relation to total profitability. Two alternate approaches can be used in allocating costs. These approaches are the full cost approach and the contribution margin approach. In the full cost approach, illustrated in Table 8.4, all costs—direct and indirect—are allocated to a specific category, such as a product. This determines the net profit contribution of each product to total profit.

However, this approach poses a problem. It forces allocation of indirect costs to individual products. Indirect costs are those costs that are not eliminated even if a given product is dropped. For example, the sales manager's salary is an indirect cost of a particular product. If you eliminate that product you would not eliminate the manager's

TABLE 8.3. Activity Cost Analysis

	Activity cost groups							
	Ledger total	Direct selling	Advertising and promotion	Transportation and shipping	Storage	Credits and collections	Financial and clerical	Marketing administration expenses
Sales force commissions	\$312,000	\$312,000						
Sales force salaries	120,000	120,000						
Office supplies	13,320	2,400	2,040	1,560	1,200	1,200	4,200	720
Media space and time	120,000		120,000					
Advertising salaries	30,000		30,000					
Administrative salaries	108,000	19,200		8,400	8,400	7,200	16,800	48,000
Rent	16,920		1,800	3,840	4,200	2,304	2,256	2,520
Taxes and insurance	13,500	2,040	960	2,760	3,000	1,260	1,260	2,220
Heat and light	7,020		960	1,620	1,620	1,020	1,020	780
Depreciation	9,240	960	600	2,040	2,640	480	1,920	600
Miscellaneous	4,560	420	960	600	780	960	660	180
Totals	\$754,560	\$457,020	\$157,320	\$20,820	\$21,840	\$14,424	\$28,116	\$55,020

TABLE 8.4. Income Statement by Product: Full Cost Approach

	Total	Drills	Drill bits	Grinders
Net sales	\$3,600,000	\$1,200,000	\$600,000	\$1,800,000
Less cost of goods sold	<u>2,520,000</u>	<u>880,000</u>	<u>440,000</u>	<u>1,200,000</u>
Gross margin	\$1,080,000	\$320,000	\$160,000	\$600,000
Less operating expenses				
Direct selling	\$457,020	\$132,536	\$82,264	\$242,220
Advertising and sales promotion	157,320	56,635	23,598	77,087
Transportation and shipping	20,820	7,912	5,205	7,703
Storage	21,840	8,955	5,678	7,207
Credits and collections	14,424	4,472	2,596	7,356
Financial and clerical	28,116	8,997	7,873	11,246
Marketing administrative	<u>55,020</u>	<u>18,707</u>	<u>8,803</u>	<u>27,510</u>
Total operating expenses	\$754,560	\$238,214	\$136,017	\$380,329
Net profit before income taxes	\$325,440	\$81,786	\$23,983	\$219,671

salary. To allocate indirect costs, a basis of allocation must be selected. Three commonly used allocation methods are (1) allocating equally to each part of a segment; (2) allocating in direct proportion to sales of each part of a segment; or (3) allocating in direct proportion to the direct cost of each part of a segment. If you choose to allocate the sales manager's salary equally to each product and the salary was \$30,000, then each product would be assigned \$10,000 as its share of that indirect cost. Although all indirect costs must be allocated to arrive at a net profit figure by product, this process can be misleading. For example, a product that is not showing a profit should be eliminated, thereby increasing total profitability. However, if a product is eliminated only direct costs are eliminated, and the indirect costs have to be reallocated to remaining products.

To overcome this problem, the contribution margin approach is commonly used. With this approach only direct costs are allocated to each part of a segment (see Table 8.5). The contribution margin is the amount each product contributes to cover indirect costs and earn a profit after all its direct costs are subtracted. As long as a product's contribution is positive, the firm is better off keeping it—i.e., its sales cover all of its costs and make a contribution to indirect costs and

TABLE 8.5. Income Statement by Product: Contribution Margin Approach

	Total	Drills	Drill bits	Grinders
Net sales	\$3,600,000	\$1,200,000	\$600,000	\$1,800,000
Less cost of goods sold				
Labor and materials only	2,520,000	880,000	440,000	1,200,000
Gross margin	<u>\$1,080,000</u>	<u>\$320,000</u>	<u>\$160,000</u>	<u>\$600,000</u>
Less direct operating expenses				
Direct selling	\$370,186	\$107,354	\$66,634	\$196,198
Advertising and sales promotion	99,112	33,698	13,876	51,538
Transportation and shipping	8,328	2,748	2,082	3,498
Storage	7,862	2,359	1,965	3,538
Credits and collections	7,645	2,828	994	3,823
Financial and clerical	10,122	3,037	1,822	5,263
Total direct expenses	<u>\$503,255</u>	<u>\$152,024</u>	<u>\$87,373</u>	<u>\$263,858</u>
Contribution margin	\$576,745	\$167,976	\$72,627	\$336,142
Less indirect operating expenses				
Direct selling	\$86,834			
Advertising and sales promotion	55,208			
Transportation and shipping	15,492			
Storage	13,978			
Credits and collections	6,779			
Financial and clerical	17,994			
Marketing administrative	55,020			
Total indirect expenses	<u>\$251,305</u>			
Net profit before income taxes	<u>\$325,440</u>			

