Advertising Expenses and Sales Incentives impact on Financial Performance of FMCG industry

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Abstract

There has been much interest among academicians and practitioners to understand the role of marketing expenses in contributing to the financial performance of organizations. Especially, in times of recession, budget reduction, or market contraction, marketing budgets get the major cut. However, organizations continue to spend millions in the development and execution of marketing programs. This paper examines the effect of advertising and sales incentives on the revenue and profit of nestle and national, who are the market leaders in their respective industries of Pakistan. With the help of secondary data, it has been found that there is a negative relationship between advertising and financial performance (i.e. revenue and profit), but sales incentives on the other hand have a positive relationship with revenue and profit.

Keywords: Marketing expenses, Financial performance, Advertising, Sales incentives, Revenue and profit

Introduction

The contribution of marketing in the financial performance of organizations has been a subject of considerable debate in the past years, but the insistence to establish the marketing-finance interface has gained a greater attention, as marketers strive to defend the value of their activities amidst budget cuts Traditionally, marketing activities have been designed from the viewpoint of customers,because eventually, these regulate the mechanism of attracting, acquiring and retaining customers. However, when organizations are faced with the dilemma of reducing cost, marketing expenditures are the primary facet of the budget to be criticized.

On the other hand, it is argued that effective marketing or promotional activities, such as advertising; personal selling; sales commission and incentives; and interactive marketing could result in the achievement of long-term objectives and higher financial returns. Numerous researchers have tried to emphasize on the linkage between marketing and the essential role it plays in the enhancement of organizational performance, in terms of sustained growth and profitability it has pointed out that marketing expenditure has a direct effect on investors. Similarly, advocates of marketing, relate its activities to the opportunity of gaining competitive advantages. Recent advances in this paradigm have triggered the investigation of marketing activities' impact on firm's accounting and financial market performance

Despite affirming to the underlying relation between marketing activities, and organization's sales and profitability in several studies (Joshi & Hanssens, 2010), the issues concerning marketing budgets, especially advertising, are still found vulnerable (Lodish & Mela, 2007). Conversely, in the context of pakistan, there is no adequate evidence or literary work to put light on this theory. Since businesses operate with the primary purpose of maximizing the return of shareholders' investments, according to the shareholder value principle (Joshi & Hanssens, 2010; Osinga et al., 2011), investigation of this subject area is deemed important.

This paper is aimed to not merely contribute academically, but also provide an opportunity for other organizations in the particular industries to comprehend the significance of marketing expenses and the extent to which these can influence the revenue and profit of an organization, because eventually this is what the shareholders seek to achieve.

Literature Review

In a dynamic market environment that is challenged with constant change in demands and severe competition, organizations have found the need to employ various marketing communication tools in order to attract and retain customers. Numerous studies and academic research for this purpose have been carried out to evaluate the effectiveness of various marketing actions, such as advertising, sales incentives, and sponsorship, on the augmentation of shareholder value (Osinga et al., 2011). In a research by Lodish et al., 1995, the findings revealed that TV advertisements impacted sales in the short run, but not in the long run. Resultantly, this raises skepticism regarding the big budgets allocated and spent on advertisements. Another research, carried out over a span of four years by Nijs, et al., 2001, disclosed that although price promotions had a short-term effect, advertisements on the other hand had a long-term effect on sales. Hence, this has been a subject of great interest for many researchers who have over time explored the relationship between marketing communication activities and profitability.

Okeyere et al., 2011, established that an increase in advertising and sales promotion causes the sales volume to increase as well, but the opposite was proved for the relationship between sponsorship and sales.

Advertising and Financial Performance

According to Armstrong and Kotler, 2000 (cited by Richard and Curran, 2002, p.65), advertising is "any paid form of non-personal presentation and promotion of ideas, goods, or services by an identified sponsor." Lamb, Hair and McDaniel, 2000 (cited by Richard and Curran, 2002, p.65), further added that it is an "impersonal, one-way mass communication about a product or organization that is paid for by a marketer."

