

Marketing Expenses & Profitability: Evidence from Telecom Sector in Kingdom of Saudi Arabia

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Abstract

The study focuses on statistical significance of the relationship of Selling & Marketing Expenses with profitability of all the listed Telecom companies in Kingdom of Saudi Arabia for a period of 4 years (2011 - 2014), with a total of 16 firm years. Multiple Correlation & Regression Analysis were used to test the effectiveness. Gross Operating Profitability (GOP) is used as dependent variable. Four independent variables were used. There is a positive correlation among all the independent variables i.e. the selling and marketing expense, dealers' commission, advertising expenses and salary, wages, employee benefits paid to the selling and marketing staff of these companies. There is no significant impact of Selling & Marketing Expenses on Gross Operating Profitability. However, other components of Selling and Marketing Expenses viz. dealers commission, advertising expenses, salary, wages and employees benefit expenses have significant effect on the profitability of the these firms.

Keywords: KSA, Profitability, Selling & Marketing Expenses, Telecom

1. Introduction

Industry plays a significant role in development of a country's economy. All industries / sectors contribute in national economy of a country but in varying degrees. Telecommunication is one such sector which plays a dominant role in economy of any country, mainly because of its vibrancy. The Telecom sector is very dynamic in terms of technology and customers' profile. Thus to keep pace with technological changes, companies need to continuously update and upgrade their technologies by leaps and bounds. This will amount to huge capital investments in technology. But, it is customers who are difficult to acquire, serve and retain. This area needs much deeper understanding of target customers and their expectations from the product, service and the company. Therefore all companies keep a marketing and sales budget to attract new customers and retain the current customers. But it comes with a huge cost. Therefore, the efficacy of Sales & Marketing expenses in making a business profitable has always been debated and discussed. There are many sub components of Sales & Marketing expenses. The components which are part of our study are dealers' commission, advertising expenses and salary, wages, & employee benefits. Profitability is important for survival of business. Profitability may be understood as the profit earning capacity of a company. It can also be known as Return on Investment. As Profitability is the primary goal of business, managers continuously strive to improve profitability.

In Saudi Arabia, there are four listed Telecommunications companies on Saudi Stock Exchange (Tadawul). These are Etihad Atheeb, Etihad Etisalat, Mobile Telecommunications Company and Saudi Telecommunications Company.

Table.1 Company List: Telecommunication and Information Technology Sector

SYMBOL	COMPANY NAME	SHORT NAME	ISIN CODE
7040	Etihad Atheeb Telecommunication Company	Atheeb Telecom	SA128G53E019
7020	Etihad Etisalat Co	Etihad Etisalat	SA000A0DM9P2
7030	Mobile Telecommunications Company Saudi Arabia	ZAIN KSA	SA121053DR18
7010	Saudi Telecom	STC	SA0007879543

Source: <http://www.tadawul.com.sa>

2. Review Literature

Many studies have been carried out to find out relationship between sales promotion, advertising, sponsorship, customer loyalty, customer retention, and marketing strategies with profitability.

Okyere, Agyapong and Nyarku, (Ghana, 2011) concluded that there is positive relationship between sales promotion and advertising budget with total sales. But they also found negative relationship between sponsorship and total sales. They found negative correlation between TV advertisement budgets with total sales.

As per Halaoui, Smayra & Surssock, (Booz and Company, 2011), European operators reinvest up to 3 percent of revenues on customer retention efforts such as loyalty programs. It further says that the GCC operators might have to follow this and increase their marketing expenditures as their markets mature.

Nsour, (Kingdom of Saudi Arabia, 2013) found that relationship marketing practices have a positive impact on profitability and customer loyalty of Saudi Telecom Company.

Gautam, (India, 2013) found that Promotion possesses a significant key role in determining profitability and market success.

On the contrary, the relationship between promotion consideration and business performance is significant, but the relationship is negative (Gbolagade, Adesola, Oyewale, Nigeria; 2013).

In a study conducted by Oloko, Anene, Kiara, Kathambi, Mutulu (Kenya; 2014), they found that marketing plays a crucial role in enhancing a company's growth and performance in capturing new markets, retaining the market and promoting financial muscles in profits of an organization.

In yet another research, Ayanda, Tunbosun (Nigeria, 2012) found a positive correlation between marketing strategy and organizational performance.

3. Need for study

There are many research works carried out establishing relationships between sales promotion, advertising, sponsorship, customer loyalty, customer retention, and marketing strategies with profitability. There is scarcity of research work bringing out relationship of Sales and Marketing Expenses with Profitability. Since any company would like to know the effectiveness of selling & marketing expenses on profitability, there arises a need for such a research. Moreover, this research might be of utmost importance to the management of telecommunications companies for making some crucial decisions that may increase the profitability of these firms.

