The Cost of Marketing

A General Analysis of the Factors Involved

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THE AMERICAN Marketing Society welcomes this opportunity to meet with the Taylor Society. We appreciated your invitation to arrange the program for one of your meetings last winter; we are gratified to find that our participation at that time encouraged you to ask us to arrange the program for this session.

We are a young organization. Our object is to promote the scientific study of distribution. When Mr. Frederick W. Taylor was doing his important work some thirty years ago, the field of distribution had not been recognized as a separate and important phase of economic activity. There was no literature and no body of knowledge on the subject. Scientific analysis of marketing problems had not been thought of. Only during recent years has the importance of the subject been recognized, due largely to the shifting of emphasis from production to selling problems.

Today there are many men who are devoting their lives to marketing problems. We have banded together to promote scientific research, to increase the efficiency of the marketing system, and to reduce the cost of distribution. We have chosen as our general subject for this session, "The Cost of Marketing."

This subject, "The Cost of Marketing," covers a broad field and has many phases. There is the question of the total cost of marketing and whether it is increasing. This includes a study of manufacturers' selling costs, wholesale costs, and retail costs. It covers such problems as the following: the effect of large-scale marketing in lowering costs; the variation in costs by size of city, section of the country, and by trade; the analysis of costs by item, by size of order, and by customer; the relation of advertising costs to selling costs; and finally, what has been done and can be done to reduce distribution costs?

As for the total cost of marketing, which will be considered in this paper, I have roughly estimated that in 1929 the total cost of getting goods from producer to consumer in the United States amounted to around twenty-seven billion dollars. This is made up of retail costs of about thirteen billion dollars; wholesale, about six billion dollars; transportation, about four billion dollars; and manufacturers' selling costs about four billion dollars.

If anything, this estimate is probably too conservative. No attempt has been made to reach the highest possible degree of accuracy, because the main object of this estimate has been simply to point out the tremendous importance of marketing in our national economy. This estimate of the total cost is a sum equivalent to nearly one-third of the estimated national income of 1929; marketing activities account for the work of somewhere around thirteen million people, or about 27 per cent of the total number gainfully employed. This great field of economic activity has been largely neglected by economists and has been subjected to scientific study only within the past fifteen or eighteen years.

This high marketing cost is in itself no indictment of our marketing system. Distribution from producers to consumers is necessarily a costly and complicated process. It involves various services or functions, as follows: the assembling of products from various sources for redistribution; the storing of articles in public warehouses, wholesalers' warehouses and retail stores; the financing of operations, involving the tieing up of billions of dollars by the owners of commodities during the marketing process; the assumption of risks from price fluctuations and from deterioration in quality; sorting and grading, including breaking up of large packages into smaller units and repacking them; the actual selling and advertising; and the transportation of commodities from one place to another, including delivery by wholesalers and retailers.

All these functions must be performed in the marketing process and it costs money to perform them. Eliminate a middleman and you do not eliminate the functions that he has been performing. Middlemen are specialists in their field and by combining the outputs of many producers, they are able to perform the marketing functions at a lower cost than producers could perform them individually. In other words, their existence reduces rather than increases the cost of marketing.

When we study the trend of marketing costs, we find many sensational statements to the effect that they have been rising abruptly during recent years. Professor McNair of the Harvard Business School, in an address before the recent Boston Retail Conference, referred to rising costs in retail stores and concluded that, "If we are to keep business on an even keel and maintain the steady flow of commodities from producer to consumer, we cannot tolerate the existing waste and inefficiency of distribution." The Twentieth Century Fund recently reported that "preliminary and tentative figures," covering a diversity of manufacturing concerns showed "from 1920 to 1930 an increase of nearly 30 per cent in the relation of selling costs to sales." A recent writer in the New York Times claimed that selling costs have doubled since 1870 and that they are now a great burden on industry. These are samples which represent the prevailing opinion with regard to marketing costs.

In discussing this subject there are three fundamental facts that must be borne in mind, each of which deserves elaboration. They are first, that over a long period of time costs have necessarily risen, due to the bigger job that the marketing system has been called on to perform; second, that there is no such chance for mechanization in marketing as there is in manufacturing; third, that cost changes during depressions and periods of rapidly falling prices do not represent fundamental trends in marketing costs.

Long-Time Cost Trends

As for the fact that costs have necessarily risen over a long period of time, it is obvious that the marketing job was comparatively simple 150 years ago when the system of household economy prevailed and when there were no factories and no railroads. When each family produced most of the goods it needed, little marketing was necessary. When each family specialized on the production of some one commodity, marketing was still a simple matter, often carried on by barter.

With the advent of the industrial system came geographical specialization. People in each part of the country devoted themselves to the production of certain commodities and they became more and more dependent on the outputs of factories and farms

located hundreds and even thousands of miles away. Along with this change there necessarily developed a distributing system composed of wholesalers, who gathered goods in large quantities from distant communities, and retailers to parcel these goods out in small quantities to consumers.

