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Marketing Investments from the Financial Perspective: Problems and Suggestions

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Abstract: Working with marketing investments is considered to be very difficult due to the nature of investment as well as the way it is being treated in companies. There has been a lot of misunderstanding between marketers and accounting managers due to financial issues and goals. This led to a point when the top management's interest towards the marketing function had consequently been decreasing which in its turn resulted in the reduction of marketing budgets. This study gives a short introduction to the concept of marketing investments. We analyse difficulties in evaluating marketing investments where marketing itself is considered today as an intangible asset. Another issue we discuss is a short-term perspective on marketing investments where marketers and accountants have some troubles in finding a compromise. In conclusion, the idea of marketing accountancy is introduced which is claimed to be a solution for current problems related to marketing investments.

Key words: Marketing investments, accounting management, misunderstanding, analyse, short term prespective

INTRODUCTION

Marketing is one of strategically important activities in every company and the way it is dealt with refers to the use of accounting information in order to incorporate it the best possible way. However, marketing accounting in general is not the kind of subject that has received much public or private attention. Gradually, some managers are acknowledging the need for changes in the ways that accounting and marketing functions interact with each other (Meldrum *et al.*, 1986).

This study gives a short introduction to the concept of marketing investments. We analyze difficulties in evaluating marketing investments where marketing itself is considered today as an intangible asset. Another issue we discuss is a short-term perspective on marketing investments where marketers and accountants have some troubles in finding a compromise. In conclusion, the idea of marketing accountancy is introduced which is claimed to be a solution for current problems related to marketing investments.

MISUNDERSTANDING BETWEEN MARKETERS AND ACCOUNTING MANAGERS

It is common that a marketing manager and an accounting manager would often argue on financial criteria and goals. This happens when those managers with different professional roles work in accordance with their own norms and the result is poor communication (Wilson, 1986).

The emerging needs of marketing practitioners have not been facilitated by procedural and legislative traditions of accounting butit is mainly accountants who have the responsibility to relate to the planning, decision-making and control needs of the marketing manager.This situation could be enhanced if accountants take a broader view of assets-in marketing terms, their valuation and the process of investing in marketing assets. It has been suggested that most managers, other than marketing managers, believe that the amount of money invested in marketing is much higher than it should be.

However, the accountants could contribute to improved decision making in marketing by looking at marketing expenditures as investment expenditures rather than as current expenses. Otherwise, the effect of those expenses will not be fully represented by the accounting information and will makeit much more difficult to make decisions on the use of marketing (Meldrum *et al.*, 1986).

Moreover, gathering competitor data will be more effectively accomplished where management accountants and their marketing colleagues, together with others,

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cooperate fully. Consequently, marketing managers after having been poorly served by accountants, require changes in the area (Roslender and Hart, 2002).

MARKETING AS AN INTANGIBLE ASSET

Production assets to a large extent are tangible where as marketing assets are mostly intangible. Marketing assets are considered to be of an uncertain value, intangible and difficult to transfer (Johanson and Mattsson, 1985). In addition, firms might find it advantageous to show lower profits in current periods for tax reasons.

One of the influencing factors on the accounting treatment of marketing costs is the recording of intangible assets. Both intangible assets and deferred marketing expenditures experience similar problems as plant assets regarding the original carrying amount, the amount of amortization or depreciation as well as writing-down if the value declines significantly and permanently. However, intangible assets and deferred marketing costs lack physical qualities which make their existence a little elusive. Therefore, their value is often difficult to estimate and one cannot determine the period in which their benefits will be received. The above-mentioned characteristics of intangible assets and deferred marketing costs make their treatment in financial statements more difficult (Shah and Akbar, 2008).

MARKETING-SHORT-TERM OR LONG-TERM INVESTMENT?

According to previous research studies, there are a lot of large and small companies that are very successful in financial evaluation of their major investment decisions concerning tangible fixed assets. At the same time, there is no much information about how companies made their major investment decisions on marketing.

Even though, the expenditures on marketing are mainly long-term financial investments and often are much higher than on tangible ones, companies are less strict in their financial evaluation. Many industries consider short-term and long-term marketing expenditures to be of a similar nature and consequently count both types as short-term. Some authors claim that the focus has been shifted on short-term measures and earnings due to increasing financial pressures. Moreover, this short-term focus influences future performance and forces reductions in marketing expenses.

