Foxy Originals Case:
Expansion into the US Market

Managerial Accounting (1:00 pm)

Jenny Liang, Alexander Xu, Clare Zhou

Executive Summary

Foxy Originals company is considering an expansion into the United States. In response to this inquiry, the following report includes a detailed qualitative overview on the U.S. market and the two proposed operation models. It also provides a quantitative analysis on these operation strategies. This report primarily focuses on projections of revenue and income for the upcoming fiscal year 2005. Long-term forecast is not contained in the scope of the report. In this summary, we will highlight the setbacks and benefits of U.S. expansion and offer insights through the comparison between operation options.

Expansion into the U.S. will undoubtedly have risks, the most significant one being dealing with a less responsive market. 50% of Foxy Originals product line may not be as well-received because consumer preference in the U.S. varies significantly from that in Canada. Staying in Canada will also allow Foxy Originals to reshape their image into a more selective jewelry brand. However, the opportunities of entering the U.S. market is promising as it unlocks a new revenue stream for Foxy Originals. Moreover, establishing a presence in U.S. will help to alleviate the problem of market saturation they face in Canada. They will be able to preserve the uniqueness of their brand in the new market. Therefore, we conclude that an expansion operation for Foxy Originals is worth considering.

There are two viable distribution strategies--trade show and sales representatives. From a qualitative perspective, trade shows would help Foxy Originals earn brand recognition. However, distribution via sales representatives would relieve Kluger and Orol the burden of trade show logistics, which is out of their field of expertise and thus an inefficient use of their time.

Our cost-volume-profit analysis shows that under the estimated high sales volume, which is an aggressive goal, trade show distribution proves to be more profitable. Under average and low sales volumes, the sales representatives option outperforms trade shows. It is also more risk-resilient than the trade show option because of its low fixed costs. There is no significant difference in the two options in reaching an income goal of $100,000; however, the sales representatives method has a higher profitability throughout most of the relevant range. Considering both the qualitative and quantitative analyses, we conclude that Foxy Originals should expand via sales representatives distribution.

Report

<u>A Qualitative Overview</u>

Having already established a strong Foxy Originals presence in the Canadian market, Kluger and Orol were ready to explore their options of expanding into the United States. Doing so would allow them to reach a wider consumer base, specifically in the key fashion hubs of New York, Los Angeles, Chicago, and Dallas. With the U.S. jewelry market being over 10 times larger than the Canadian jewelry market, Foxy Originals would have a much greater opportunity for product exposure. More importantly, this would allow Foxy Originals to avoid saturation of the Canadian market, a problem that is becoming increasingly evident due to the brand's popularity in Canada. Continuing on this path would take away from the attractiveness of the brand, from the consumer's perspective, because the jewelry would be over-worn, and from the distributor's point-of-view, because Foxy Originals jewelry would no longer be a unique addition to the store's inventory.

While Foxy Originals would theoretically be able to reach more customers in the United States, they would have to face the risk of selling to a potentially less responsive market. Although they had achieved success in Canada, Kluger and Orol believed that their classic jewelry (currently 50 per cent of Foxy Original merchandise in Canada) would not be as well-received in the United States because Americans preferred the latest trends. The demographics of their consumers remains the same--style-conscious women from age 18-30. Foxy Originals would also have to deal with the added costs of expansion—an increase in fixed costs allocated to the new factories Foxy Originals might build in the United States, the hiring of a new operations team based in the U.S., as well as other unforeseen costs.

Another impact of expanding to a new consumer market is that Foxy Originals will be giving up the chance to be more selective in choosing their distribution channels in Canada. The complaint that Kluger and Orol received from Gibson, one of their retail customers, exemplified a need for Foxy Originals to expand their market. Gibson had once been the exclusive carrier of Foxy Originals in the area, but Foxy Original's growing popularity and resulting saturation of the Canadian market gave rise to many more carriers of their brand. However, while expanding to the United States would seem like one logical path to take, there would also be benefits to staying in Canada. Due to the high demand for Foxy Originals products in their current market in Canada, Kluger and Orol could focus on being more selective in choosing their distribution channels, if they chose not to expand to the United States. They would be able to bargain for more attractive deals with their carrier boutiques and even re-brand their jewelry line from "lifestyle" to "luxury" by choosing higher-end stores to carry their products. Though this deviates from Foxy Originals core values of being a cheap high quality brand, this option is nevertheless important to keep in mind.

