**CFM CASE ANALYSIS**

Mr Rajeev and Baskar have to take a no of measures to reform the process of recovery. Currently the company CFM is dealing with a no of problems. First of all there is the problem of decreasing profit margin in spite of increasing sales. Even if CFM has been able to increase its turnover over the last few years, it has not really been able to reduce the cost of operations and thereby there is the fall in overall profits. The father and son duo has been looking at a series of innovations such as increasing the investment in the retail chain, expanding their outsourcing platform more vigorously and to further the branch network as they are really comfortable with them instead of Wholesale Network.

CFM is concerned more with reviving profitability and thus exploring a few options like:

1. Closing the Manufacturing facility at Pickering.

2. Return to being a retailer only.

3. Continue both the operation (wholesale and retail)

4. Close down both the business.

But throughout the last year Mr Rajeev is looking at very good alternatives which can revive the business of the CFM including:

1. Investment in the wholesale Business with the purpose of reversing its losing streak.

2. Outsource more robustly from global manufacturers.

3. Expand Branch stores more vigorously.

4. Vertical integration.

**Where does CFM stand right now?**

Because of the experience of the Management doing such business for a long time, the CFM stands on a very sound and solid ground. It’s currently run by the father and son duo of Baskar and Rajeev with the aim of increasing the Profit Margin.

Currently CFM operates two stores, one at Toronto, which is a good location for retailing and earns $50,400 profits per month but it is before pre-allocations and taxes. Preallocations include warehousing costs and delivery costs. So it’s considerably low when we take both of these and taxes into consideration.

The second store is operated at Pickering which is basically a wholesale store and its profitability is stands at $700 profits per month. Again it is before pre-allocations and taxes. Preallocations include warehousing costs and delivery costs. So it’s considerably low and perhaps there are losses when we take both of these and taxes into consideration.

But to me the situation is not that bad when we are looking at reviving the business by being proactive in all aspects.

|  |  |
| --- | --- |
| Product portfolio | Home furnishings products especially aimed at Living Rooms, Dining Rooms, Bedrooms etc. |
| Intended Market | Lower to middle income People. |
| Geographic thrust | The thrust is aimed at Greater Toronto Area. |
| Value Creators | Experienced management team of Rajeev and Baskar. |
| Target Market Segment | The Market they are targeting at price conscious consumer and especially low to mid- price segment. |

**CRITICAL APPRAISAL**

The Pickering location of CFM is low on sales and thus reducing the profitability. To make it worse, the rent of the Pickering location is increasing because of its locational advantage. It’s a problematic area and it shall be the first job of the Management to look at picking an alternative location if possible which would reduce the total cost down overall.

**Financial Alternatives**

The Pickering store can have alternative financial plans to look into the possibilities that can happen in the near future. Because CFM operates in a price sensitive consumer environment, a change in Prices of the products can have major financial implications for the company.

|  |  |  |
| --- | --- | --- |
|  | CURRENT FINANCIAL STANDING | |
|  | Toronto Store | Pickering store |
|  | $ | $ |
| sales | 2,58,000 | 71,700 |
| less: |  |  |
| cost of goods sold | 1,66,400 | 43,700 |
| gross Margin | 91,600 | 28,000 |
| less: |  |  |
| rent | 18,900 | 15,800 |
| advertisement | 14,000 | 6,000 |
| selling expenses | 4,800 | 4,000 |
| utilities | 3,000 | 1,500 |
| Miscellaneous | 500 | 0 |
|  | 41,200 | 27,300 |
| income before allocations and tax | 50,400 | 700 |
|  |  |  |
| GP MARGIN | 0.35503876 | 0.390516039 |
|  | 35.50% | 39.05% |

The situation at Pickering is not that bad as it was projected out to be. In fact the gross margin at the Pickering store is better than that of the Toronto site by a healthy 4%.

