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Market-Orienting Company and its Information Needs

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The preceding article dealt with marketing in its broadest aspects. This one deals with the day-to-day specifics of working with —

THE MARKET-ORIENTED COMPANY AND ITS INFORMATION NEEDS

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THE MARKET-ORIENTED company is the "in" thing. Witness the burgeoning of the marketing function in corporations in recent decades. Titles like Marketing Vice President, Director of Marketing, and Brand Manager appeared for the first time in companies that had previously been process- or product-oriented. And high places have been assigned to these functions on organization charts.

The appearance of marketing men with marketing titles in the upper echelons of the corporate structure is no accident. It results from a long-term trend in business philosophy. No longer do people believe with Emerson that building a better mousetrap will cause the world to beat a pathway to your door. The admonition now is, "Before you go making mousetraps, find out how many people will buy them and what price they are willing to pay."

Know thy market. That's the watchword. Better still: To thine own market be true. It is sad that "Do your own thing" has become a slogan for dropouts. But realism requires that business, especially big business, avoid the risks entailed in any approach that ignores the marketplace.

It is a popular, and useful, exercise to ask, "What business are you in?" Judging from the way the question is answered, it might better be couched in these words: "What wants and needs does your business satisfy?" That, of course, is a marketing question; and we have here another indication of the marketing approach to modern business management.

In taking the market-oriented path, business management is headed along the same route as our society in general. In *The Lonely Crowd,* David Riesman predicted that "the hegemony of other direction lies not far off." That is to say, in our personal life style, other direction, or the influence of our contemporaries, is replacing inner direction, or conscience. Inner direction had earlier replaced tradition direction.

In like manner, market orientation, which is an institutionalized form of other direction, is replacing *technological orientation,* with its rationalization of processes, which is a form of inner direction. And this had earlier replaced the stagnation of tradition-directed economic arrangements.

The turbulence of rapid change has become so much a part of our daily lives that slow-moving groundswells may not impress us as much as they should. But then, in a world that sometimes seems to have come unhinged, it is reassuring to know where some changes are taking us. Now let us turn to trends in accounting and see how they parallel trends in business and in investment psychology.

John L. Carey, in *The CPA Prepares for the Future,* lists nine "conditions prerequisite to exercise of the attest function." Let us look at the last two:

"Number 8. Requisite knowledge and skills on the part of the independent auditor in all important phases of the measurement, substantiation, and communication processes involved.

"Number 9. Familiarity on the independent auditor's part with the purposes of the communication, including appreciation of the user's needs."

Clearly, in evaluating an information system or in advising a client concerning an actual or a proposed information system, an accountant must have an understanding of his client's needs. The only defensible approach to information and communication in business is a pragmatic approach.

Carrying this logic a step further, the market-oriented company has distinctive needs for information; and the independent accountant can serve such a client properly only if he understands those needs and knows how to translate them into effective systems for gathering and reporting information.

In this century, we have seen two shifts in emphasis with respect to accounting presentations. The shifts were gradual; one of them is still going on. And they were rooted in the theory and practice of business and finance during the periods of change.

To begin with, the balance sheet was the principal statement that businessmen relied on. There was good reason. To trade creditors, short-term lenders, and owners with limited capital, solvency is a major issue. When you want to know whether a business is in a position to meet its current obligations, the balance sheet can be very useful to you.

A subsequent shift in emphasis to the income statement was prompted by several factors. As established companies acquired a measure of financial stability, they could afford to pay more attention to long-term trends in earnings. Indeed, investors in stocks and bonds of public corporations found that their own interests were affected more by earnings over a long period than by net assets at a given time.

Meanwhile, industrial engineers had introduced scientific management to operations. In rationalizing production and promoting efficiency, they focused attention on expenditure of effort, on waste, on cost and the reduction of cost.

This activity confronted accountants with new challenges, which they met by devising cost systems capable of reporting material, labor, and overhead costs for departments and for products. Standard costing techniques were developed to handle variations and fluctuations arising from differences in time and place. Responsibility accounting assisted efforts to control expenditures.