profit. This type of analysis does not reveal why costs or contributions are the way they are. It simply analyzes what is happening in specific areas of the firm's business.

The analytical methods discussed in this chapter can provide specific detailed data about markets and products. The analyses are not done in many companies because marketing planners may not understand the procedures. Another factor that may limit their use is that the planner must submit a detailed request in order to secure the information that is so vital to effective planning. Since the analyses are not part of a typical accounting system, additional expenditures are nec-

essary to complete the analyses and make them available for use in planning. This investment in information should produce a very high and quick payback in the form of better marketing plans.

Profit Control

Profit control begins with profitability analysis by products, territories, and customers. This involves a breakdown of sales and costs by various market segments to determine either a profit contribution or a contribution to cover indirect costs and earn a profit. Profitability analysis is the only way to identify the strong and weak products, territories, or customers. Until specific products can be identified as unsuccessful no action can be taken to correct the situation. Managers need specific information about a product or customer on both sales revenues generated and the costs associated with a given level of revenue.

Once specific information on profitability analysis is available action can be taken to achieve profit control. Table 8.6 shows data on order size for a grocery wholesaler. In this example, many of the customers were placing small orders, which actually resulted in losses. When the cost of goods sold and other direct expenses such as sales commission, order picking, and delivery were calculated, there was a negative contribution margin for orders under \$200. Sales revenues did not cover direct expenses. A naive decision would be simply to stop selling to these customers. This would reduce sales revenue, but the decrease in direct expenses would more than offset the decrease in revenues.

TABLE 8.6. Number of Customers by Order Size

Number of customers	Order size
31	Over \$1,000
50	\$800-\$999
80	\$600-\$799
90	\$400-\$599
75	\$200-\$399
65	Less than \$200

A more analytic approach would determine why the orders were small and what could be done to increase their size. Possibly, these are all small retailers, and little can be done to increase order size; or these retailers may be splitting orders with several wholesalers. Following are some corrective actions.

1. Get several small retailers to pool their orders.
2. Have the salespeople call on them less frequently, thus increasing the size of individual orders.
3. Start a cash-and-carry operation to deal with these retailers.
4. Have these retailers order by phone or via Internet product listings.
5. Encourage them to concentrate their purchases with one source of supply.

Several possible corrective actions could improve order size and permit the wholesaler to continue to deal with these retailers. If none of the corrective actions evaluated is feasible, a minimum-size order could be established. This decision could eliminate some customers, but it cannot be avoided if profitability is to be improved.

Customer Feedback

Performance evaluation on customers involves analysis of customer awareness, knowledge, attitudes, and behaviors. Communication efforts should be goal oriented. The goals are to have consumers become aware of products, services, or stores; possess certain knowledge; and exhibit certain attitudes and behaviors. These should be specified in the operating and strategic objective statements and then become the standards to which current consumer data are compared.

Data on consumers must be collected either by the company or a research firm. Many research firms specialize in providing commercial data to companies, either as a one-time research project or on a regular basis. Store audits, awareness studies, and attitudinal surveys are available by subscription for most consumer goods. Several research firms specialize in industrial markets and provide appropriate data on these customers.

Consumer data are especially valuable if collected over a long period of time. Information such as awareness levels, attitudes, and purchase behavior can be analyzed to reveal trends and areas for further investigation. Also, changes in consumers' attributes can be related to marketing activities, such as coupons or the introduction of a new advertising theme.

Consumer feedback can also be obtained by customer-attitude tracking. Following are the main customer-attitude tracking systems:

1. *Complaint and suggestion systems.* In this system, companies record, analyze, and respond to written and oral complaints from customers. Management should attempt to correct whatever is causing the most frequent types of complaints. Many organizations provide suggestion cards to encourage customer feedback.

2. *Customer panels.* Some companies use panels of customers who agree to periodically communicate their attitudes through phone or mail surveys. These panels provide a broader range of customer attitudes than customer complaint and suggestion systems.