Pickering store is not doing well because of its lower sales growth and having not many stores like Toronto stores to supply at. This can be done away with by either opening new stores or reducing the fixed operating costs. If it’s not possible then the sales can be increased by reducing sales price. Because the target market is low to medium market segment and very price segment we can look at this from the aspect of reducing sales price and increasing sales overall.

**GROWTH ASSUMPTIONS:**

1. Reduce the selling price by 10%.

2. This reduction would increase the sales by 20% as the market is price sensitive.

3. Further assume that a 15% reduction in price can increase the sales by 30%.

4. Other relevant costs would remain the same as there is enough unutilised capacity.

|  |  |  |  |
| --- | --- | --- | --- |
|  | PROPSED FINANCIAL PLAN | |  |
|  | CURRENT | PROPOSAL 1 | PROPOSAL 2 |
|  | $ | $ | $ |
| sales | 71,700 | 77436 | 79228.5 |
| less: |  |  |  |
| cost of goods sold | 43,700 | 47197.242 | 48289.77075 |
| gross Margin | 28,000 | 30238.758 | 30938.72925 |
| less: |  |  |  |
| rent | 15,800 |  |  |
| advertisement | 6,000 |  |  |
| selling expenses | 4,000 |  |  |
| utilities | 1,500 |  |  |
| Miscellaneous | 0 |  |  |
|  | 27,300 | 27,300 | 27,300 |
| income before allocations and tax | 700 | 2,939 | 3,639 |
|  |  |  |  |
| GP MARGIN | 0.390516039 | 0.3905 | 0.3905 |
|  | 39.05% | 39.05% | 39.05% |
| INCREASE IN INCOME BEFORE  ALLOCATIONS | | 2,239 | 2,939 |
| % INCREASE |  | 319.82% | 419.81% |

This clearly is making its mark on the profitability of the firm and the Pickering Store is not doing that bad. Further the margin can be improved with the capacity being more utilised in the next year or so as there has been a proposal to open new stores (retail) to augment the Toronto store and as the management is more comfortable in running such retail joints.

**STORE NETWORK EXPANSION**

New stores would bring in economies of scale. It would also help to reduce the piled up inventory being cleared in a few months by reducing the price by offering volume discounts.

New stores would reduce the fixed costs apportionment and thus reduce the overall cost of production. The reduction will save costs which can be used b the company to outsource some of the material components form outside of Canada and thus make it viable as more components would reduce the per unit or per tonne transportation cost by being able to engage full containers.

But it has its own disadvantages:

1. Finding the right location
2. New stores need more working capital investment in the form of inventory.
3. Staffing and hiring trained salesmen is an area of concern.

When analysed from the above perspectives the results are found to support network expansion. The Retails store (single) is assumed to incur the following expenses in the first month of its operations:

|  |  |
| --- | --- |
| STORE NETWORK EXPANSION FOR CFM (AVG MONTHLY ESTIMATE) | |
|  | ESTIMATED $ |
| sales | 2,00,000 |
| less: |  |
| cost of goods sold@67% | 134000 |
| gross Margin | 66,000 |
| less: |  |
| rent | 15,000 |
| advertisement | 17,000 |
| selling expenses | 4,800 |
| utilities | 3,000 |
| Miscellaneous | 500 |
| DELIVERY EXPENSE | 4,300 |
| SET UP COST | 1,200 |
|  | 45,800 |
| income before allocations and tax | 20,200 |
| GP MARGIN | 0.33 |
|  | 33% |

If additional branches are opened, then it is going to add to the profit margin in a healthy manner. The profit of $20,200 is coming after sales and rent estimations are taken at their lowest values. If actual sales are higher then it would increase the profit margin of the whole chain.

Further by opening up new stores the capacity of the Pickering Store can be better utilised and cost of goods sold can be kept down to further minimum. Current COGS is an estimated 61% and if it can be furthered then it can boost the profitability a little bit.