And yet, we must recognize the limitations of an income statement, or any other report that is essentially historical. The income statement reports past events and the results of past events. For that reason, it cannot, by itself, satisfy the real wants and needs of the sophisticated modern investor. He is aware that projecting future results by merely extrapolating past earnings is a risky, unrewarding exercise.

Here we have one of the factors impelling us toward a second shift in emphasis: from the income statement to the profit plan. Investors want to look ahead; and they want accounting reports that look ahead. Their own financial analysis would benefit thereby.

Management also wants to look ahead. It feels the need to plan so that its business can survive competitive onslaughts. Viability is important to the managers and owners of all businesses, and to their employees and suppliers as well.

Size has led also to specialization, and functional specialization has created problems of coordination and control. Hence the development of organization theory, the concern with communications, the adoption of such techniques as management by objectives. Hence also the evolution of budgetary control and profit planning, developments that were spearheaded by accountants.

As planning gained ground in industry and extended beyond the short range to long-range planning, new and more sophisticated techniques were adopted. Forecasting has become more scientific, and so have risk analysis and decision making. Calculations of estimated return on investment are quite refined.

It is no accident that all these techniques are among the prerequisites for a market-oriented operation. The fact is that market orientation is implied in modern financial planning. The first decisions are often concerned with markets; and the first information to be gathered is often market information.

Accordingly, computer technology has been recruited in the effort to provide market data and market analysis to the decision makers in industry. In support of the computer programs are data bases and a large quantity of published information. Economic indicators and aggregates are published regularly. We are by now conditioned to look for the latest published figures on gross national product.

To sum up: Business has become market-oriented with especial emphasis on planning; accounting has evolved financial planning to accommodate trends in business thinking; computer programs and data bases are capable of supporting sophisticated techniques that have been developed for the assistance of business planners and decision makers.

What decisions to make?

What are the decisions that the management of a market-oriented company is called on to make? Once we have answered that question, we will be in a position to define the information and analysis that is required by a market-oriented company.

First, let us agree that marketing is concerned with more than just selling, advertising, and promotion. Marketing is concerned with the interaction of supply and demand, with the wants and needs of people and the marshalling of resources to fill those wants and needs.

To be specific, marketing comprises all of the following elements:

1. Product characteristics, product development, modification, and deletion
2. Value analysis and cost/price relationships
3. Time and place considerations
4. Promotion distribution and the development of demand.

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Marketing decisions can be classified along these lines. For convenience, therefore, let us examine marketing decisions and the information they require in these four categories: product characteristics; cost/price relationships; time and place considerations; and promotion/distribution.

Product decisions are made at various phases in the life cycle of a company's products. Concepts are first proposed, developed, and tested; design modifications and inventory accumulation and promotion decisions may be made prior to and immediately after introducing a new product; sales may grow rapidly and then taper off; the period of saturation, followed by falling sales and possibly obsolescence, requires marketing decisions, including deletion of the product from the line. Let us survey the kinds of information that would be useful in making product decisions at several points along the life cycle.

In selecting proposals, management reviews its options against a background of its own long-range goals. This process is facilitated by the existence of formal plans for the company's future, plans that are designed to fulfill express commitments.

Thus, if a company wants a fifteen per cent return on investment, the sum of the contributions of all its products, after charges for promotion, administration, and overhead, must be sufficient to realize fifteen per cent of its total investment in assets of all kinds. The overall plan must be brought down to the level of the individual product's contribution to overhead.

Implied in this thinking is optimum allocation of resources. For guidance in this area, sophisticated analysis may be appropriate, perhaps something that applies the techniques of linear or other types of mathematical programing.

In selecting and testing a product, market analyses are essential. Beginning with a definition of the wants and needs that the proposed product would satisfy and identification of market segments that possess those wants and needs, market studies are designed to locate and measure the strength of various elements of demand.

