Case Study on Masterton Carpet Mills Recommendation:

The recommendation suggested to Masterton Carpet Mills, Inc., after a review of quantitative and qualitative information as well as directives given is to establish their own distribution centers or wholesale operations focusing on residential business in an effort to maximize profits. This recommendation would allow Masterton Carpet Mills, Inc. to retain the $13.5 million normally spent in the wholesale channel to help finance this endeavor from the company¡¦s internal funds as is the company policy. This alternative would also afford Masterton Carpet Mills, Inc. more stability due to the lack of intermediary conflict or instability within the external environment.

Problem Statement:

Given recent developments within the floorcovering industry, Masterton Carpet Mills, Inc., a privately held manufacturer of medium to high priced carpet, is considering the possibility of establishing their own distribution centers or wholesale operations focusing on residential business in an effort to maximize profits.

Facts and Underlying Issues:

Masterton Carpet Mills, Inc. is looking to improve their profit margin in a highly competitive, consolidated industry. In 1999, Masterton Carpet Mills, Inc. lagged behind the industry sales growth, but still managed to be profitable by recording a 3.6% sales increase over the previous year.
U.S. consumers and businesses spend approximately $50 billion per year on floorcoverings. The largest category of floorcoverings is carpet and rugs which accounted for an estimated $17.9 billion in sales. The residential segment accounted for 74% or $13,246,000,000 ($17.9 billion x 74%=$13,246,000,000) of the total U.S. sales. This segment is dominated primarily by three companies, Shaw Industries, Mohawk Industries and Beaulieu of America, which control 85% of the U.S. residential carpet and rug market.
Masterton Carpet Mills, Inc. is not inexperienced in the area of direct distribution. They currently directly distribute their contract sales to institutions and business. However, these sales only account for 28% of company sales and occur primarily in the southeastern U.S.
Wholesale and retail distribution in the U.S. carpet and rug industry has been subject to much instability since the 1980¡¦s. There were three major competitive trends within the industry.
1. The first trend occurred in the mid-1980¡¦s when the larger carpet and rug manufactures began to eliminate the margins paid to wholesalers by bypassing them and selling directly to retailers. Smaller manufacturers continued their use of wholesalers because of their lack of capital. By 1990, a majority of the residential carpet and rug sales for residential use were distributed through company distribution centers to retailers, altering the industry.
2. The second trend occurred in the early 1990¡¦s with the emergence of the retail buying group. They combined their purchases in order to obtain quantity discounts from manufacturers. This led to the projected decline of the share of wholesaler floorcovering sales from 26% in 1995 to 23% in 2000.
3. The last change took place when Shaw Industries, the carpet and rug industry leader, began to open and operate its own retail stores and commercial dealer network. This action led to Shaw Industries being dropped by stores such as Home Depot and several buying groups. Four years later Shaw sold its retail stores and was again found in Home Depot.

1,200 of Masterton¡¦s retailers are members of buying groups. They represent one third of the company¡¦s residential segment sales.
Upon news of Masterton¡¦s investigation into the possibility of directly distributing to retailers, a wholesaler threatened Suzanne Goldman with the mass exodus of all wholesalers upon the opening of the first company warehouse.

Assumptions:

We assume that sales are at the same level as in fiscal 2000. All calculations are based on the assumption that should we decide to proceed with the direct distribution into retail accounts all wholesalers would leave, as threatened, with the first warehouse operation opening; however, it is also assumed that we would keep all 4000 current retail accounts and sales would remain the same (Appendix 6). Calculations are also based on the assumption that the number of weeks worked in a year is 50 (52 weeks ¡V 2 weeks vacation = 50 weeks). We also assume that Masterton Carpet Mills, Inc. is content with current retail market coverage (Appendix 6). The final assumption is that all profit margin gains from the elimination of the wholesalers, $13.5 million (Appendix 5), would be kept by Masterton Carpet Mills, Inc.

Analysis:

An analysis of 2 alternatives has been performed considering the possibility of Masterton Carpet Mills, Inc. establishing their own distribution centers or wholesale operations focusing on residential business. The alternatives are as follows:

1. Do Nothing
2. Masterton Carpet Mills, Inc. should establish its own distribution centers or wholesale operations for residential business.

Currently, Masterton Carpet Mills, Inc. is lagging behind in sales growth, but managing to remain profitable. They are a small manufacturer in a large, highly competitive industry. The first alternative is to do nothing and continue to use the current wholesale distribution method. For a basis of comparison the following criteria have been evaluated to achieve the total estimated wholesale distribution cost of $18,070,049: wholesaler margins, cost of servicing wholesalers, and the accounts receiving carrying costs (Appendix 4). Through a 25% wholesale markup, there is presently $13.5 million spent at the wholesale level. The margin of $13.5 million paid out to wholesalers could be retained by Masterton Carpet Mills, Inc. to fund the change in the distribution channel using internal capital. This would satisfy conditions set forth by Robert Meadows, President of Masterton Carpet Mills, Inc. and company policy to finance programs from internal funds except for capital expansion. The cost of servicing the current wholesalers is $3,240,000 which is 6% of sales ($54 million x 6% = $3,240,000). Given that it typically takes 90 days for Masterton Carpet Mills, Inc. to collect its retail accounts receivable and that accounts receivable carrying costs are 10% of sales, the total cost is $1,330,049 (Appendix 5). If Masterton Carpet Mills, Inc. continues the use of wholesalers, $18,070,049 will continue to be spent in that segment of the distribution channel (Appendix 4). The second alternative is for Masterton Carpet Mills, Inc. to establish its own distribution centers or wholesale operations focusing on residential business. Using criteria such as warehouse expenses, salaries of sales representatives and sales managers, cost of sales administration, inventory carrying costs, accounts receivable carrying costs, and transportation expenses the estimated costs for this endeavor total $14,196,561 (Appendix 4). Expenses for one warehouse located in each of seven metropolitan areas, Houston, Chicago, Denver, Los Angeles, New

York City, Philadelphia, and Richmond is calculated to be $700,000 each and total warehouse expenses are expected to reach $4,900,000 ($700,000 x 7 = $4,900,000). If Masterton Carpet Mills, Inc. maintains the same retail proliferation currently offered through the wholesale channel presently used, $2,240,000 should be spent on the salaries of 32 sales representatives and an additional $320,000 should be spent on the salaries of 4 overseeing managers if each sales manager manages eight individual sales representatives (Appendix 6). The total spent on sales administration, which is 40% of the salaries of the total sales force and management costs per year, total $1,024,000 ($2,240,000 x $320,000 = $2,560,000 x 40% = $1,024,000). The cost to carry inventory and accounts receivable total 10% each of sales. With the current desired inventory turnover of 4 times per year, inventory carrying costs would total $1,350,000 and accounts receivable carrying cost would be $1,662,561 (Appendix 6). Transportation expenses equal 4% of sales and total $2,700,000. The total estimated cost of Masterton Carpet Mills, Inc. movement into direct distribution would be significantly less expensive, with $14,196,561 spent in the distribution to retail accounts, than maintaining the current wholesale distribution. With $16,625,000 in networking capital (Appendix 5) this venture could be financed using internal funds. However, with the threat of mass exodus by wholesalers this issue also is time sensitive. An immediate and complete detioriation of the wholesale channel would prevent a slow, integrated movement to direct distribution and would likely cause a major loss in sales hindering Masterton¡¦s ability to efficiently integrate to direct distribution.