**Satyasriharsha Buddha**

**11627317**

**Individual Case Summary for**

**Crafton Industries, Inc.**

**MKTG 5150**

**Marketing Management**

**Spring 2023**

Attached is my summary for the Crafton Industries, Incorporated case. Included are two tables which provides supporting data for my recommendation.

# The Problem

Should Crafton Industries modify its distribution channel in light of intensifying price competition and increasingly costly demands from its current wholesalers?

# Recommendation

Crafton Industries, a rug and carpet manufacturer, should stick to its current method of distribution through wholesalers, rather than considering in-house wholesale operations. Although the idea of cost savings may seem attractive, Crafton must consider its size, associated financial risks and Non- financial risks before making such a significant change.

**Table 1. Relative Costs of Direct and Indirect Distribution**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Cost of Indirect Distribution | |  | | Cost of Direct Distribution | |  | |
| Margins Provided1 | $13,500,000 | | Warehouse Expenses4 | | $4,900,000 | |
| Service Cost2 | $3,240,000 | | Sales Representatives5 | | $2,240,000 | |
| Accounts Receivable Carrying Cost3 | $1,330,049 | | Sales Managers6 | | $320,000 | |
|  |  | | Sales Administration7 | | $1,024,000 | |
|  |  | | Inventory Carrying Cost (higher number)8 | | $1,350,000 | |
|  |  | | Accounts Receivable Carrying Cost9 | | $1,662,562 | |
|  |  | | Transportation10 | | $2,700,000 | |
| Total Estimated Cost | $18,070,049 | | Total Estimated Cost | | $14,196,562 | |

1WholeSalers’s Cost = $54,000,000, Wholesaler's MU based on cost=25%, Margins Provided = (54,000,000\*0.25) = $13,500,000

2 Service Cost= 6% of residential sales = (54,000,000\*0.06)= $3,240,000

3Accounts Receivable carrying Cost = ((sales to wholesalers)/Average Accounts Receivable) \*carrying costs)=(54,000,000/(365/90))\*0.10)= $1,330,049

4$700,000 (average warehouse cost) \* 7 (number of warehouses needed) = $4,900,000

5 SalesRepresentatives = (4000 retail accounts \* 1 hour per call \* 12 months) / (1500 hours per year \* 50 weeks @ 40 hours per week) x 25% of time not spent selling= $2,240,000

6 Sales Managers= 32 Reps/8= 4 Managers. Total Sales Managers= 4\*managers salary = 4\*80000=$320,000

7Sales administration=(Sales Managers+Sales Represenstatives)\*40%=(2,240,000+320,000)=(2,560,000)\*0.40=$1,024,000

8Inventory Carrying Costs= Based on 4 turns a year, the average inventory is calculated as $54,000,000/ 4= $13,500,000. The case outline specifies a 10% cost of inventory carrying, resulting in a carrying cost of $13,500,000 \*0.1, which equals $1,350,000.

9 Accounts Receivable Carrying Cost = (New estimated sales revenue/payment terms)\*Carrying Costs)=(67,500,000/4.06)\*0.10=$1,662,562

10 Transport costs= New Estimated sales Revenue\*4%= 67,500,000\*0.04=$2,700,000.

**Economic Analysis**

**Indirect distribution costs.**

Crafton Industries should consider several financial factors when considering the Indirect distribution model, including the provided margin, service cost, and carrying cost of accounts receivable. According to the available data in Table 1, the company can avoid a total cost of $18,070,049 if it chooses the normal distribution method instead.

***Wholesalers’* *margins***

Wholesalers' margins refer to the profit margins that wholesalers earn in the distribution chain. It is the difference between the price at which wholesalers purchase products from manufacturers or suppliers and the price at which they sell those products to retailers or other customers. In this case, the wholesalers' cost is $54,000,000, and the markup based on cost is 25%, resulting in a margin of $13,500,000.