There are several reasons that explain the lack of strict financial evaluation for the majority of marketing investments. One of the reasons explaining the lackis a system of accounting principles of financial reporting in the USA and UK that assists in protecting the interests of share holders and creditors.One of the most essential accounting principles states that if one invests money in a project then there should be a sound guarantee that sufficient returns will be generated in future accounting periods in order to cover the current expenditures.

Further more, difficulties in accounting for marketing expenses also arise because of the difficulty of identifying the costs related to particular activities, projects or achievements as well as determining the scale of future benefits and the length of its useful life. Since management can anticipate current profit levels with more certainty compared with future profitability, firms would normally prefer to write off all expenditure in the current period. A firm might not have sufficient income during subsequent upcoming periods to take up amortization of these costs.

It was back in 1993 when the American Institute of Certified Public Accountants Published Statement of Position 93-7 which requires marketing costs to be expensed as they are incurred or when the marketing first occurs. Consequently, marketing expenses have traditionally been written off against profits in the current accounting period. That is why, it often happens that managers tend not to evaluate long-term marketing investment decisions. Thus, the influence of these financial accounting principles on internal accounting for management decision has been very strong.

However, there are several authors, e.g., Hirschey (1982), Hirschey and Weygandt (1985) who believe that marketing expenditures should be capitalized and amortized over their functional periods. According to these authors, the marketing expenditures should be recorded as an intangible asset and amortized against current and future revenues because investment in marketing would be beneficial for both current and future periods (Wilson, 1986).

Indeed, even though marketing expenditures have been traditionally expensed immediately, their effect does not necessarily take place in the period in which the expense is incurred. Extended delays may happen between the marketing of products that are used primarily for certain age groups and the time that the message recipient is old enough to have demand for the product. Also marketing builds up impressions over time until a purchasing incentiveis strong enough to result in a sale.Thus, most accountants agree that marketing expenditures may have a holdover from one period to the next (Rayburn, 1986).

Thus, marketing investments should be treated as long-term investmentsbecause these expenditures will

generate money back not within a current year but rather in several future accounting periods. It is vital for companies to do internal marketing investments analysis in order to have a competitive advantage, since intangible marketing assets such as for instance brands are very high-priced and valuable for companies.

CONSERVATISM

As mentioned before, the major accounting practice treats marketing expenditures as current expenses which results in a 100% amortization rate. According to Rayburn (1986), this practice is based on conservatism, tax benefit considerations and a lack of an acceptable system of amortization.

In the early years of the accounting profession, the conservative view was dominating and any intangible cost such as deferred marketing cost was considered doubtful. There was an overall suspicion of recording any type of tangible costs on the books. Also, in those early years, the balance sheet was considered a more important financial statement. Consequently, under that view managers were more resistant to report deferred charges and intangibles as assets.

During the 1930s, the income statement had begun to bemore emphasized. Along with this change in the financial statement emphasis, the matching principle of accounting became more important (Rayburn, 1986).

However, there is a possible conflict between the matching principle and conservatism. Conservatism often damages the effectiveness of accounting statements for analysis and comparison purposes. Moreover, conservatism is often regarded as an excuse for undervaluation. Conservatism in the current period, after marketing expenditures are expensed, results in a lack of conservatism in future income statements when sales revenues are earned as a result of previous period's marketing. While the conservative principle is strictly followed in expensing marketing expenditures, the matching principle is often violated in accounting for marketing costs (Piercy, 1986).

SUBJECTIVE ALLOCATIONS

One reason often mentioned for failing to recognize marketing expenditures as assets is the degree of complexity related to allocating the costs to the appropriate period. However, accountants have been allocating production costs for many years which in many cases resulted in the lack of objectivity. Only recently has attention been directed to marketing costs. Depreciation and amortization methods are used for the purpose of allocating costs to the same period in which revenue is earned. Indeed, all depreciation methods are subjective to a certain extent, even though accountants continue to use them because it is believed that this allocation has some rational basis (Rayburn, 1986). Moreover, Arthur Thomas' work, The Allocation Problem in Financial Accounting Theory, concludes that it is impossible to allocate costs properly.

HOW TO TREAT MARKETING?