Market studies are supported by reports of sales trends for similar product lines, both internal and external to the company. At later stages, of course, a product's sales can be compared with forecasts by geographical areas and market segments; and its share of market can be followed, along with the shares attained by competing products.

Since a new product is not just for the moment, but usually for some years ahead, a complete market analysis must contemplate the dynamics of population trends and changing wants and needs. As a class of people becomes more affluent, it develops new tastes, and it may trade up to higher quality. On the other hand, as a particular neighborhood deteriorates, it becomes less attractive as a market for certain high-grade products. You may need to quantify such developments. Again, if your product appeals to older people, you will want to know how many older people there will be in the coming years.

Consequently, demographic studies are a necessary part of market analyses that project demand at future times. In considering information systems for market-oriented companies, accountants must recognize the need to employ data that are generated outside their own or their clients' offices.

Accountants are certainly familiar with sales reports for products and sales territories, including reports of contribution to overhead and reports of sales trends and projections. Analyses of performance within market segments and variations from projected demand are useful in revising plans and estimates. They may be useful also in planning market strategy.

The emphasis must be on spotting trends before they develop fully. Relevant, timely reports can assist in making the right decisions. They can identify the specific market segments where products are unexpectedly strong or weak, so that the products themselves or the methods for marketing them may be improved.

At the end of a product's life cycle, the decision must be made to delete it from the line. The timing of this decision can be improved by proper reporting and analysis.

In one company, the production department is reluctant to recommend deletion of products they believe to be unprofitable. They base their reluctance on a paucity of accurate information regarding the cost of changeovers in the production lines for short runs, handling costs for small orders, and inventory carrying costs for slow-moving items. This company's cost accountants do not provide such information, although it is vital to sound and timely decisions on deletion of declining products.

We have now entered the territory where product decisions merge into questions of cost. Let us pursue further the cost information that is necessary to pricing decisions.

At the beginning of the life cycle, when a product is being designed, accurate costs must be made available on every aspect of every variation in the proposal. A value analysis for each component should weigh its cost against benefits received by the company. Is the part costing too much in comparison with what can be bought outside?

One company we know of reduced its cost by standardizing parts used in similar products. Another company found it could get a serviceable product with less expensive methods.

And, also, is the part costing too much in consideration of what consumers are willing to pay for the function it performs? This is not an easy question to answer, but it spared a company from the gross error of installing heavy-duty controls in household appliances that didn't need them.

Where packaging influences sales volume, and especially where a company's options include packs and cases of varying size, cost/effectiveness data should be reported and analyzed by package design and size. Removal of slow-moving sizes has been an effective money saver.

Analysis of sales trends by size has kept another company ahead of the market in adding new sizes and deleting old ones.

The development period, before a product is brought to market, is the time to gather competitive price data. It is sometimes helpful also to develop detailed costs for products already being offered for sale by competitors.

Although this exercise can involve knotty problems of analyzing and pricing components or ingredients as well as processes, there are companies that regularly attempt to cost competing products.

For many products, it is necessary to conform to an established retail price structure and established dealer markups. Cost factors must obviously influence engineering design in these cases. All the more reason for accountants to be involved in product development. For who is better equipped to help plan a product that must sell for, say, $5.95 at retail, while allowing the dealer a markup of 37 per cent?

Accountants can bring many advantages to the process of estimating the costs of new product proposals. They can bring the accuracy of estimates based on standard cost systems in operation, the precision of costs segregated as to fixed and variable components, the flexibility of direct costing, and the adaptability of opportunity costs to such varied problems as by-product evaluation and allocation of resources.

In one company a by-product of fractionation was consumed in another process as a replacement—a poor substitute, at that—for a raw material costing four cents a pound. All the while, a market was neglected, a market willing to pay nineteen cents a pound for the by-product.

The reason for this neglect? The by-product was improperly valued at twenty-four cents a pound, because it was derived from an expensive oil in the fractionating process. A change to opportunity costing brought about a reassessment of the by-product from a market-conscious standpoint. In the end, a highly profitable market was tapped for the first time.