***Cost to service wholesalers.***

The cost of servicing wholesalers refers to the expenses incurred in providing services and support to wholesalers in the distribution process. These costs are essential for ensuring efficient operations and maintaining a strong business relationship with wholesalers. In this case, the service cost is calculated as 6% of residential sales, resulting in $3,240,000. This means that 6% of the revenue generated from residential sales is allocated towards servicing wholesalers

***Accounts receivable carrying cost.***

Accounts receivable carrying costs represent the cost of financing and managing outstanding invoices or receivables from wholesalers. In this case, the carrying costs percentage is calculated as 10%, and the turnover rate is obtained by dividing the sales to wholesalers by the average number of days in the collection period, which is 90. The turnover rate is then multiplied by the carrying costs percentage to determine the accounts receivable carrying costs. In the given scenario, the carrying costs amount to $1,330,049.

**Direct distribution costs.**

Crafton Industries should consider several financial factors when considering the direct distribution model, including warehouse expenses, sales representatives, sales managers, sales administration, inventory carrying cost, accounts receivable carrying cost, and transportation. These costs add up to a total of $14,196,562.

***Warehouse expenses.***

Crafton Industries requires seven warehouses to service its residential segment. To calculate the warehouse expenses, we need to consider two factors: the average warehouse cost and the number of warehouses needed. In this case, the average warehouse cost is $700,000, and the number of warehouses needed is seven. Therefore, the warehouse expenses are calculated as Average Warehouse Cost \* Number of Warehouses = $700,000 \* 7 = $4,900,000.

***Sales representative costs.***

Crafton Industries considers variables like the quantity of retail accounts and the time needed for sales calls when calculating the necessary number of salespeople. To establish the required workforce, calculations including annual hours worked and selling time are made. To handle its 4,000 retail accounts in this situation, Crafton Industries needs 32 full-time sales agents. Each sales representative is expected to spend 40 hours per week for 50 weeks, with 25% of that time being spent on activities other than selling. As a result, according to Table 1, the anticipated cost of recruiting the salesforce is $2,240,000.

***Sales manager costs.*** If wholesalers are eliminated, Crafton Industries will also need to hire sales managers.Crafton Industries needs four sales managers to manage the 32 sales representatives. The total cost of the sales managers is calculated as 4 \* $80,000 = $320,000.

***Sales Administration.***

The sales administration cost for Crafton Industries is calculated as the sum of the sales managers' and sales representatives' salaries multiplied by 40%. The total cost of hiring 32 sales representatives is $2,240,000, and the cost of hiring four sales managers is $320,000. Therefore, the total cost of the salesforce is $2,560,000, and 40% of this cost is $1,024,000, which is the estimated sales administration cost.

***Inventory carrying costs.***

The inventory carrying cost for Crafton Industries is calculated based on four turns per year. The average inventory is calculated as $54,000,000 / 4 = $13,500,000. The case specifies a 10% cost of inventory carrying, resulting in a carrying cost of $13,500,000 \* 0.1, which equals $1,350,000.

***Accounts receivable carrying costs.***

The accounts receivable carrying cost for Crafton Industries is calculated by multiplying the new estimated sales revenue by the payment terms and the carrying costs. The new estimated sales revenue is $67,500,000, and the payment terms are 4.06. Therefore, the new estimated sales revenue divided by the payment terms is $67,500,000 / 4.06 = $16,611,570.24. The carrying cost is 10%, so the accounts receivable carrying cost is $16,611,570.24 \* 0.10 = $1,661,157.02, which is rounded to $1,662,562

***Transportation costs.***

The transport costs for Crafton Industries are calculated as 4% of the new estimated sales revenue. The new estimated sales revenue is $67,500,000, so the transport costs are $67,500,000 \* 0.04 = $2,700,000

## Effect on Channel Relationships with Direct Distribution

Direct distribution can impact channel relationships by influencing "who owns the customer franchise." In direct distribution, the manufacturer assumes control over all aspects of distribution, including customer relationships. This may create conflict with intermediaries like wholesalers and retailers, who may perceive a threat to their established customer connections. Crafton Industries' distributors hold substantial power, evident in their threats and cooperative agreements, as they possess the customer franchise with established relationships with retailers and buying groups. The potential risk of wholesalers abandoning Crafton Industries can significantly impact their business. While direct distribution strengthens customer relationships, it also presents the challenge of potential conflicts with intermediaries feeling threatened. Therefore, Crafton Industries needs to carefully evaluate the impact of direct distribution on its channel relationships and determine the best approach to maintain these relationships while achieving its business objectives. In this case, it is more of a risk rather an opportunity.