As per a report by Communication and Information Technology Commission, KSA, (ICT Indicators Report, Feb, 2014), the total number of mobile subscriptions reached around 51 million by the end of 2013, with penetration rate of 169.7 %. Fixed telephone lines stood at 4.7 million, total number of mobile broadband subscriptions reached 14.27 million, and estimated number of Internet users in the Kingdom was 16.5 million, with a population penetration of 55.1%, by the end of 2013. Telecom services revenues in Saudi Arabia have been steadily growing at a Compound Annual Growth Rate (CAGR) of around 10%, increasing from about SR 20 billion (US \$5.3 billion) in 2001 to SR 75 billion (US \$20 billion) in 2013. Therefore, the sector is growing fast and holds significance in the economy of Kingdom of Saudi Arabia. This underlines the need for study in this area.

4. Objectives:

- The main objectives of the study is to identify the effect of selling and marketing expenses on profitability of telecommunication companies listed in Saudi Stock Exchange (Tadawul).
- To trace out the relationship between selling and marketing expenses and profitability of the telecommunication companies in Saudi Arabia.
- To suggest the companies to increase their profitability.

5. Hypotheses:

H1: The Selling and Marketing expenses significantly affect the profitability of the telecommunication companies.

H2: Dealers Commission significantly affect the profitability of the telecommunication companies.

H3: Advertising Expenses significantly affect the profitability of the telecommunication companies.

H4: Salaries, Wages & Employees Benefits significantly affect the profitability of the telecommunication companies.

6. Research Methodology:

6.1 Scope of the Study

Quantitative methods are used to examine the relationship between the independent variables viz. Selling & Marketing Expense Ratio (SME), Dealers Commission Expense Ratio (DCE), Advertising Expense Ratio (Advt. E) and Salary, Wages & Employee Benefits Expense Ratio (SWEBE), and Gross Operating Profitability (GOP) as dependent variable. The data has been collected from four Telecommunications companies listed on Saudi Stock Exchange (Tadawul) for a period of four years from 2011 to 2014 making a total of 16 firm years.

6.2 Data Collection

This research work is based on secondary data sources. The data was collected from the audited annual reports and financial statements of four Telecommunications companies listed on Saudi Stock Exchange (Tadawul). Where information was not available in Annual Reports, data were obtained from the companies' websites. In order to find out the values of variables used in the research, Directors' Reports, Income Statement, Balance Sheet, Cash flow Statement and Notes to the Accounts were studied.

6.3 Statistical Tools

Mean, Standard Deviation, Min. and Max. were used as statistical tools for descriptive statistics. Multiple Correlation analysis was used to find out the relationship among variables. Regression Analysis was used to test the effectiveness of the variables in order to draw conclusion.

6.4 Variables and Their Measurement

The variables used in the research are categorised into two:

- Dependant Variable: Gross Operating Profitability (GOP) which is a measure of profitability of firms and is used as dependant variable.

$$GOP = \frac{\text{Revenue} - \text{Cost of Sales}}{\text{Total Assets}}$$

- Independent Variables: Selling & Marketing Expense Ratio (SME), Dealers Commission Expense Ratio (DCE), Advertising Expense Ratio (Advt. E) and Salary, Wages & Employee Benefits Expense Ratio (SWEBE) are used as independent variables.

$$\text{Selling \& Marketing Expense Ratio (S M E)} = \frac{\text{Selling \& Marketing Expense}}{\text{Revenue}}$$

$$\text{Dealers Commission Expense Ratio (DCE)} = \frac{\text{Dealers Commission Expense}}{\text{Revenue}}$$

$$\text{Advertising Expense Ratio (Advt. E)} = \frac{\text{Advertising Expenses}}{\text{Revenue}}$$

$$\text{Salary, Wages \& Employee Benefits Expense Ratio (SWEBE)} = \frac{\text{Salary, Wages \& Employee Benefits Expenses}}{\text{Revenue}}$$

6.5 Study Model

Pearson Correlation is used to measure the degree of association between different variables.

Ordinary Least Square (OLS) regression model is used to estimate the extent and direction of relationship between profitability and various components of selling and marketing expenses.

$$GOP = \alpha + \beta_1 (SME) + \beta_2 (DCE) + \beta_3 (Advt. E) + \beta_4 (SWEBE) + \varepsilon$$

Where:

GOP = Gross Operating Profitability

α = Intercept of the equation

SME = Selling & Marketing Expense Ratio

DCE = Dealers Commission Expense Ratio

Advt. E = Advertising Expense Ratio

SWEBE = Salary, Wages & Employee Benefits Expense Ratio

ε = Error Term

7. Findings and Discussion

Table 2: Descriptive Statistics of Dependant and Independent Variables

	GOP	SME	DCE	Advt. E	SWEBE
N	16	16	16	16	16
Mean	0.178	0.176	0.032	0.043	0.095
Standard Deviation	0.116	0.110	0.015	0.093	0.102
Min.	0.021	0.058	0.007	0.017	0.032
Max.	0.313	0.421	0.056	0.181	0.419

Table 2 depicts a summary of descriptive statistics of dependant and independent variables of all (4) telecommunication companies listed on Saudi Stock Exchange (Tadawul) for a period of four years from 2011 to 2014 making a total of 16 firm years.