The final decision to add a new product to the line calls for accounting studies such as breakeven analysis and risk analysis. These are supported, in turn, by a budgeted brand profit and loss statement capable of inclusion in the company's overall profit plan. Eventually actual brand profit and loss statements will test the validity of the budgeted figures in preparation for a new budget cycle.

In discussing product and price decisions, we could not avoid some overlap; and as we turn now to decisions of time and place, we can expect to find additional overlap here. For we are concerned now with where the markets are and when to proceed with various phases of a market plan; these decisions are not made in a vacuum;

they must relate to the product.

We have already covered company sales statistics by product and by geographical area. Let us take note of the fact that there is a big, wide world outside the company, a world full of potential customers that no company can afford to ignore.

What would we want to know about the potential market in a given region? To begin with, we can make use of information on how various market segments are represented in that region: the distribution by age, education, income, and so on. If our product is sold to automobile owners, then we would want data on the automobile owners in the region. We would want to zero in on their discretionary spending habits.

By contrast, a greeting card company, knowing that a group of cards appeals primarily to a specific age group with a particular educational background, seeks to stock that group of cards in stores whose location and clientele fit the market description.

Accounting reports then provide feedback as to the accuracy of assumptions concerning both cards and market segments. Future plans may be modified on the basis of such feedback.

But consumer markets are not the only markets. We might want to know what industries are represented in the region, their size, and other characteristics. In the end, we want to be able to form sound judgments as to the products we should be able to sell in the region and what our sales targets ought to be.

We arrive at these conclusions from analyses of the wants and needs of market segments, both consumer and industrial, in the region. And we use these analyses in a number of ways:

- To organize and train a sales force that will specialize in selling to particular market segments.
- To structure sales territories within the region.
- To guide promotional efforts and the selection of distributors.
- To assist salesmen in allocating their time to customers. We can do better than to allow the number of calls to a customer and the length of a call to be determined by chance factors or personal whim. One company regularly provides salesmen with data on individual customers' potential as well as actual sales. Salesmen for this company are encouraged to allocate roughly one hour for each $300 of actual sales or each $600 of potential sales, where the prospects look favorable. These criteria were worked out by a consultant, based on the company's compensation plan and other data.
- To provide material for further studies to select plant sites or warehouse locations.

If markets show regional patterns, they also show seasonal patterns and fluctuations over time. Reports that indicate these temporal aspects of market behavior are useful in two distinct types of planning:

- Timing a company's promotional efforts to take advantage of market patterns. There is no sense in being out of phase with the seasons, and no one is likely to be out of phase by six months. But how many campaigns are planned and executed one month earlier or later than they should be for maximum results?
- Influencing market behavior to change by offering special rates or conducting off-season sales. Whole industries have adjusted the dates of their shows in order to smooth their sales curves.

One company produces a quality line of style items in season for specialty shops and a discount line of staple products out of season under special contracts. The purpose: to hold the work force together and incidentally to cut payroll tax expense and provide a small contribution to overhead.

In recognition of the ongoing need for information on which to make decisions with respect to time and place, companies now regularly prepare profit plans by local territory and broader region; and these plans are presented by month as well as year. Actual profit and loss statements also present monthly data by territory and region for comparison with plans and maintenance of budgetary control.

Having covered product, price, time, and place decisions and the kinds of information that can improve them, we come now to the last of our categories: distribution and promotion.

A principal aim of financial studies of distribution methods is the assessment of cost/effectiveness for specific distribution channels. This being the case, profit contribution should be reported regularly, along with sales, by distributor, dealer, and salesman.

It is often helpful, too, to summarize data for distribution channels and industrial customers by category, size, or industry. Such information may lead to redirection of promotional efforts: We may find it advantageous to turn certain classes of customer over to distributors for servicing; we may allocate funds for product development aimed at specific markets.

One company built up a line of diagnostic products, one at a time, because they were useful to laboratories it sold to. Some of the products were new—genuine research contributions.

