PURDUE UNIVERSITY

SALES, MARKETING AND LIQUIDITY

by Jaclyn Kropp

For better or worse, marketing and sales efforts affect not only the profitability of a firm but also the firm's liquidity, or its ability to meet short-term financial obligations.

More formally, liquidity refers to the structure of a firm's balance sheet. A firm is considered liquid if its current assets exceed its current liabilities where "current" indicates a period of one year.

Current liabilities include items such as wages and accounts payable, short-term debt, and the current proportion of long-term debt. Current assets include cash, cash equivalents, marketable securities, accounts receivable, and inventory.

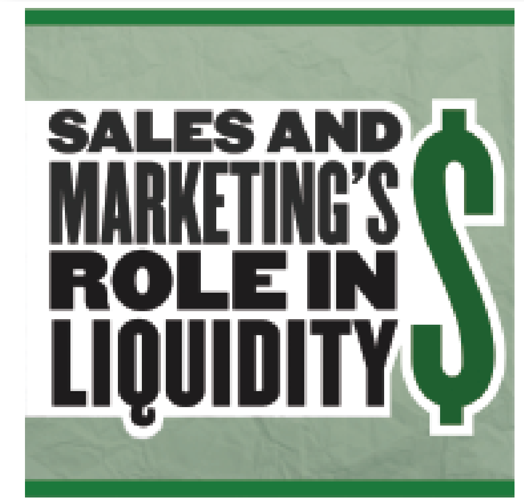
Obviously, marketing and sales efforts directly impact inventory. In addition, these efforts also affect the firm's margin and bottom-line and, ultimately, the amount of cash the firm has on hand to pay its bills.

The liquidity of a firm is frequently measured using the current ratio defined as the ratio of the current asset to current liabilities. If this ratio exceeds one, then the firm is considered liquid. However, if inventory accounts for a significant share of the firm's current assets, then the current ratio may overstate the firm's true liquidity position.

While inventory is considered a liquid asset in that it can be converted to cash rather quickly, it is often difficult to move large stockpiles of inventory quickly without having to deeply discount the price. Hence, a firm may also track its liquidity through its quick ratio or the ratio of cash, cash equivalents, marketable securities, and accounts receivable to current liabilities in order to obtain a clearer picture of the true abilities to meet short-term financial obligations. The larger the inventory stockpile, the larger the difference between the firm's current ratio and the firm's quick ratio.

SUCCESSFUL PROMOTIONS

Successful marketing and sales promotions convert inventory into sales, which ultimately increases the company's cash position and narrows the cap between the firm's current ratio and its quick ratio. As a result, management may incentivize its sales force to move inventory to improve the firm's liquidity.



However, if the firm's sales force sells to retailers rather than selling directly to the to the end customer, other issues that impact liquidity may arise. It is not uncommon for firms to incentivize their sales team to push inventory to retailers through various promotions offered to retailers without developing strategies to assist the retailers to sell through to the end consumer. As a result, the retailers may develop a glut of inventory.

So-called "stuffing the channel" causes the inventory to move off the firm's balance sheet and onto the balance sheet of its retailers, thus improving the firm's liquidity position. However, if the retailers are not selling through to the end consumer, then inventory management and liquidity problems are likely to arise further down the road.

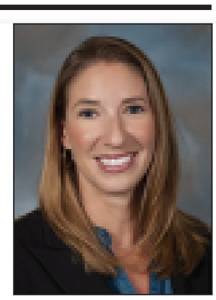
Future sales to the retailers will be more difficult when the retailers are sitting on large stockpiles of inventory. In essence, they have just kicked the can down the road by trading today's liquidity for future liquidity.

Another all too common mistake is mixing up margin and markup while negotiating terms with retailers. Gross margin is the firm's total sales revenue less its cost of goods sold (COGS) divided by total sales revenue. Markup is the ratio between COGS and the item's selling price.

Confusing these two terms can be a costly mistake, directly affecting both the firm's profitability and liquidity. Thus, it is vitally important that the sales force has a working knowledge of basic financial concepts.

AGRIBUSINESS FINANCE FOR NON-FINANCIAL MANAGERS

Agribusiness professionals can gain a working knowledge of financial concepts and learn to think more like a CFO at the Agribusiness Finance for Non-Financial Managers workshop from **Purdue University's Center for Food and Agricultural Business**. This professional development program covers financial statements, financial evaluation and management, profitability analysis and more. It runs July 24-27 on the university's West Lafayette campus. Learn more and register. **AM**



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