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## Preparation and Choice of Methods of Advertising Budget

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“Half the money spent on advertisement is wasted, and the trouble is you don't know which half”

*This chapter deals with the budgeting method and the factors for allocating the funds for the same.*

# Preparation and Choice of Methods of Advertising Budget

The money spent in advertising forms an important cost factor and no matter what type of company it is, large or small, budget decision may lead to profitability or drain away most of the profits. Advertisement can be considered as an investment into future sales. Proper budget allocation for long-term reinforcement effect is necessary for proper planning. Setting the budget is a different job and a lot of experience is required to avoid overspending yet maintaining the company's image. There are certain factors that must be taken into consideration for preparing the budget. These are:

1. Stage of the product life cycle: Different budget allocation are made in different stages. The products which are selling and are in the mature stage of PLC require less expenditure. Whereas the products in the introductory stage of PLC or new products require much heavier expenditure to create awareness.
2. Market share is also an important factor for preparing of budget. To gain greater market share the advertising budget should be high.
3. With competition one tries to out do the competitor and competitive parity method is used.
4. Greater advertisement frequency needs greater expenditure and a higher budget.
5. If the product can be differentiated and has noticeable features and attributes it may require lesser advertisement expenditure.
6. It is difficult to measure the effectiveness of advertising sales, as it can be due to other factors as well.

### ■ 12.1 Budgeting Methods

#### **“Not even the most productive cow can be milked without spending money”**

Amount of money spent on advertising depends on objectives. It differs from company to company various practises are followed:

1. Competitive parity method.
2. Affordability method.
3. A fixed percentage of turnover method.
4. Budget based on functions to be performed (Objectives and task method).

**5. Regression analysis:**

Based on historical data

Time series data

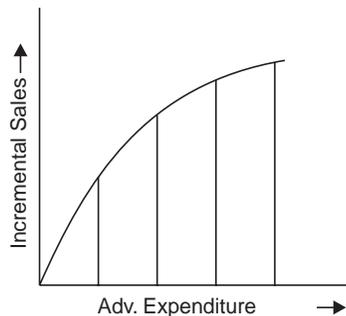
To predict dependent variable—sale or market share.

Advertising expenditure is the independent variable.

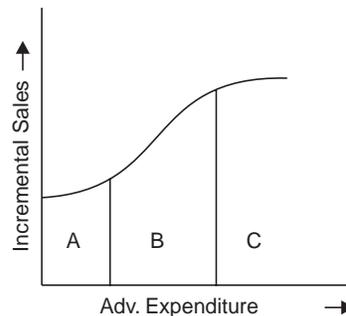
**6. Adaptive Control Model:**

Advertising budget decision need changing as relationship between advertising and sales change over time. It gives an idea of optional expenditure on audience to be reached, size, location, media cost etc.

In connection with the response to advertisement there are 2 models to be considered.



**Fig. 12.1**



**Fig. 12.2**

Concave downward response curve shows that the effect of expenses on advertising follows the micro-economic law of diminishing returns. When the amount of advertising increases its incremental value decreases as shown in the curve. The response in the beginning is very good but with further increase in advertising the response becomes smaller.

**S-Shaped Response Curve:**

In this three ranges A, B and C are shown. In the A range, the expenditure is lower than required and there is no increase in sales. In the second or B range which is most effective, the sales start increasing and goes upto the beginning of sales C where with the additional expense there is little increase.

**■ 12.2 Budgeting Approaches**

We are discussing here 2 approaches to budgeting. They have their advantage and disadvantage.

**Top-Down Approach**

It is called top-down approach because the budgets are made by the top executed and then the money is passed down the line to various departments. This approach is applied in affordable method percentage of sales, competitive parity method and Return On Investments (ROI) method of budgeting.