Many academicians have argued over this notion that advertising has the capability of capturing potential customer's attention, driving a positive buying attitude, and eventually encouraging consumer response (Riaz et al., 2015). Contrariwise, there are two schools of thoughts: one argues that advertising increases profit by creating false product differentiation and amplifying the entry barriers for other companies; the other suggests advertising has informative character that can shape the market to be more competitive and distributing the profits to more companies sharing the market (Greuner et al., 2000). Simester et al., 2009, added that advertising undoubtedly affects sales, but the long-run result is not always positive. Nevertheless, the benefits of advertising for an organization cannot be shunned, as it continues to reflect in the expenditure of many bigger names in the market. For instance, in the year 2016, China's largest online retailer, Alibaba accounted for a 50-percent rise in their advertising and promotional spending. Furthermore, Amazon has exceeded other marketers like Coca-Cola and McDonald's in their advertising expenditure, and has been positioned as one of the highest ranked global advertisers (Johnson, 2017).

Lee et al., 1996, found out a two-way causal relationship between advertising and sales. Advertising is believed to influence the consumer's mindset and taste, which eventually contributes to the purchase behaviour of consumers. Alternatively, the other direction of the causality claims that sales and profits possess the key to determine advertising budget. This causality was then criticized in the findings of Leach, 1996 (cited by Chowdhury, 2017), where the former causal relationship was proved, but the latter, i.e. sales causing advertising expenditure, was rejected. Some other research, such as the one done by Elliot, 2002 (cited by Linson & Thomas, 2016), suggests there is a substantial effect of advertising on sales turnover in the food industry; and a measurable effect in the soap manufacturing companies as highlighted by Linson & Thomas, 2016. Similarly, Kambar (2002) and Sundarsan (2007) provided evidence of a positive relationship in context of different company sizes. Hence, it would be interesting to find out whether advertising in the context of pakistan, has a significant impact on financial performance, and if so, whether it is a positive or a negative relationship.

Sales Incentives and Financial Performance

Sales incentives are considered as an important marketing tool through which superior performance is derived from the sales force, so that sales volume is increased in return. Usually sales incentives are categorized into two groups: monetary incentives (i.e. commission, bonus system, share of profits, and cash rewards), and the other being non-monetary incentives (i.e. merchandise awards, travel awards, and sales contests) (Arbatt, 1989, p.209). As quoted by Couretas, 1985 (cited by Arbatt 1989, p.210), the primary objective of incorporating sales incentives into the marketing program of an organization is “to increase sales per salesperson”. However, during times of market contraction, managers are often faced with the challenge to reduce costs and simultaneously improve sales. In such situation, decisions regarding instilling sales incentive program in the budget becomes complicated, because it incurs cost, but at the same time it is needed to raise sales volume (Jiménez et al, 2013).

Sales incentives are not only used to generate sales volume, but nowadays it is more about creating profitable sales volume and thus, a decision regarding this should be carefully analyzed (Spiro et al., 2003).it is argued that in companies where sales generation highly depends on selling efforts, incentives play a major role in motivating sales employees to provide additional efforts that can be transformed into higher returns (John & Weitz, 1989). In case of sales incentives, the academic findings have often failed to match the real scenario, mainly because the subject overlaps in many different domains, such as marketing, organizational behaviour and psychology; and another major reason is that companies hardly allow experiments with their sales-force (Zoltners et al., 2008). Nevertheless, researchers in the past have measured the outcomes of sales incentives in terms of high market share, profitability and sales (Behrman and Perreault, 1982; Piercy et al., 1998). In accordance to the literature discussed, the hypothesis is as follows:

Research Methodology

In line with the purpose of this particular research, which is to assess the impact of advertising expenses and sales incentives on financial performance, revenue and profit after tax (PAT) have been used as the main financial indicators; thus, treated as dependent variables. Whereas, among all marketing expenditures, this research focuses on advertising Expenses and sales incentives, representing the independent variables. This research is solely based on secondary data and follows the procedure to test causality between the dependent and independent variables. To test the hypotheses, a quantitative research has been conducted using the secondary data gathered from the audited annual reports of both the organizations (i.e. nestle and national), over the span of five years from 2013-2017. Since, these two organizations are market leaders in their respective industries, they are selected to provide an overall view of the contribution that marketing expenses make to their financial returns. The Statistical Package for Social Sciences (SPSS) version 24, have been used to investigate the hypothesized causal relationship through conducting a correlation, followed by regression analysis, in both the cases.