3. *Customer surveys.* Periodic questionnaires directed to a random sample of customers can be used to evaluate the friendliness of the staff, the quality of the product or service, and so on. Customers can respond to questions on a scale ranging from, e.g., very dissatisfied, to dissatisfied, neutral, satisfied, and very satisfied. The responses are summarized and provided to local managers and to higher-management levels. Results show how the various components were rated in the current period compared to the last period, to the average of all the local units, and to the standard.

4. *Mystery shoppers.* In this system, people are recruited to pose as potential customers and report on their experiences shopping and buying the product or service.

Ratio Analysis

Another useful type of analysis is called ratio analysis. In ratio analysis one financial value is shown in relation to another value. The resulting ratio can show the absolute standing of the company in a given area but is best used in comparison with previous time periods or industry averages. Some of the most commonly used ratios are discussed as follows.

Profitability Ratios

Gross profit margin. This is an indication of the total margin available to cover operating expenses and yield a profit. It is calculated as shown in the following equation.

$$\text{Gross profit margin} = \frac{(\text{Sales} - \text{Cost of goods sold})}{\text{Sales}} \quad (8.1)$$

Net profit margin or net return. This shows aftertax profits per dollar of sales. Subpar profit margins indicate that a firm's sales prices are relatively low, its costs are relatively high, or both.

$$\text{Net return} = \frac{\text{Profit after taxes}}{\text{Sales}} \quad (8.2)$$

Return on total assets. This is a measure of the return on total investment in the enterprise. Sometimes it is adjusted by adding interest to aftertax profits to form the numerator of the ratio since total assets are financed by creditors as well as by stockholders; hence, it is accurate to measure the productivity of assets by the returns provided to both classes of investors.

$$\text{Return on total assets} = \frac{\text{Profit after taxes}}{\text{Total assets}} \quad (8.3)$$

or

$$\frac{(\text{Profit after taxes} + \text{interest})}{\text{Total assets}}$$

Liquidity Ratios

Current ratio. This ratio indicates the extent to which the claims of short-term creditors are covered by assets that are expected to be converted to cash in a period roughly corresponding to the maturity of the liabilities.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}} \quad (8.4)$$

Quick ratio (or acid-test ratio). This ratio measures a firm's ability to pay off short-term obligations without relying on the sale of its inventory.

$$\text{Quick ratio} = \frac{\text{Current assets} - \text{inventory}}{\text{Current liability}} \quad (8.5)$$

Leverage Ratios

Debt-to-assets ratio. This measures the extent to which borrowed funds have been used to finance a firm's operations. It provides another measure of the funds provided by creditors versus the funds provided by owners. It is also widely used to measure the balance between debt and equity in a firm's long-term capital structure. This ratio also measures the extent to which earnings can decline without a company becoming unable to meet its annual interest costs and is a more inclusive indication of a firm's ability to meet all of its fixed-charge obligations.

$$\text{Debt-to-assets ratio} = \frac{\text{Total debt}}{\text{Total assets}} \quad (8.6)$$

Debt-to-equity ratio. This provides another measure of the funds provided by creditors versus the funds provided by owners.

$$\text{Debit-to-equity ratio} = \frac{\text{Total debt}}{\text{Total stockholder's equity}} \quad (8.7)$$

Times-interest-earned ratio. Measures the extent to which earnings coverage can decline without the firm becoming unable to meet its annual interest costs.

$$\text{Times-interest-earned ratio} = \frac{\text{Profit before taxes}}{\text{Total interest charges}} \quad (8.8)$$

Activity Ratios

Inventory turnover. When compared to industry averages, this ratio provides an indication of whether a company has excessive or perhaps inadequate inventory.

$$\text{Inventory turnover} = \frac{\text{Sales}}{\text{Average inventory}} \quad (8.9)$$

Asset turnover. This is a measure of the turnover and utilization of all of a firm's assets; a ratio below the industry average indicates that a company is not generating a sufficient volume of business, given the investment of its assets.

$$\text{Asset turnover} = \frac{\text{Sales}}{\text{Total assets}} \quad (8.10)$$

Accounts receivable turnover. This ratio measures the time it takes the firm to collect credit sales.

$$\text{Accounts receivable turnover} = \frac{\text{Annual credit sales}}{\text{Average length of turnover}} \quad (8.11)$$

None of the performance evaluation data described are going to be available unless they are requested and funds are made available to finance analyses. Thus data-collecting and reporting procedures must be set up by the marketer in consultation with managers who are going to use the control data in decision making.

The procedures will usually change over time as some types of analyses or reporting times are found to be better than others. The most important requirement is that the data meet the needs of managers in taking corrective actions to control marketing activities.