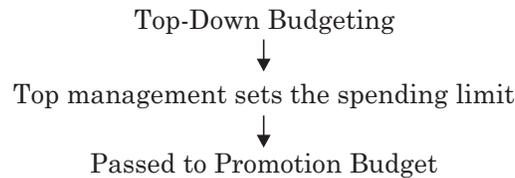


Fig. 12.3

### Bottom-up Budgeting

In this method promotion objectives are set for the tasks to be performed. All the necessary activities to achieve the objectives are planned. The cost of these activities are ascertained and budgeted. The total promotion budget is then approved by top management. This is also known as the build-up approach of budgeting.

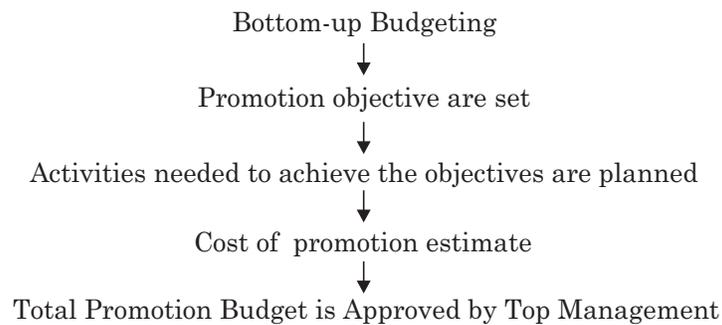


Fig. 12.4

**“Money is the backbone of all organization. Your budget should be in accordance with your objectives and the chosen Media”**

### Competitive Parity Method

Many firms base their advertising expenditure to compete with their rivals or their competitors. The information regarding this is found in business magazines, journals and annual reports of the company. They not only try to have the same expenditure but also try to choose the media accordingly. They also choose the media vehicle and the frequency of advertisement to match with that of the competitor. Firms believe that by following this method they can make the optimal expenditure to lead to stability in market place etc.

This method may ignore the objectives of the company and concentrate only on competitive advertising. It may also ignore the other aspects like creativity and the role of media. The effect of expenditure is known after the advertisement has been released, and one does not know the next move of the competitor for expenses on the advertisement and promotion. Some companies use the comparative method in conjunction with other methods as well. It would however be more appropriate to keep in mind the objective of the firm before going in for this method.

### Affordable Method

This simply means what the firm can afford after meeting all their expenses. The firm allocates the amounts to be spent on production and after that allocation is done for advertising and promotion. The tasks to be performed by advertising is not considered. In this method there can be chances of overspending or under-spending. This approach is common in small firms and some big firms not having much knowledge of advertisement resort to this method as well. In this method it is difficult to get into financial problem as we are spending only what we can afford. In this method it is difficult to assess whether the advertising expenditure made is optimal and will give proper results. Advertising expenditure must lead to sales. In this connection we have to refer to the S-shaped response model, which is dealt earlier.

### A Fixed Percentage of Turnover Method

This method is most common used in small and medium-sized companies. A percentage amount of the sales as decided is allocated for advertising expenditure. The percentage is based on last year's sales. The sales can be projected for next year and percentage expenses incurred accordingly. The advertising expenses can be calculated on straight percentage sales or on the percentage of unit cost.

#### Method I—Percentage Sales

That sales in the year ending	
2002-2003 is	Rs. 80,00,000
if the % of sales is 10%	800,000
Advertising Budget is	800,000

#### 2. Method Percentage of Unit Cost

If the cost of a unit is Rs. 1000/-	
If 1,000 unit are sold revenue generated is	10,00,000
if the % decided is 10%	1,00,000
Advertising Budget	1,00,000

The percentage of expenditure allocated differs from one company to another. Some companies go for a higher percentage and others for lower depending upon their needs and situations faced by them. This method is simple to calculate and is safe. In case of fluctuating sales one has to be careful both in increasing and decreasing of sales. It may lead to overspending when the potential is low and underspending when the potential is high.

In case of a new product there is no previous record hence it is difficult to judge and may be risky. In this method it is safer to see the past sales and make a forecast of the expected sales as well.

### Objective and Task Method

The expenditure allotted depends on the functions to be performed to achieve the objectives of the organisation.

- In this method objective are defined and the specific strategies are formulated to achieve them. Then the cost of implementing these strategies is estimated.