Overview of the Case

Nestle, which is a big name in food and beverage industry company, commenced its operations in 1905(nestle Financial Report, 2018). Although, they are not the first to start the FMCG company in pakistan, they still found their way to success, having 21% to 91.4 billion net acquisitions had a positive impact of .7% As this figure show the revenue and profit after tax compariesion in the graphic which we can see that revenue reaching at high level and profit after tax is reaching on low level in several year if we see these 5 years,

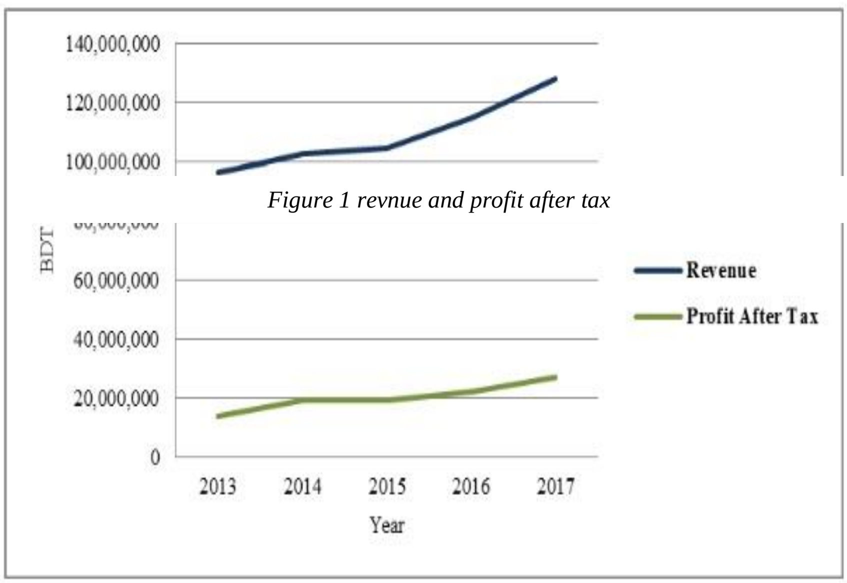

Figure 1 revnue and profit after tax

The increasing sales revenue and profit figures, over the span of five years (i.e. Year 2013-2017) have been illustrated in Figure-1. The expenditures for advertising and sales incentives are represent-ted in Figure-2. It is intriguing to note that the expenditure for sales incentives increased, whereas the amount of advertising expenditure decreased..