Of course, Foxy Originals could take on expansion to the United States and consolidation of the Canadian market, however this would mean they will have fewer resources to allocate to either option. Given that both initiatives are huge ventures requiring a large investment of assets and resources, and that both will likely have a high impact on future company prospects, it would be risky for Foxy Originals to attempt both simultaneously. Furthermore, if Foxy Originals focused on their performance in Canada first, they could better prepare themselves for a later entry into the United States market with a better established brand and with larger scale.

There are two routes for Foxy Originals' entrance into the United States market. From a purely qualitative stance, attending trade shows seems optimal compared to developing a sales force in the key fashion hubs in the United States. Although the sales representatives option allows Foxy Originals to spread their influence into various cities in the United States with high efficiency, their lack of brand recognition in the States decreases from their ability to make the headway they desire. They do not want to simply exist in the United States market, but are set on making their presence well-established through reputable stores. While developing a sales force will allow Foxy Originals to cover more ground, trade shows would provide a better means for establishing their brand. Another benefit of trade shows is that it allows Foxy Originals to enter a "proof-of-concept" stage. Trade shows attract distributors and consumers from around the country, giving Foxy Originals access to invaluable feedback from a more diverse audience.

Finally, although they can enter the U.S. market through a hybrid strategy of the two mentioned earlier, it is ultimately unfeasible. The critical challenge in pursuing both expansionary visions is territory ownership. Sales representatives that operated in the same area as a trade show is expected to earn 15% commission from trade show sales. An attempt to mitigate this problem would be to base sales commission on personal sales. This then gives rise to the issue of internal competition between sales representatives and Foxy Originals themselves. Spillover sales would no longer be reimbursed to the sales representatives. Sales representatives are now also faced with the concern of retailers ordering directly from Foxy Originals. To circumvent the issue of internal competition, Foxy would have to send sales representatives to smaller cities, where the consumer market is smaller and not as "fashion forward." This would translate to the reduction in projected sales and brand presence, which ultimately make the operation less than optimal to pursue.

Cost-Volume-Profit Analysis

The total fixed cost for the trade show distribution channel is $104,330, while that for sales representatives is significantly lower at $30,320. The cost of registration, travel and product sample at each show account for the large difference. Hiring sales representatives will reduce the fixed cost by avoiding financial commitments to fees related to trade show. The operating leverage at the average sales for trade shows and sales representatives is 1.93 and 1.26, respectively, which concurs with trade show's larger fixed cost. This entails that when sales increase by the same amount, trade show will have a greater percentage increase in profit, which is appealing especially when the sales volume is high. Total variable cost per order at a trade show is $236.25, lower than $321.60 per order via sales representatives. The only difference between variable costs is the 15% commission paid to each sales representative. The contribution margin of trade shows, $332.75, is higher than that of sales representatives, $247.40. Since the product mix is the same for both distributions, the difference in contribution margins again is due to the variable commission fee.

The break-even point for trade show is 314 orders, which equates to a sales revenue of $178,403.52. The break-even point for sales representative is 123 orders, which equates to a sales revenue of $69,733.55. The safety margin at the average sales volume for trade show is 51.7% while that for sales representative is 79.5%. The higher safety margin of the sales representatives model tolerates a larger decrease in sales before economic loss incurs. Thus, operating through a sales representative network will be more likely to generate profit in the face of market fluctuation. Given the uncertain nature of international expansion, risk resilience is an important factor to consider among viable strategies.

To reach the targeted income of $100,000, there must be 614 orders made in trade shows, or 527 orders under sales representative. Note that the projected high sales volume for each strategy is 900 and 720 orders, respectively. There is a cushion of 286 units (25%) under trade show and 193 units (26%) under sales representative. There is no significant difference in the profitability of the two options. This goal should be fairly realistic under whichever method they choose.

A sensitivity analysis was performed based on high volume, average volume, and low volume sales (Exhibit 2.a-b). Trade show will generate an income of $195,145, $111,958 and $28,770 respectively. The sales representative method will generate an income of $147,808, $118,120 and $88,432. While trade show is more profitable under a high sales volume, the sales representative strategy is more profitable under an average and low sales volumes. Further analysis reveals that for both distribution methods to achieve equal profit, the sales volume must be 868 orders, which comes close to the expected high sales for trade show and surpasses the expected high sales for sales representatives. If Foxy Originals has an aggressive profit goal, then trade show will be the better choice. If the company is more conservative with their estimated sales, sales representative should be chosen.