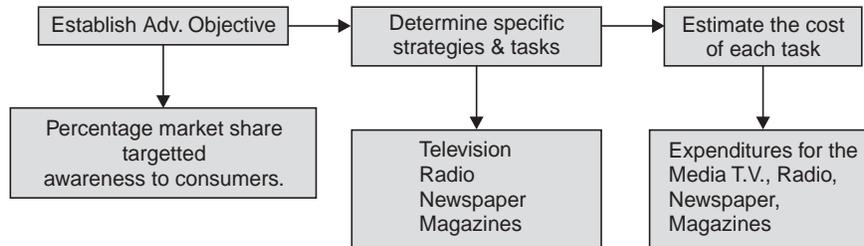


Fig. 12.5

Establishing of objective may be interpreted as achieving a percentage market share and bring awareness of the brand to the consumers and general public. The strategies may include advertising in various media, and other elements of promotion mix. Then the cost of various media chosen is estimated. It is also necessary to monitor the expenses and evaluate the results.

It is difficult to correlate the expenses with the task performed for this experience is required.

Other methods consist of regression analysis, adaptive control model and compromise method given earlier.

## ■ 12.3 Other Factors Affecting the Allocation of Advertising Budget

### Market Size and Potential

The size of the market affects the advertising expenditure. Greater the market share, greater is the expenditure and vice-versa. The ambitious is the plan for promotion more is the advertising expenditure. If the market and its potential is small then greater advertising expenditure will be a waste. If the market is concentrated in a geographical area lesser expenditure is required. If the market is dispersed then it requires more expenditure. By potential we also mean that there is greater potential of advertisement services in urban rather than rural areas. There is more potential for coffee in the south than in the north. There is more demand of woollens in the north of India than in the south and so on. We therefore see that the potential and size of the market affects the advertising expenditure.

### Market Share Goals

The studies taken from Harvard Business Review by John Jones compared the advertising expenses with the share of advertising voice (total value of the main media exposure in product category).

He classified the brands under 3 categories.

(a) Profit-making brands as underspenders.

(b) Investment brands whose Share Of Voice (SOV) is above their share of market.

(c) Brands with small-market share, which do not make much profit or have a proportion of smaller share of voice.

New brands have to be supported and require a great amount of advertising expenditure.

Older and more matured brands are milked when they reach the maturity stage therefore advertising support is reduced.

Thirdly there is an advertising economy of scale where advertising is more effective for well-established brands and the expenditure is lower. By economies of scale we mean that the bigger companies who advertise more get better rates from the media than the smaller firms who advertise less. They get the advantage of advertising several products jointly. They also enjoy a more favourable time and space position, cooperation of middle men and favourable publicity. All these advantages are known as *economies of scale*.

Another suggestion is given by James Shroer in a situation where the firm wants to increase its market share. He suggests that the firm or the marketer should:

- (a) Segment the market on the basis of weak competition and spend less in those markets rather than indulging in a national advertising effort.
- (b) Segment the market where there is competition and increase the expenditure to fight the competition.
- (c) It should not save advertising expenditure to get short-term gains or profits.
- (d) In short, it should concentrate on their niche market and niche strategies rather than long-term wars.

### Organisational Characteristics

There are a number of factors regarding the organisational characteristics that are to be considered. These factors vary from one organisation to another as their characteristics differ and influence the advertising expenditure.

- Structure of the organisation *i.e.*, centralised, decentralised, balanced, formalisation and complexity of the organisation.
- Power and politics in the organisation with vested interests.
- The use of expert opinion *e.g.*, consultants.
- Characteristics of the decision maker (Preference, experience, expertise etc).
- Approval and negotiation channels
- Pressure on senior managers to arrive at the optional budget.

### Conclusion

Money is the backbone of all organisations and it should be spent wisely. Advertising expenditure is a very important element of budgeting and sales promotion. It is to be determined how much money is to be allocated and for what purpose. The media is then chosen and implementation is to be done keeping all the factors in mind.

### Questions

1. What factors should be taken into consideration for preparing a budget ?
2. Describe the various methods of budgeting.