But the production site is facing the issue of quality control and finding it very difficult to supply goods in time the complicated models because of lack of skilled personnel. Because of non-reliant supply from its own manufacturing unit in time, CFM has to outsource the units and thus margin is lost in the process. This can be taken care of by employing skilled personnel at a slight higher cost or alternatively they have to train them to handle the rush in due process.

The store at Toronto is giving better results but it is facing ever rising competition from competitors. Increasing competition would force the store to reduce pricing in the Long Run as higher prices can’t be sustained for Long.

However it is presenting a case scenario under which the management of CFM can work out a Long term Plan and deduct them into short term achievable objectives.

Immediate Plan:

1. Build a new manufacturing Warehouse and open new stores.(0-6 months)
2. Manufacture from warehouse, reduce prices to increase volume and be sustainable by perking of volume.( 6 months – 2 years)
3. Outsource the delivery services etc and open new stores. Explore the option of being supplier to other retailers and wholesalers in the distant area (2 – 5 years)

**CLOSE TORONTO & PICKERING STORES AND MANUFACTURE**

This is an alternative which shall be explored in detail as the management is experienced in Manufacturing and is capable of being sole supplier. It can source Raw material and required machinery globally as they have past experience in dealing with it. Margin is good as selling won’t be a problem in the Long run as there is not many local suppliers in the greater Toronto area.

**VERTICAL INTEGRATION**

A firm should buy in order to avoid cost of making something. Somebody has to pay the cost of making it. If you buy it, you have to pay the supplier enough to make it worth their while to make it. The real question is whether they can make it more cheaply than you can. Also in contrast to outsourcing, vertical integration can assure timely delivery of any item.

|  |  |  |
| --- | --- | --- |
| FORECAST OF INCOME STATEMENTS | |  |
|  | 2005-06 | 2006-07 |
| NO OF UNITS: |  |  |
| LIVING ROOM SETS | 1100 | 1210 |
| MATRESS SETS | 2175 | 2392.5 |
| SELLING PRICE: |  |  |
| LIVING ROOM SETS | 1100 | 1100 |
| MATRESS SETS | 300 | 300 |
|  |  |  |
| TOTAL SALES | 1862500 | 2048750 |
| LESS: |  |  |
| COGS @67% | 1247875 | 1372662.5 |
| GROSS MARGIN | 614625 | 676087.5 |
| WAGE | 60,000 | 60,000 |
| rent | 1,20,000 | 1,20,000 |
| advertisement | 2,04,000 | 2,04,000 |
| selling expenses | 57,600 | 57,600 |
| SET UP COSTS | 14,400 | 14,400 |
| utilities | 36,000 | 36,000 |
| Miscellaneous | 6,000 | 6,000 |
|  | 4,98,000 | 4,98,000 |
| income before allocations and tax | 1,16,625 | 1,78,088 |

The vertical integration process shows marked improvement in the profitability of the company and augments process capabilities very well.

Pros:

1. The industry is fragmented. It would guarantee the first mover advantage.
2. Long-term profit potential is always associated with it as it would expand the profit margin by 15-20% in the Long Run.

Cons:

1. It does not work in the short run and thus Heavy planning is required in this stage.
2. Staffing in this becomes an issue as the company is dealing with shortage of skilled people.

**Recommendations**

As we have already envisaged from the financial analysis, it would not be prudent to close the Pickering store as its not making losses. It’s not performing well but it can be restructure along with opening new stores and the profit margin can be improved by reducing price and adding volume. These things look promising and the following recommendations are made.

**In the Short Run**

* + Go for Vertical Integration, it would create value and bring down the costs eventually.
  + Explore New Markets and enter New segments to have a complete product mix and be more competitive.
  + Start new store as they contribute to overall margin.

**In the Long Run**

* + Outsource delivery services as it would result in better service and concentrate on quality of the production issues.
  + Train people and retain them by offering internships etc.
  + Relocate the Pickering store and its staff to better location and lower the fixed cost.
  + Begin supplying to Local stores as local supply is rare.
  + Take a place on lease for warehouse and eventually own the place by paying off.