THE MARKETING AUDIT

In some situations an organization may want to extend the evaluation process to include the entire marketing process. This is referred to as a marketing audit. The concept of a marketing audit was derived from the accounting field in which audits have traditionally been

used as a procedure for internal financial control. A marketing audit is “a *comprehensive, systematic, independent, and periodic* examination of a company’s—or business unit’s—marketing environment, objectives, strategies, and activities with a view to determining problem areas and opportunities and recommending a plan of action to improve the company’s marketing performance.”³ A *marketing audit* is a critical, unbiased review of the philosophies, personnel, organization, purpose, objectives, procedures, and results associated with some activity. It is a review of everything associated with the marketing process within a company.

Audits are appropriate for virtually any type of organization—new to old, small to large, healthy or ailing—engaged in providing services or physical products. The need for a marketing audit may stem from changes in: target markets, competitors, internal capabilities, the economic environment, etc. Consequently, an audit may have many purposes:⁴

- Appraisal of the total marketing operation
- Evaluation of policies and objectives and their underlying assumptions
- Diagnosis and prognosis of the marketing program
- Searches for market opportunities and how to capitalize on them
- Searches for weaknesses and ways to eliminate them
- Identification of preventive as well as palliative marketing practices

The marketing audit process can be lengthy and complex. A great deal of prior planning and preparation is necessary. Ultimately, it involves (1) deciding who will do the audit; (2) agreeing on its objectives, scope, and breadth; (3) identifying sources of data; and (4) deciding on the format used to present its results.

Audit Personnel

Kotler has offered six ways in which a marketing audit may be conducted: (1) self-audit, (2) audit from across, (3) audit from above, (4) company auditing officer, (5) company task-force audit, and (6) outsider audit. Generally speaking, the best audits are likely to come from experienced outside consultants who have the necessary objec-

tivity and independence, broad experience in a number of industries, some familiarity with this industry, and the undivided time and attention to give to the audit.⁵

Basically, the choice is between internal and external auditors. Internal auditors have the advantage of working relationships and familiarity with a company's operating environment. An audit performed by higher level executives or an auditing staff can be less time-consuming and perhaps less costly. However, internal auditors cannot be myopic in their knowledge of planning procedures. That is, they must have a good understanding of how planning should take place in any organization and not just in their particular company. Analysts must possess the depth and breadth of knowledge needed in marketing to make effective judgments.

If their experience is broad-based, external auditors can provide some of the breadth of knowledge needed. Consulting firms specializing in marketing may bring a perspective to a firm's planning process that could not otherwise be obtained, especially for firms with inbred executives. The major disadvantage of using external auditors is the time needed for them to gain an understanding of the company's approach to planning and the qualifications and training of the people involved in the planning process. A long-term relationship with the same consulting group would help alleviate this shortcoming.

Objectives, Scope, and Breadth of Audit

A meeting between the company officer(s) and the marketing auditor(s) should result in an agreement on the objectives, coverage, depth, data sources, report format, and the time period for the audit. Auditing time and cost can be kept to a minimum by carefully preparing a detailed plan for who is to be interviewed, the questions to be asked, the time and place of contact, and so on. The marketing audit should include data and opinions from not only company executives but also customers, dealers, and other outside groups to better understand how they see the company.⁶

The audit is most effective when its philosophy is built on three attributes: comprehensive, systematic, and periodic. An audit should not be considered comprehensive unless all aspects of planning are analyzed. A sales force audit or promotional audit by itself provides

depth but is not comprehensive enough to evaluate relationships among personnel, organizations, and procedures. The audit should contain an examination of six major components of the company's marketing situation:⁷

Marketing environment: Analyze the major macroenvironmental forces and trends that are key components of the company's environment such as: markets, customers, competition, distributors, suppliers, and facilitators.

Marketing strategy: Appraise how well the company's marketing objectives and strategy are adapted to the current and forecasted marketing environment.

Marketing organization: Evaluate the capability of the marketing organization to implement the necessary strategy for the forecasted environment.

Marketing system: Examine the quality of the company's system for analysis, planning, and control.

Marketing productivity: Examine the profitability of different marketing entities and the cost effectiveness of different marketing expenditures.

Marketing function: Conduct in-depth evaluations of the major marketing-mix components.

A systematic audit follows logical, predetermined steps. The areas covered (based upon the major components of the marketing situation) and the types of questions asked provide the basis for analyzing a company's procedures. Figure 8.4 provides one such approach to conducting an audit.