The table shows that the average value of gross operating profitability (GOP) is 17.8 % and the standard deviation is 11.6 %. The standard deviation of 11.6 % implies that the value of profitability can increase or decrease by 11.6% from its average. The Gross Operating Profitability of these companies varies between 2.1 % and 31.3 %.

Selling and Marketing expenses as a percentage of revenue of the telecommunication companies is 17.6 on an average and the standard deviation of this expense is 11%. Minimum and Maximum amount spent on selling and marketing of telecommunication product are 5.8 % and 42.1 % respectively.

Average amount spent on dealers commission as a percentage of total revenue is 3.2 with a standard

deviation of 1.5 %. Minimum and maximum amount spent of dealers commission as a percentage of revenue are 0.7 and 5.6.

Advertising expense ratio shows the relationship between amount spent of advertisement and amount generated on sale of telecommunication products. Mean of advertising expense ratio is 4.3 % with a standard deviation of 9.3 %. Minimum amount spent on advertising telecommunication product is 1.7 % whereas the maximum amount spent on the same is 18.1 % of the revenue.

Average of the amount spent on salary, wages and employee benefits pertaining to the selling and marketing staff of telecommunication products is 9.5 % of the total revenue generated. Such an expense ratios lies between 3.2 % to 41.9 %.

Table 3 Correlation Matrix

Variables	GOP	SME	DCE	Advt. E	SWEBE
GOP	1				
SME	-0.509	1			
DCE	-0.639	0.618	1		
Advt. E	-0.183	0.654	0.556	1	
SWEBE	-0.643	0.495	0.460	0.649	1

Table 3 depicts that there exist a negative correlation between dependant variable (Gross Operating Profit) and Independent Variables (Selling & Marketing Expenses, Dealers Commission, Advertising Expenses, Salary, Wages and Employee Benefits Expenses). Negative correlation between dependant and independent variable implies that increase in the expenses leads to decrease in gross operating profit and vice versa. Highest negative correlation (-0.643) can be observed between gross operating profitability (GOP) and salary, wages and employee benefits expenses (SWEBE) of the telecommunication companies. Advertising expenses of these companies have a very low correlation coefficient (-0.183) with gross operating profit. It can be observed from the table 3 that there is a positive correlation among all the independent variables i.e. the selling and marketing expense, dealers commission, advertising expenses and salary, wages, employee benefits paid to the selling and marketing staff of these companies.

Table 4 Regression Analysis

Variables	Coefficients	Standard Error	t-stat	P-Value
Intercept	0.351	0.030	11.646	1.582
SME	-0.366	0.168	-2.173	0.052
DCE	-4.126	1.119	-3.685	0.004
Advt. E	2.454	0.495	4.961	0.000
SWEBE	-0.878	0.167	-5.238	0.000
R ²	0.865			
Adjusted R ²	0.816			
F-Value	17.691			

The purpose of the regression analysis is to find out the significant effect of various components of the selling and marketing expenses on profitability of telecommunication firms operating in the kingdom. Table 4 reveals the result of regression analysis relating to Gross Operating Profitability, Selling and Marketing Expenses Ratio, Dealers Commission Expense Ratio, Advertising Expenses Ratio and Salary, Wages, Employee Benefits Expense Ratios.

The value of the R² in the model is 0.865 which indicates that 86.5 % of the variation in the dependant variable (Gross Operating Profitability) is explained by the variation in independent variables (Selling and Marketing Expense, Dealers Commission, Advertising Expense, Wages, Salary, and Employee Benefits). It can therefore concluded that 13.5 % (1-0.865) of the changes in dependant variable are unexplained by independent variables and are the results of other factors. Since the value of R² is higher, we have better prediction of regression model. Common Regression F-Statistic (17.691) shows that overall model is significant and Adjusted R Square is 81.6 %.

Based on the regression analysis, from the table 4 it can be seen that, there is no significant (P > 0.05) impact of Selling & Marketing Expenses on Gross Operating Profitability of the telecommunication companies operating in the Kingdom of Saudi Arabia. It is, therefore, H1 is rejected. However, the other components of Selling and Marketing Expenses viz. dealers commission, advertising expenses, salary, wages and employees benefit expenses have significant effect (P < 0.05) on the profitability of the these firms. Hence, the hypotheses H2, H3, and H4 are accepted.

8. Conclusion & Direction of Further Research

Selling and Marketing expenses hold great significance in companies' profitability. Companies deliberate hard

before arriving at Selling and Marketing expense, as the stakes are high. An effective Selling and Marketing expenses can contribute immensely towards Profitability. It can be concluded that there is a positive correlation among all the independent variables i.e. the selling and marketing expense, dealers' commission, advertising expenses and salary, wages, employee benefits paid to the selling and marketing staff of these Telecom companies. Further research can be carried out on the same topic in other GCC countries. Also, the research area can taper down to one of the independent variables, for example, effect of advertising expenses on profitability.

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