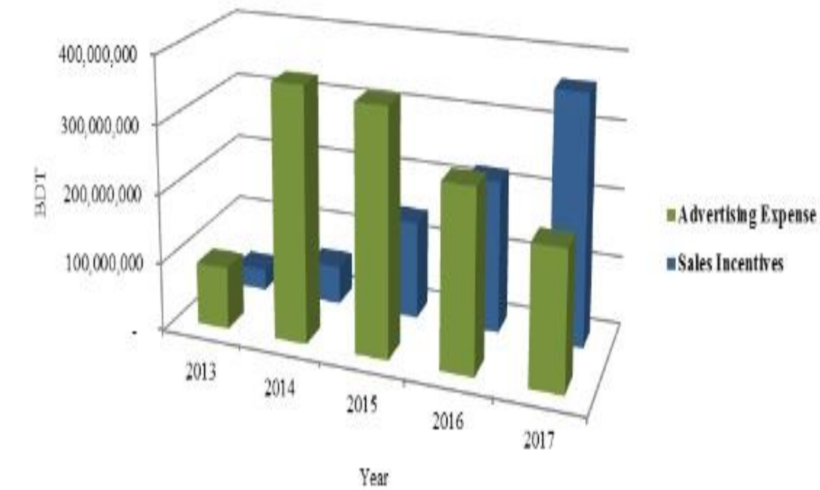

figure 2. Advertising Expenses and Sales Incentives of nestle (Financial

Case 2-national: the leading FMCG company in Pakistan

. Figure-3 represents the increase in sales revenue and profit after tax of national pakistan from the year 2013 to 2017. However, the disparity between the revenue figures and profit is huge, with a loss in

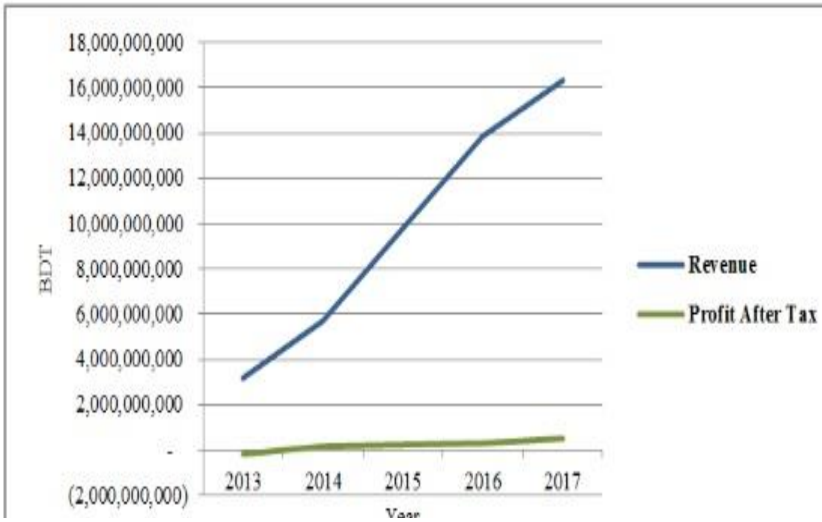

Figure 3.Revenue and PAT figures of natoinal (Financial reports, 2013-2017)

2013, which could perhaps be due to its parent company being a social enterprise, or also because they have had a huge amount of outside investments in the initial years

Figure-4 explains the expenditure for sales incentives is increasing significantly, whereas the advertising expenses are decreasing over time. In contrast, it can be seen that from the year 2013.

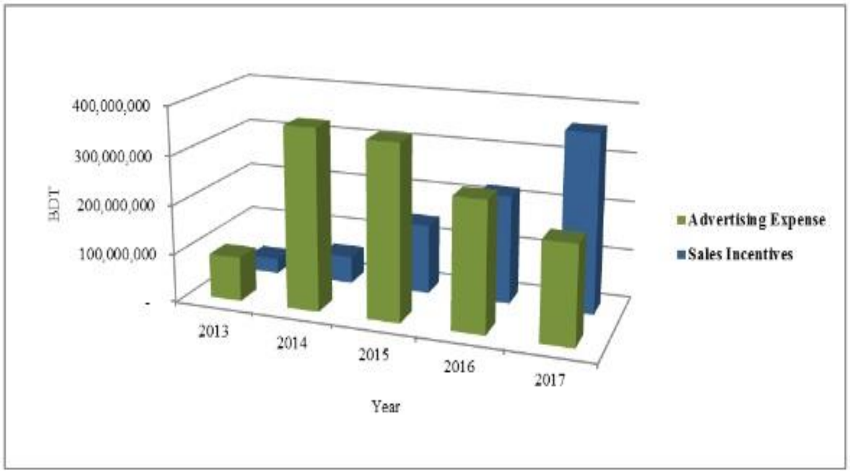

figure 4.Advertising Expenses and Sales Incentives (Financial reports, 2013-2017)

Data Analysis

Analysisfor Case 1: nestle

Table 1Correlation Coefficients for Case-1 (nestle)

	Revenue	Profit After Tax	Advertisement	Sales Incentives
Revenue	1	.968**	-.905*	.994**
Profit After Tax	.968**	1	-.812*	.943*
Advertising	-.905*	-.812*	1	-.932*
Sales Incentives	.994**	.943*	-.932*	1
**. Correlation is significant at the 0.01 level (2-tailed).				
*. Correlation is significant at the 0.05 level (2-tailed).				