This systematic approach should uncover a great deal of data about the planning process within a company. The continual questioning of why? about procedures, decisions, and controls is the key to uncovering who did what with what efficiency and provides input for answering, Are we doing the right things?

The audit should be undertaken with sufficient periodicity to avoid crisis circumstances. Many firms do not audit their managerial activities until a crisis occurs, but in many cases a crisis can be avoided by an audit. Few marketing planning processes are so successful that yearly or second- or third-year audits should not be used.

Part I: The Company Marketing Environment

- A. Purpose
 1. Has a meaningful statement of company purpose been developed?
 2. Has it been effectively communicated to all marketing personnel?
- B. Organization
 1. Has the responsibility for developing the marketing plan been assigned within the organization?
 2. Are the right people involved in preparation, review, and approval of completed planning documents?
- C. Market analysis
 1. Has a general environmental analysis been completed that identifies salient factors in the company's operating environment?
 2. Has an environment analysis been completed to identify the product/market's boundaries (i.e., set of customer needs for particular customer segments served by alternative technologies)?
 3. Have the movements along these product/market dimensions been tracked over time to identify evolving trends?
 4. Have the major market factors been identified and their relation to revenue studied?
 5. Have these market growth factors been properly forecasted for planning periods?
 6. Have the key success factors for the product/market been identified?
 7. Has an analysis of sales and cost been conducted by market segment served?
- D. Customer analysis
 1. Have customers' needs been carefully studied by market segments?
 2. Are sufficient data on customers available for planning? What is the nature and time period covered by these data?
 3. Have customers' motivations been analyzed? What approaches were used to accomplish this?
 4. Has purchase behavior been studied in detail over time? What patterns were identified?
 5. What conclusions were reached about customers' needs, motivations, and behavior?
 6. Have the product/markets been segmented? Have the segment profiles been determined? Have segments been targeted?
- E. Competitive analysis
 1. Has the nature of competition in the market been analyzed? Defined?
 2. Have competitive activities been systematically evaluated?
 3. What competitive advantages were uncovered?
- F. Opportunity analysis
 1. Were the opportunities identified and described in detail?
 2. Were sufficient data used to evaluate these opportunities?
 3. Was the compatibility of these opportunities studied in relation to the resources of the firm?
 4. Were economic, legal, technological, and cultural factors analyzed for each opportunity? What decisions were made?

FIGURE 8.4. The Marketing Audit Format

Part II: Objectives

- A. Nature of objectives
 - 1. Were specific objectives developed?
 - 2. Did these objectives meet the requirements of good objectives? How was this tested?
- B. Types of objectives
 - 1. What types of objectives were established?
 - 2. Was a sufficient database used to establish realistic objectives?

Part III: Strategy

- A. What basic strategy was used? Was it appropriate?
- B. Were alternative strategies evaluated? How?
- C. What approach was used in establishing prices? Products offered? Place? Promotional mixes?
- D. Were sufficient resources available to implement the strategy?
- E. Was the financial impact of the strategy evaluated? How did this influence strategy decisions?

Part IV: Monitoring and Control Feedback

- A. Was a control system established in the planning process?
- B. What types of data were collected with what periodicity?
- C. Were these data and time periods appropriate?
- D. What results were achieved? Were these compared to objectives?
- E. Was performance evaluation completed on all products by market segment? What types of performance were evaluated?
- F. Was corrective action taken as a result of this feedback? What specific actions were taken?

FIGURE 8.4 (continued)

Audit Data and Reporting Format

The data for the audit must be provided through source documents (sales reports, sales training procedures, advertising budgets, media schedules, etc.) and interviews with personnel involved in marketing planning. Top management must ensure that auditors have complete cooperation from these personnel and access to any needed information, especially when external auditors are used. Failure to provide access to the same data available to the planners is sure to lead to a superficial audit and can result in an incomplete and misleading audit report.

Most companies assign one high-level executive to work with the auditor. Information requests routed through that executive carry authority by “virtue of office.”

A variety of reporting formats is possible but one of the most appropriate is a written report of findings and recommendations. In such a report, the auditors’ findings are written out for each area of study and a specific recommendation for improvement is stated for each finding. Thus the reporting format is action oriented, and specific actions can be evaluated for improving the planning process.

SUMMARY

The final step in the effective marketing management process is connecting with customers—establishing long-term, mutually satisfying relationships. Optimal performance in an organization depends upon having controls in place to identify where efforts need to be targeted to improve marketing activities directed at making such connections. This chapter reviewed the need for control, described what is to be controlled, and discussed control procedures. Sales control, cost control, and profitability control methods were discussed, along with consumer feedback mechanisms, ratio analyses, and the rationale and content of a marketing audit.