Recommendation

Although we recognize that each option has its own benefits, cost analysis data supports expansion through sales representatives. The sale representative distribution method has a smaller operating leverage, which indicates that it has a lower break-even point. The trade show distribution method will have greater marginal profit when the actual sales is greater than the equal income quantity. In this case however, the equal income point—868 sales—is very close to the estimated high sales of the trade show method. In other words, there is a very small chance that Kluger and Orol will be able to take advantage of the large operating leverage from the trade show option. Rather, an opportunity cost may incur if the actual sales is below the equal point since the sales representatives strategy is more profitable for the majority of the relevant range.

Kluger and Orol are proficient in production, design, and domestic operations. They have proven their savviness in understanding both the products and the Canadian market in their early success. Their experience with selling at festivals and music concerts has equipped them with the skills needed to be successful at trade shows. However, there has yet to be evidence that this same proficiency translates to expansion. Trade shows are more labor demanding and time consuming for Kluger and Orol as they have to prepare and attend all 10 shows. This is further exemplified given the fact that Kluger and Orol currently assume all operational functions for Foxy Originals. If Kluger and Orol were also responsible for the U.S. trade show logistics, they would not be able to devote as much attention to their already profitable business in Canada. Attempting to mitigate this problem would result in incurring more costs in order to meet the increased need for operational roles via hiring personnel.

The sales representative option, in addition to its favorable cost analysis, is largely devoid of the above problems outlined in trade shows. Distribution via sales representatives, given the necessary fixed costs and variable costs for sustaining the operation, is a largely autonomous mode of distribution. The delegation of daily operations in the U.S. allows Kluger and Orol to maintain operations in their successful Canadian market, while leaving most of the logistics to a bookkeeper. Expansion is important, but protecting the company and their revenue streams is fundamental to expanding in general, which is the role the Canadian market serves. Conclusively, we recommend distribution via sales representatives.

Exhibits

	Trade Show	Sales Representative
Total Variable Cost per Order	$236.25	$321.60
Total Fixed Cost	$104,330.00	$30,320.00
Contribution Margin	$332.75	$247.40
Break-even Point (orders)	314	123
Break-even Point (dollars)	$178,403.52	$69,733.55
Sales Volume for Target Income of $100,000	614	527
Sales Volume for Equal Profit	868	
Safety Margin at average sales	51.7%	79.5%
Operating Leverage @ ave. sales	1.93	1.26

Exhibit 1. CVP analysis

Trade Show @ 900 orders		Trade Show @ 650 orders		Trade Show @ 400 orders	
Revenue	$512,100	Revenue	$369,850	Revenue	$227,600
Total Variable Cost	$212,625	Total Variable Cost	$153,563	Total Variable Cost	$94,500
Contribution Margin	$299,475	Contribution Margin	$216,288	Contribution Margin	$133,100
Registration	$40,000	Registration	$40,000	Registration	$40,000
Shipping	$15,000	Shipping	$15,000	Shipping	$15,000
Travel	$20,000	Travel	$20,000	Travel	$20,000
Product samples	$28,000	Product samples	$28,000	Product samples	$28,000
Booth Depreciation	$1,330	Booth Depreciation	$1,330	Booth Depreciation	$1,330
Total fixed cost	$104,330	Total fixed cost	$104,330	Total fixed cost	$104,330.00
Income	$195,145	Income	$111,958	Income	$28,770

Exhibit 2.a Projected Income Statements, FY 2005

Sales Rep @ 720 orders	
Revenue	$409,680
Commission	$61,452
Variable Product Cost	$170,100
Total Variable Cost	$231,552
Contribution Margin	$178,128
Book-Keeper	$1,920
Rental Space	$14,400
Sample Boards	$11,600
Promo Materials	$2,400
Total Fixed Costs	$30,320
Operating Income	$147,808

Sales Rep @ 600 orders	
Revenue	$341,400
Commission	$51,210
Variable Product Cost	$141,750
Total Variable Cost	$192,960
Contribution Margin	$148,440
Book-Keeper	$1,920
Rental Space	$14,400
Sample Boards	$11,600
Promo Materials	$2,400
Total Fixed Costs	$30,320
Operating Income	$118,120

Sales Rep @ 480 orders	
Revenue	$273,120
Commission	$40,968
Variable Product Cost	$113,400
Total Variable Cost	$154,368
Contribution Margin	$118,752
Book-Keeper	$1,920
Rental Space	$14,400
Sample Boards	$11,600
Promo Materials	$2,400
Total Fixed Costs	$30,320
Operating Income	$88,432

Exhibit 2.b Projected Income Statements, FY 2005

Bibliography

Gupta, Nina. *Foxy Originals--Expansion into the US Market.* Richard Ivey School of Business Foundation No. 907B04, London, On, CA: Ivey Publishing, 2014. Accessed Nov, 2017.