Promotional methods also are susceptible to cost/effectiveness analysis. Accounting systems should be sufficiently flexible to accumulate and report costs and results for each advertising or promotional campaign separately.

Methods determine reports

The choice of the most appropriate studies and reports for a particular company depends mainly on its marketing methods. Properly selected reports relate to marketing operations.

For example, if the sales force in the field pushes our products through the distribution system, then our reports will emphasize cost/effectiveness in selling to customers and dealers. Interpreters of these reports will look for opportunities to improve profits by adjusting territories, making personnel changes, revising compensation policies, providing incentives, and the like.

On the other hand, if advertising is directed at the ultimate consumer by way of television, magazines, and point-of-sale displays, so that products are pulled through the distribution system, then our reports will emphasize cost/effectiveness with respect to advertising. Specific advertising efforts should be related to sales in specific market segments.

Interpreters of these reports will look for better ways to allocate advertising dollars, based on comparisons of results achieved with efforts expended. They will also seek formulas for determining optimum levels of advertising.

It is often easier to talk about cost/effectiveness than to isolate the variables that are to be compared. Consequently, advanced methods of analysis are sometimes necessary in such studies. To illustrate, multiple regression analysis permits measurement of the relative contributions of factors that operate concurrently, so that the effectiveness of each factor may be evaluated for future decision making.

In another type of situation, discriminant analysis may be helpful. If the problem is to evaluate the feasibility of a campaign or a plant site, discriminant analysis establishes the predictive value of each of a number of factors from data accumulated in the past. Data are gathered for the proposal, the factors are evaluated, and their combined influence is calculated as an aid in decision making. It is now relatively simple to apply these techniques.

There is another kind of computer application that requires much more programing preparation. If a company wants to predict the effects of proposed changes in policy, plans, or outside conditions, it can simulate its operations by computer, but only after it has drawn up a corporate model, at considerable expense, into which it may then feed new parameters or new variables at will. Many companies, however, find that the benefits outweigh the cost. Real time simulation programs, in offering rapid response to "What if?" questions, measure the susceptibility of a course of action to vagaries in the principal variables and estimating errors in the parameters. Here real time simulation programs offer a powerful tool to the decision maker. Sensitivity analysis calculates the expected effect on the outcome of specified variances in the input.

To achieve the greatest benefit from a program of profit improvement, attention is just directed to specific areas and items of income and expense, and the question is raised at the outset: Where do the best opportunities lie for significant improvement? This question may be rephrased to read: For which specific items do variations have the greatest impact on earnings? Stated this way, of course, the question is the basic consideration of sensitivity analysis. Moreover, the answers lead to those items that not only offer the greatest promise of improved earnings but also deserve the most attention in controlling operations.

We have now surveyed the range of marketing decisions, rather sketchily, and indicated some of the information needs of the decision makers. Admittedly, much of what we have considered is more directly the concern of financial executives within a client company than of independent accountants on the outside. It is more directly their concern, but not exclusively, for the independent accountant has responsibilities in this area, too.

What we have covered is an introduction to the market-oriented company and its information needs. An accountant who is interested in the subject will have to do much more research than we have been able to present. But, above all, he will require an imaginative approach that will enable him to provide fresh insights and new solutions.

Demands will grow

We have started with a classification of routine marketing questions, and we have translated some of the decisions that must be made into the kinds of information they should be based on. From that point, accountants should be able to envision specific reports and the systems that will produce them.

Another way of describing our purpose is to say that we have surveyed opportunities for meeting the wants and needs of our clients, a market-oriented approach to the practice of accountancy itself. Lest this thought disturb you, let me hasten to add that there is nothing unprofessional about providing services that meet the needs of clients.

In our brief survey of opportunities, we have been looking ahead in the direction that business currents are taking us. The market-oriented company is here to stay, and its demands on information systems are likely to increase. Accountants can make a significant contribution to industrial growth by leading the way in this development.