OPINION

# Finance and marketing share three fundamental beliefs

*Marketing and finance share several beliefs about business, they just differ on how to carry these out, making them closer to sibling rivals than full-on enemies.*

By Jonathan Knowles | 8 Oct 2024

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Marketers are prone to ascribing terms like "nonbelievers" to those who do not understand their value. But when marketers use this term about finance, they are doing themselves a disservice.

Finance is marketing's sibling, not its enemy. Finance and marketing share three fundamental beliefs: that value is the foundational concept of business; that the short term and long term both matter; and that risk is an important aspect of management.

Marketing and finance argue because of the similarity of their beliefs, not due to their differences. The intensity of these arguments reflects the frustration that we feel when our siblings are being obtuse and unreasonable.

Let's explore these three common beliefs, starting with value.

## It's all about value

Both marketing and finance believe that the concept of value is the cornerstone of business.

Marketers often quote the great management consultant Peter Drucker in arguing that "the purpose of a business is to create a customer", and will argue customers are only created when the business offers them a set of benefits which has perceived value exceeding the price being asked.

Finance argues that "the purpose of a business is to earn an excess return on capital" and this only happens when the price charged to the customer exceeds the economic cost of the services provided.

Note that there is no fundamental disagreement here. In both cases, value is a ratio. Marketing defines this ratio from the customer's point of view (benefit to price) while finance defines it from the point of view of the business (price to production cost). Merge these two ratios and you get the holistic definition of the purpose of business – "to deliver benefits to customers at a cost that leaves the business with an adequate return on its invested capital".

So why then is there so much apparent conflict between marketing and finance? Because each is trying to maximise their respective value ratio.

Marketers want to "win" with customers, while finance wants to "win" with investors. Both functions need to remember that the interests of the business are best served when marketing and finance collaborate to optimise the ratio between the cost structure of the business, and the scale of the benefits delivered to customers.

This observation is especially important when we consider the time lag between investments and returns – the second area in which marketing and finance have a shared belief but often seem to be in conflict.

## The short term and the long term

Both marketing and finance have well-developed mental constructs for the importance of both the present and the future, and how they are related.

For marketers, this is most obviously represented in the concept of the marketing funnel. "Creating a customer" is a process that begins with identifying prospects and nurturing them through a sequence of steps that leads to a sales transaction and to an ongoing relationship. This customer journey takes time. Marketing is constantly balancing its spending between the "harvesting" and "sowing" aspects customer management – specifically, between focusing on reaping the returns from past investment in customers (delightfully referred to as "monetisation") while also sowing the seeds of future customer relationships and the revenue they will represent months or years from now.

Finance has similarly strong concepts of how to represent the present and the future – namely, the income statement and the balance sheet. The income statement (and associated cash flow statement) show how the business has performed over the recent past (typically, quarter or year) in terms of revenues and costs. The net operating profit after tax represents the residual profit that can be used to pay the investors who provided the debt and equity capital. The balance sheet is a point in time inventory of the asset base of the business – the capital resources that represent the "factory" for the generation of future revenue and profits.

Marketing and finance both agree that revenues and profits are a good measure of performance in the short term. But they too often diverge in their opinions about how the long-term productivity of the business should be measured. Marketers view the "factory" of the business to be primarily associated with the quality and endurance of customer relationships (that's why marketers talk endlessly about the importance of the "brand"). Finance folk see the "factory" as the current operating model with a bit of innovation sprinkled in to ensure that it continues to generate cash flow.

This is why the concept of "performance marketing" was so attractive to finance and detrimental to marketing. By focusing on immediate, attributable sales, performance marketing appeared to finance as a fundamental improvement in the efficiency of the operating model of the business – the equivalent of lean manufacturing or total quality management now being applied to enhance the efficiency of marketing activities.

