
MANAGEMENT ACCOUNTING – AN APPLICATION TO MARKETING

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Management and Financial Accountants define Management Accountancy as: 'The application of professional knowledge and skill in the preparation and presentation of accounting information in such a way as to assist management in the formulation of policies and in the planning and control of the operations of the undertaking.' The management accountant thus uses all accounting information, i.e. both costing and financial, to help in the corporate management and is directly involved in corporate planning, business finance, setting company objectives, laying down policy and procedures, and the appraisal of investment proposals.

The aim of this paper is to outline the work of the management accountant within the marketing department and by doing so give the student an insight of the use of several management accounting techniques. The Marketing department is one of the most difficult departments to run in any firm; this department has to be very flexible in the sense that it has to change constantly its responsibility and organisation to equip itself better to meet the needs of marketing in a dynamic economy. The lack of organisational stability in marketing as contrasted with production has been observed by accountants, but this appears to be inherent in the nature of marketing rather than in the qualities of the personnel involved. To maximise his service to marketing management, the accountant should study first the products and their markets, and then the marketing organisation, and the particular problems faced. Only when he has done this can he develop the appropriate information and control systems, and assist in the formulation of suitable strategies. Quantitative analyses directed to marketing management must encompass more than the limited area traditionally envisioned as marketing. Consequently, manufacturing and other cost implications must be conveyed to marketing management through analyses designed to provide an effective basis for planning and budgeting.

In establishing marketing plans, especially those of a long term nature the accountant is in the position to furnish special reports for the use of marketing management in arriving at decisions concerning alternative courses of action. For example; he can indicate the relative profitability of these alternatives such as plant location, warehouse location, sales strategies and also the profits resulting from the long – range profit plan, pointing out the existence of any adverse fac-

tors which may affect future profits. To do this the accountant makes extensive use of marginal costing techniques.

Cost Control

The productive output of a firm is what the marketing man is attempting to market, and it follows that an understanding of production costs and problems is essential for anyone working explicitly towards the goal of customer satisfaction. Profit can only be achieved with safety if it is pre-planned, with cost and financial control as the means, and management accounting as the tool. Management accounting provides the means whereby information on the firm's activities may be obtained, processed, summarised, and presented in such a way that actual results may be compared to those previously established in the planning phase. The more often that variances can be extracted and examined, the finer is the degree of control obtained. The determining factor must be the length of time it takes in collecting, processing and presenting data to an acceptable standard of accuracy, which involves weighing up the use which will be made of such data and the cost of acquiring it in the necessary form. The use of computers has nowadays speeded up this process, in some cases at an even cheaper cost.

Financial statements

The tasks of the control accountant are to establish, co-ordinate and administer, as integral part of management, an adequate plan for the control of all operations. Reports of performance relative to the plan must be prepared and interpreted, then communicated and compared with goals. The result is the degree of goal attainment achieved. The economic and social forces bearing upon the business, along with governmental influences must be interpreted, since these help to explain why actual results differ from desired results. The financial outcome in relation to profitability of sales is reflected in the Profit and Loss account, whilst the financial position shown in the Balance Sheet is a measure of the strength and stability available to support future marketing effort.

Since the major determinant of financial strength is the profit generated by marketing operations, it can readily be appreciated that marketing control and financial control are closely interlinked. The presentation of financial reports on the profitability of marketing activities is thus an important factor to consider. Such statements are able to serve two purposes:

- a) they are the principal product profit planning tools of top management; and
- b) they are the cost and profit control tools of product and marketing managers.

When budgeted year to date and variance figures are shown together, they can reveal the degree to which activities are progressing in accordance with plans, but certain drawbacks must not be overlooked such as:

- a) the cost figures may contain arbitrary allocations that could seriously distort them, thereby rendering the product profit figures incorrect.
- b) the cost figures will be composed of both controllable and uncontrollable costs, and a failure to distinguish them will make control impossible to achieve.
- c) on account of the interplay of fixed and variable costs, management may not be able to relate changes in costs to changes in volume. For these reasons it follows that static budgets and full cost allocations are not the ideal techniques for measuring performance and profitability; firms must break away from both traditional accounting techniques and forms of reporting and evolve their own systems.