Table 1 denotes the correlation between all the variables derived for the case of nestle. Although, advertising is believed to have a positive impact on revenue and profit, the correlation coefficients state otherwise. The correlation between advertising and revenue is strong, but negative (r=-.905, p<0.05), and the same correlation stands with PAT (r= -812, p<0.05). On the contrary, a strong, positive relation can be observed between sales incentives and revenue, and also between sales incentives and PAT (r=.994, p<.01; r=.943, p<.05 respectively). Moreover, the high correlation between revenue and profit, and advertising and sales incentives are quite apparent.

Table 2.Regression Model 1-Relationship between Advertising & Financial Performance of nestle

Variable	Beta (β)	t	Sig.	Variable	Beta (β)	t	Sig.
(Constant)		14.705	.000	(Constant)		6.308	.000
Advertising	-.905	-3.696	.034	**Advertising**	-.812	-2.412	.008
R Square (R^2)	.820			R Square (R^2)	.660		
Adjusted R^2	.760			Adjusted R^2	.546		
a. Dependent Variable: **Revenue**				a. Dependent Variable: **Profit After Tax**			

Regression analysis has been carried out in order to examine hypothesis 1, the results of which are shown in Table 2. The hypothesis argues that there is a significant relationship between advertising and financial performance (i.e. revenue and profit), which in this case has been accepted because the significance value matches the standard level of acceptance (p<0.05). However, it is fascinating to find that a negative relationship exists between the variables. This implies an increase in advertisement negatively impacts financial performance.

In addition, the strength of association between a dependent variable (revenue, PAT) and an independent variable (advertisement expense) can be explained with the help of R2 (Hössjer, 2008).Here, a strong association is detected, as 82.0% and 66.0% of the variation in the dependent variables (i.e. revenue and profit respectively) is explained by the variation in advertising.

Table 3.Regression Model 2-Relationship between Sales Incentives& Financial Performance of nestle

Variable	Beta (β)	t	Sig.	Variable	Beta (β)	t	Sig.
(Constant)		3.615	.000	(Constant)		-1.769	.005
Sales Incentives	.994	16.237	.001	**Sales Incentives**	.943	4.888	.016
R Square (R^2)	.989			R Square (R^2)	.888		
Adjusted R^2	.985			Adjusted R^2	.851		
a. Dependent Variable: **Revenue**				a. Dependent Variable: **Profit After Tax**			

Regression model 2 (shown in Table 3) has been carried out to test hypothesis 2. The hypothesis is accepted because again the significance level reaches the accepted benchmark. Additionally, the positive relationship between sales incentives and revenue, as well as with profit, suggests that an increase in sales incentives causes an increase in financial performance of the firm. The strength of association between the dependent variables and independent variable is quite high, signifying a 98% of variation in revenue and 88% in profit are explained by the variation in sales incentives.

From the above analysis, it can be confirmed that advertisement expense and financial Performance have a negative relationship, but on the other hand, sales incentives and financial performance have a positive relationship.

Analysis for Case 2: national foods

Table 4.Correlation Coefficients for Case-2 (national food)

	Revenue	Profit After Tax	Advertisements	Sales Incentives
Revenue	1	.914*	-.118	.968**
Profit After Tax	.914*	1	-.455	.858**
Advertising	-.118	-.455	1	-.051
Sales Incentives	.968**	.858**	-.051	1
*. Correlation is significant at the 0.05 level (2-tailed).				
**. Correlation is significant at the 0.01 level (2-tailed).				