## Resources Required for Direct Distribution

Direct distribution requires significant resources, such as working capital, management expertise, and specific skill sets. It involves assuming control over all distribution aspects, including customer relationships, requiring significant investments in technology, logistics, and marketing. Understanding customer needs through data analysis is crucial. To implement direct distribution, Crafton Industries would need to finance the switch from their available internal capital. Based on the June 30, 2010, balance sheet, Crafton possesses around $16,625,000 in working capital, derived from current assets of $26,937,500 and liabilities of $10,312,500. While technically sufficient to fund the switch, it would deplete almost all of Crafton's working capital, posing a fiscal risk with minimal remaining capital. The major concern arises if distribution costs fluctuate and substantially increase, potentially resulting in the loss of most, if not all, of their working capital.

## Continued Service to Retail Buyers

Transitioning distribution channels is a significant decision that requires careful consideration. One thing to consider is that wholesalers have expressed dissatisfaction with Crafton for evaluating direct distribution as a possibility, and they would likely draft agreements with Crafton’s competitors. The wholesalers have established relationships with retailers, and by burning this bridge, Crafton may incur additional costs associated with retailer distribution. Crafton will need to plan for additional time and resources to build new relationships with customers in order to once again be in a competitive position. Direct distribution can be time-consuming and costly for business owners, and companies that distribute their products themselves are forced to juggle several things at once, rather than focusing on the competency of their core business.

## Time Constraints

## Crafton Industries would need to respond quickly to the risk of wholesalers becoming aware of the direct distribution plans and potentially initiating a mass exodus. However, executing a rapid transition to direct distribution would involve significant cash outlays and an aggressive recruitment program to build a robust sales force. Considering the limited current assets and the absence of a proper existing workforce, executing such a transition is currently not possible for Crafton Industries.

## Lack of Experience

## Crafton Industries lacks significant wholesale experience, and the threats of wholesaler exodus may force the company into a rapid distribution transition. However, looking at Shaw as an example, Crafton should be wary that a much larger brand with more resources was unable to switch distribution models successfully. Failure is even more likely for Crafton, as they have less experience with internal wholesale operations, and are a smaller company with fewer resources.

**Brand Perception**

Crafton Industries needs to be cautious about the potential negative impact on brand perception when transitioning to direct distribution. The company has established long-term relationships with wholesalers and abandoning them may lead to negative perceptions among customers, retailers, and other stakeholders. This could result in a loss of trust and loyalty among customers and retailers, which could ultimately harm the company's reputation and bottom line.

**Table 2 Comparative Income Statements (Residential Sales)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Direct Distribution** | |  | **Wholesale Distribution** | |
| Residential Revenue1 | $67,500,000 |  | Wholesale Revenue | $54,000,000 |
| Residential COGS2 | $40,500,000 |  | Residential COGS | $40,500,000 |
| Gross Margin | $27,000,000 |  | Gross Margin | $13,500,000 |
| % Margin | 40% |  | % Margin | 25% |
|  |  |  |  |  |
| Distribution & Sales Expense3 | $14,196,562 |  | Distribution | $1,620,000 |
| Other Expenses4 | $1,620,000 |  | Sales & Admin | $8,100,000 |
| Net Income before Taxes | $11,183,438 |  | Other Expenses | $1,620,000 |
| Net Margin | 16.5% |  | Net Income Before Tax | $2,160,000 |
|  |  |  | Net Margin | 4.0% |

1…Residential Revenue= (wholesalers cost)/(1-Margin)=(54,000,000)/(1-0.25)=$67,500,000.

2…Residential COGS= 72% of overall costs of goods sold=56,250,000\*0.72=$40,500,000.

3…From Table1, we get Distribution and sales expense=$14,196,562.

4Other expenses for residential sales are 72% of $2,250,000 reported for the firm as a whole.