The myth of performance marketing is that transactions occur in the absence of relationships. That the purchase cycle only begins when the buyer is first identified as a sales prospect. It ignores the importance of "top of the funnel" activities (that should more accurately be described as "relationship development" activities) in industries where purchases are based on trust because the consequences of a poor choice are significant.

As any farmer can tell you, you can eat like a king for a season by consuming your seed corn – but you should not expect a harvest the following year.

A focus on performance marketing is not a recipe for success in industries in which current sales are the direct consequence of past investments in customer relationships. Nike and Starbucks are two recent examples of companies that learned the dangers of chasing financial efficiency (specifically in the form of the higher margins they believed they could earn through direct-to-consumer channels) at the expense of long-term customer value. Both companies discovered that the decline in their revenues and margins was a direct consequence of their previous failure to invest in the long term.

This brings us to the third area of shared belief between marketing and finance – the importance of risk.

## Calculated risk-taking is essential to business success

Both marketing and finance agree that risk management is a critical component of how to manage a business effectively.

Marketers live in a world of constant change – customers ageing into and out of their target segments; shifts in customer preferences; new competitors using new technologies and new channels as the basis for a superior value proposition.

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Marketing is the discipline responsible for ensuring that the awareness and salience of the company's offerings remain high among the target audiences to whom the company can offer distinctive value. Marketers are paranoid because they know that whatever got the company to its existing level of success is unlikely to be sufficient to sustain it going forward.

By contrast, finance professionals live in a world where annuities (a series of regular payments) are highly valued – those "set and forget" investments that continue to generate excess returns on capital year after year.

Call them "strategic moats" or "structural advantages" (often a synonym for "de facto monopolies" achieved through industry consolidation or regulatory capture), these are "assets" that effectively guarantee stable cash flows into the future.

Within this world, finance has two fundamental measures of risk – beta and alpha. Beta is a measure of average risk and is used to determine the cost at which the company can raise capital (beta is a central component of the Capital Asset Pricing Model). A higher beta indicates higher volatility. Alpha is a measure of excess returns – the degree to which a company exceeded the earnings that its beta would have predicted.

'Beta' creativity refers to all the actions taken by marketing to ensure a brand maintains the salience among target customers, ensuring that customer acquisition and retention continue at a rate that delivers stable, enduring cash flows to the business. This type of creativity is all about using effective positioning (such as Mastercard's 'Priceless' or Cadbury's 'There's a glass and a half in everyone') and distinctive brand assets (such as Coke's packaging design or GEICO's gecko) to sustain the brand preference ('moat') that leads to consistent revenues and profits.

'Alpha' creativity, on the other hand, is the type of disruptive creativity that is celebrated by advertising awards (think Cannes) but has a distinctly patchy record of delivering financial returns. It has creative impact that often does not translate into business impact (mouldy whoppers, anyone?). This is why CFOs may be sceptical about the motivations of their CMOs and their marketing teams. They need to be reassured that the proposed investment in a dramatic new positioning for the business is motivated by the desire to create a distinctive and sustainable 'moat' (see beta creativity above) rather than just to win the applause of the marketing community with no promise of revenue delivery.

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Marketing and finance both agree that business success requires an effective balance between alpha and beta. You need to take calculated risks to deliver higher profits than expected (alpha) but you want to show stability of earnings (beta) so your borrowing costs are lower and your future earnings are discounted at a lower rate, raising their Net Present Value and therefore your share price.

The sad reality is that the quickest boost to short-term earnings for the CFO will always be to cut investments in things that affect the future potential of the business but not its current performance. This is why research and development, staff training, and brand building are often the first to get cut. This is why it is so important that CMOs be financially literate.

Rather than accusing finance of being "non-believers" and adopting an adversarial stance, marketing should recognise that finance is family, not foe.

By leaning into the shared belief in value, the importance of both current and future performance, and informed risk-taking, marketers can create the basis for renewed collaborative discussion about how the business can best allocate its resources in a way that ensures its commercial sustainability.

These discussions will be heated and passionate – but this is normal for siblings.