This marketing organization developed gradually. At first it was crude. Goods were packed and handled carelessly; unsanitary conditions prevailed; people of low intelligence were employed; retailers especially in small towns and cities bought half a year's supply at a time; goods became antiquated and shopworn; consumers went to stores with market baskets and carried their goods home; higgling was a common occurrence; honesty was not always considered the best policy. Some of these shortcomings and crudities have not entirely disappeared today.

The point is that the services offered by middlemen have gradually improved; and this improvement has necessarily increased the cost of distribution. In other words, marketing costs have risen during the past hundred years, and even during the past twenty years, because the distributive system has been called on to do a bigger and better and more complex task. Whatever the spread is between producers' and consumers' prices, we are better off today under our system of industry and trade than was ever possible under the old household system. The benefits of factory production and geographical specialization far outweigh such disadvantages as are inherent in our expensive marketing system.

Restricted Field for Mechanization

That there is no such chance for mechanization in marketing as there is in manufacturing is due to the simple fact that salesmen still have to be used in making business contacts and in effecting exchange. It is true that some marketing is done automatically through slot machines or through "coin-device automatic merchandising," as it has been called. It is said that twenty-five million dollars worth of cigarettes are sold through coin machines each year; that Automat restaurants feed 500,000 people a day in New York, Philadelphia and other cities; that there are 10,000 handkerchief vending machines in the United States; and it is well known that hundreds of millions of pieces of gum and candy are sold in this way.

There are other developments in mechanization of marketing. Machinery is used for handling goods in warehouses and stores. There is the standardization of methods of chain stores in accounting and display. There is the self-service principle which reduces personal salesmanship in retail stores; and in this connection, advertising should be mentioned as also displacing personal salesmanship. Some companies let advertising do the whole job of creating demand. Selling and marketing costs today would be immeasurably higher if the present volume of trade were accomplished entirely by personal salesmanship. But on the whole, personal salesmanship is still necessary and will continue to be necessary in the marketing process, and therefore there is no such chance for technological development as there is in factory production.

Costs During Depression

The third point is that cost changes during depression do not indicate long-time trends. We must draw the line sharply, for example, between the tendencies of marketing costs up to 1929 and the trend during the three years that followed. Costs, when expressed as a percentage of sales, invariably tend substantially upward during a business depression, because of declining volume of dollar sales. The cost of operating wholesale hardware houses increased from 20 per cent of sales in 1929 to 26.5 per cent in 1931; operating costs of large department stores increased from around 33 per cent in 1930 to around 35 per cent in 1931; women's specialty shops showed an increase from around 35 to over 36 per cent. These figures are typical of what happened in all trades.

This does not mean that actual operating costs increased. We are aware of the heroic efforts made by wholesalers and retailers to reduce costs by dismissing employes, by cutting salaries and by carrying smaller stocks. But expenses have not dropped in proportion to the decline in dollar volume, and hence they have become a larger percentage of sales. From 1929 to 1932 both prices and physical volume declined radically.

These considerations suggest that the method of expressing cost as a percentage of sales must be used with caution in measuring cost trends over a period of years. Allowance must be made for price and volume changes before sound conclusions can be drawn. An executive of a large chain store company told the writer, "Of course, costs rose in 1932 when expressed as a percentage of sales, but expenses per ton of goods handled actually decreased." The tonnage basis of expressing costs is impossible for most stores, although cost per ton or per unit is valuable whenever practicable.

It is hard enough for a retailer to reduce variable expenses, such as salaries, during a period of depression, but the reason why he cannot adjust expenses to declining dollar volume is that so many of his costs are relatively fixed. Rent, heat, light and taxes vary little with changes in dollar sales. Difficulties that retailers have experienced with rents during 1931 and 1932 illustrate this point. The United Cigar Stores Company was forced into the hands of a receiver largely because of real estate losses and high rents. A large retail clothing house in New York, which also had to go into receivership, found that rents in some of its stores amounted to more than 20 per cent of sales. The University of Chicago in co-operation with the United States Department of Commerce made a study of bankrupt retailers in Chicago in 1932 and found that the rents of these concerns ran as high as 25 or 26 per cent in some trades, whereas the normal rent of successful stores in the same trades ran from 4 to 5 per cent of sales. Many retailers have obtained readjustments of their leases during depression by proving to landlords that they would have to go out of business unless substantial concessions were made. Retailers are prone to expand their operations, move to expensive locations, and increase the proportion of non-selling space during times of prosperity. The element of inflexibility in costs becomes a serious matter when prices and physical volume decline, and tends to prolong the period of hardship.

Recent Cost Trends

To come back to the main question as to whether marketing costs have been rising during the past fifteen or twenty years, (aside from temporary changes during periods of depression) it is difficult to give a final and complete answer. There are two avenues of approach to this problem. The first is to estimate the total cost of the whole range of marketing activities for various years. The objection to this method is that there are not sufficient data for accurate estimates. The second method is to study trends in operating costs in individual trades. The objection to this is that accurate cost figures over a sufficient period of years are available for only a few trades.

The first approach has been used in an interesting way by Mr. W. H. Lough, who presented the results of some of his studies before the Taylor Society in 1931, and who has since reported his findings on this point at the Boston Retail Conference in 1932. By building up elaborate estimates based on data from various sources for the years 1909, 1914, 1923 and