Liquidity

The transformation of stock into debtors and hence cash brings funds into the firm, and marketing management must remember the importance of liquidity. The aim should be to keep stocks moving quickly through the business, generating revenue, thereby increasing profit, working capital and liquidity – if operations are successfully managed. (The significance to the marketing manager of accounting distinctions between reserves, profits and cash is largely in the avoidance of overtrading and liquidity strain.)

Taking offensive action in a situation of poor liquidity is not the best way of managing a firm: accounting date (in the form of cash flow reports) can enable management to predict and control liquidity, thus preventing an undesirable strain on the cash position from developing. If liquidity is stretched, the marketing team must not solicit too many new orders for manufacture. The production expenses will be a further drain on the cash position that is needed to pay creditors for materials already purchased. The problem of balancing the level of sales with the financial resources available to the firm must be appreciated by both marketing management and the finance department, and co-operation developed between them. Cash budgets prepared by the accountant can be a great aid to the marketing manager in the planning and controlling policies adopted.

The financial viability of a firm's plans can be tested by studying the relationships between the income-generating and expense-incurring activities of the firm. This can be done by flow of funds analysis which shows the main sources of new funds entering the business and how these have been used. However, one must consider the time element in appraising business activities. Accounting periods are not based on the life cycle of products, and this latter division of time is, in many ways, more natural than calendar periods. This is

especially the case since it links marketing, production and financial plans on a unified base in relation to an acceptable rate of return on the capital invested.

Capital Structure

The source of the firm's finance is of importance also – especially that relating to capital structure. Marketing management must appreciate that a high proportion of loan capital (high gearing) will aggravate the problem of a market recession. For this reason, involving the high interest payments required by suppliers of loan capital, top management may be very reluctant to experiment with new products or new markets, and the marketing team must understand their rationale.

Capital Gearing must be related to the degree of risk inherent in the firm's ability to generate profit. High gearing is therefore more appropriate for steady forms of business where profits are regular, though perhaps only moderately high. Firms engaged in insecure activities should remain lowgeared. Interest payment on loan capital is a fixed cost, and this brings us on to the consideration of leverage on marketing operations. "Operation leverage" is the extent to which fixed costs are used in operations, which explains why a small change in sales (through the fixed cost element) may lead to relatively large change in profits.

"Financial leverage" is a related concept, based on the return on shareholdings. The profit responsibility accorded to the marketing manager in marketing – oriented companies makes it imperative that he understands these matters. Financial leverage can be expressed as total debt to total assets, with short – term debt being included along with long – term debt, as this is a major source of finance – especially to smaller firms. By using debt finance the firm can conduct operations with assets in excess of equity. But this is only true to a point, as the equity provides the financial base on which the ability of the firm to incur debt is established.

The major disagreements over the choice of forms of financing are likely to reflect uncertainty about the future levels of the firm's sales. Such uncertainty, in turn, reflects the characteristics of the firm's environment – general business conditions, industry trends, quality and aggressiveness of management, etc. The use of leverage magnifies the impact on shareholder of changes in the rate of return on investment. When returns are high, leverage improves the shareholders' returns; and when returns are below the cost of debt financing, the returns to shareholders are obviously unfavourable.

The most important determinants of the firm's capital structure will therefore include the following factors:

- a) the growth rate of future sales;
- b) the stability of future sales;

- c) the competitive structure of the industry;
- d) the asset structure of the firm;
- e) attitudes of lenders towards the firm and the industry;
- f) the control position of owners and management and their attitudes towards risk.

Conclusion

The management accountant must therefore aid the marketing manager by helping him to understand the way in which costs are built up and allocated to individual products, how budgets are arrived at, how best to control costs and how to make forward – planning accurate. All these functions are vital to the marketing manager as his success will be judged from the financial performance of the marketing effort.