Table 4 represents the results of correlation analysis for national foods, which demonstrates a negative correlation between advertising and revenue (r=-.118), and the same negative correlation exists with PAT (r=-.455). However, the coefficients are not statistically significant, meaning p>0.05. In contrast, a strong positive relation can be observed between sales incentives and revenue (r=.968, p<.01), and also between sales incentives and PAT (r=.858, p<.01). Unlike national, there is a negative correlation between sales incentives and advertisements; however, the results are not significant enough to be accepted. Furthermore, the positive correlation between revenue and profit is quite strong and evident.

Variable	Beta (β)	t	Sig.	Variable	Beta (β)	t	Sig.
(Constant)		1.116	.346	(Constant)		.162	.882
Advertising	-.118	-.207	.850	**Advertising**	-.455	-.885	.441
R Square (R^2)	.014			R Square (R^2)	.207		
Adjusted R^2	.009			Adjusted R^2	.157		
a. Dependent Variable: **Revenue**				a. Dependent Variable: **Profit After Tax**			

Table 5.Regression Model 3-Relationship between Advertising & Financial Performance of National

In contrary to the previous case, hypothesis 1 is rejected here because Table 5indicates that the significance of the causal relationship between advertising and financial performance (i.e. revenue and profit) does not match the standard level of $p<0.05$. Besides these, only 1.4% and 20.7% of the variation in the dependent variables (i.e.revenue and profit respectively) is explained by the variation in advertising,implying a very trivial contribution.

Table 6.Regression Model 4-Relationship between Sales Incentives & Financial Performance of national

Variable	Beta (β)	t	Sig.	Variable	Beta (β)	t	Sig.
(Constant)		2.837	.016	(Constant)		-.513	.044
Sales Incentives	.968	6.637	.007	**Sales Incentives**	.858	2.898	.003
R Square (R^2)	.936			R Square (R^2)	.737		
Adjusted R^2	.915			Adjusted R^2	.649		
F value	44.051			F value	8.396		
a. Dependent Variable: **Revenue**				a. Dependent Variable: **Profit After Tax**			

Regression model 4 (shown in Table 6) has been conducted to test hypothesis 2. The hypothesis is accepted as the results shown correspond to the standard indicator of significance level (i.e. $p<0.05$). The results further indicate a positive relationship between sales incentives and revenue, as well as sales incentives and profit. This specifies that an increase in sales incentives causes an increase in financial performance of the firm. Furthermore, R2 values are also high which indicates that variation in the dependent variable is highly impacted by the variation in the independent variable. Hence, according to the findings of this research, advertising expense and financial performance have a negative relationship but not significant enough to be counted; whereas, sales incentives and financial performance have a significant positive relationship.

Conclusion and Future Scope of Research

It can be deduced from the research that advertising has a negative association with financial performance in both the organizations: nestle and national. However, in case of the latter, the negative relationship is not significant enough to be considered. On the other hand, sales incentives indicate a strong positive relationship with sales revenue and profit after tax of the two organizations. Itis intriguing to note that while both the organizations are increasing their sales incentives, the advertising expenses in both the cases show gradual reduction. This reflects some of the prior theoretical works, which prove that there is indeed a negative relationship between advertising and sales revenue; and even if there is a positiveimpact, it is short-lived (Bagwell, 2005; Simester et al., 2009). In addition, there is literary evidence that infers sales incentives are an effective medium to generatesales volume (Spiro et al., 2003; Ryals and Rogers, 2005).

This research is not free of limitations though. Taking into account few more companies from each industry, or a number of industries could have provided a bigger picture about the impact marketing expenses has on financial performance. Therefore, the findings of this particular study have revealed few gaps, which could be analysed further. It is important to explore the reasons behind an increasing budget for sales incentives and a decreasing budget for advertising, for which primary data collection would be necessary. Since, the financial reports gathered in this research do not provide a thorough breakdown or a clear indication regarding organization's digital marketing expenditure, the financial outcome of this marketing activity also needs attention.

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