Abdel-Khalik (1975) points out that the choice of treating marketingas an expense or capitalizing marketing over its useful life issignificant because the choicemay affect the measurement of income, earnings per share and perhaps the balance sheet. If one treats marketing expenditure as an expense, it will reduce earnings for the current period. However, on the other hand, this approach could provide tax benefits to the company.

Similarly, according to the matching principle, expenses of a period should be matched with revenues of a period. If all marketing expenditure is expensed in one period while its benefits accrue in the future periods, the matching principle of accounting does not hold. Further, the immediate expensing of marketing has an impact on various measurements such as the return on equity, return on assets and other similar indicators of the financial health of a company.

DOCUMENTATION

One of the main problems regarding how marketing expenditures are being treated is that a financial effect of marketing expenses can not be documented (Gök and Hacioglu, 2010). Thus, the top management's interest towards the marketing function has consequently been decreasing which in its turn resulted in the reduction of marketing budgets. However, the marketing situation in different businesses could significantly be improved if there were a possibility to document returns on marketing investments. Hence, the absence of a clear proof about the role of marketing in an organization will result in a greater negligibility of the marketing function as well as shrinking of marketers' role. Therefore, marketers need to link the productivity and financial accountability of the marketing function more explicitly to business performance (Gok and Hacioglu, 2010).

In financial statements, accountants recognize this holdover for other assets such as plant assets but the value of marketing assets is usually not shown on the balance sheet. The only case in which marketing assets are indirectly recognized is when determining good will for

example, in an acquisition or divestment situation and in recording the cost of acquiring trade names or trademarks. A number of investigations suggest that because many marketing assets have a strong evidence of a holdover, these expenditures should be subject to the same evaluation techniques as other investments (Rayburn, 1986).

FINANCING

In general, investments can be financed by a company's equity, loans or current revenues where the major tangible production investment projects are mostly financed by the company's equity and/or borrowed capital. Company's minor marketing investments are often mostly financed by current revenues. However from the financial perspective, it becomes problematic when a company is undertaking major marketing investment because a high proportion of intangible assets is involved.

Organizational units with such an activity often face losses that have to be written off against equity or be covered by loans. Due to the fact that, the assets are intangible, it is rather difficult to borrow money for financing them since there is no conventional security that is related to investment. Thus, marketing investment is considered to be more risky than production investment (Barrett, 1986).

Sometimes, other companies can assist in financing investment. They can offer credit for products and services supplied. They might also transfer resources as part of exchange processes for which they in their own interest pay themselves. The firms in the network invest in their mutual relationships (Gok and Hacioglu, 2010).

The size of investment ought to be considered in relation to the size of a company. In a large company marketing investment might be hidden and paid for by current revenues from other activities while in a small organizational unit it is not possible. It is therefore very difficult to finance marketing investments in small companies, particularly those with small tangible assets. Thus, these companies have to rely on, for example, other firms' marketing assets, merge with other firms or get help from the government.

Marketing investments in small companies are therefore difficult to finance and such companies have to rely on other companies' marketing assets, merge with other firms or get help from the government-sponsored small-business programs (Johanson and Mattsson, 1985).

CARRY-OVER EFFECTS

Accountants have spent many years solving the problems of production cost allocationsand only recently have they begun to put a direct attention on marketing assets. Most accountants agree that not only marketing expenditures result in current customer awareness but also carry-over effects may do well to the company in the future. This belief encouraged companies to continue to advertise products during World War II and the Korean War when they were unable to execute the orders. However, accountants were questioning whether there is actually a carry-over effect of marketing that extends beyond a short time period (Wilson, 1986).

Nevertheless, accountants have been hesitating to use anything but a 100% amortization rate. The current practice of expensing the entire amount could be considered asa subjective method of allocating marketing cost. The accountants would gain a lot from applying marketing models to the allocation process that would result in an improved allocation procedure (Rayburn, 1986).

For a long time researchers have conducted empirical studies to determine if there is any significant carry-over effect. Palda (1964, 1965) conducted one of the most detailed studies providing statistical evidence on the issue of the carry-over effect of marketing. Palda (1965) pointed out a relative lack of empirical evidence regarding the increasing effects of marketing expenditure and came up with a unique analysis of the effects of marketing on sales. The results of the study indicate that marketing is an intangible asset that is subject to amortization and that, on average, 95% of the marketing expenditure is amortized during a period of almost seven years.

However, there was conflicting evidence in testing marketing experiments for "Teflon" coated cookware and apple sales. The United States Department of Agriculture's study of the effect of marketing on sales of apples found that the carry-over effect of marketing on the sales of apples is not statistically significant. However, the study initiated by Du Pont concerning the sale of cookware shows strong evidence of a marketing carry-over effect.

Likewise, a number of other prominent authors, such as Abdel-Khalik (1975), Peles (1970, 1971) and Tull (1965) provide evidence of an influence of marketing on sales. Tull's findings support the belief that such an effect exists. Tullstated that his findings are persuasive but not conclusive. One of the reasons that a carry-over effect of marketing on sales may occur is that marketing impressions may accumulate over time and build up brand awareness. It finally comes to the point when a consumer

is finally persuaded to buy so that present-period sales are partly a function of past period marketing. Marketing also introduces brands to consumers who later may develop some degree of brand loyalty so that repeated purchases may be considered to be the result of the earlier marketing. With this conflicting evidence, it is not surprising that accountants have hesitated to allocate some marketing costs to future periods and report marketing costs as a deferred asset on the balance sheet. Another reason for the delay in developing amortization rates results from the doubtfulness of using any of the marketing tools available for measuring if there is a decrease in marketing expenditures (Rayburn, 1986).

MARKETING ACCOUNTANCY

There is an urgent need to find an optimal solution on how to treat marketing expenditures so that top management is motivated to spend money on marketing issues. As mentioned before, marketing is one of the most strategically significant areas and the way it is managed has a lot to do with the use of accounting information. This topic is increasingly occupying the attention of senior management in companies that have understood the need for a marketing orientation.

Marketing accountancy is a developing sector within Management Accountancy which looks at the information needed by marketing managers in order to fully exploit it for planning and decision making and to reach satisfactory control measures. Traditional accounting systems do not always provide the right sort of information for these purposes, causing a need for the development of new ways of analyzing and presenting information. With the right type of data, better decisions can be made in terms of concentration of marketing efforts, pricing, distribution policy, marketing budgets, etc., (Meldrum *et al.*, 1986).

The rise in popularity of strategic planning over the last decade is one of the demanding factors which has caused companies to start to reconsider their practices in this area. Strategic planning incorporates such concepts as competitive analysis, core business definition, portfolio analysis, determination of corporate objectives, etc., Within this framework, marketing planning has become an increasingly important activity. In fact, marketing is the main strategic activity for many aspects of competition. Once this fact about marketing has been approved, it becomes important to manage the activity in the most appropriate way. There is a lot of sufficient information that allow for the best strategic use of these resources in order to guarantee good management of marketing. One such management tool is marketing accountancy that can supply information needed for these purposes (Roslender and Hart, 2002).

Improved accounting information for marketing can easily break down barriers between divisions within organizations and may provide for better communications inside a company. For instance, reasonable customer profitability statements have been found to be a useful base for discussions between sales and marketing personnel, the two areas which traditionally have different values and attitudes and where cooperation is hard. Communications are further improved if these reports are interpreted by finance personnel. Businesses which operate as an integrated entity are better co-ordinated and have better chances of success. Relevant marketing accounting information would seem to be one way of advancing this (Meldrum *et al.*, 1986).

The combination of developments in technology and marketing accountancy focus attention on the importance of capturing the right accounting data and coding the information so that it can be used satisfactorily. In order to accomplish this process, a careful analysis of aggregations is required where one should leave room for future changes.

There are studies which suggest that identifying of marketing costs as product specific and/or customer specific is one way in which costs should be coded. In this way, marketing accounting systems can begin to provide information for responsibility and accountability purposes and can help identify effective marketing resource allocation (Barrett, 1986).

CONCLUSION

For a long time, the area of marketing has been suffering from misunderstanding upon the financial perspective. It has been difficult to show the results of marketing investments which led to a critical point when marketing was not considered as a strategically important area of business.

However, one can see the rise of a marketing position in companies which indicates that industries do recognize the need for a greater marketing emphasis.Overall, however, it is a field that must continue to expand. It is also a field where the benefits to be gained are significant.

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