Working Capital Management
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Lecture-30
Management of Accounts Receivables-III

Welcome students so in the process of receivables management we are talking about the distribution channel and in the distribution channel to understand whether we should go for the direct marketing or we should go for the indirect marketing. But channel of distribution we should select and we should say work with that let us understand with the help of an example that if you go for the direct marketing how it is going to benefit us and if you go for the indirect marketing how it is going to benefit company.

Because ultimate objective of the company is to maximize the ROI Return on Investment and where ROI is maximized that should be the preferred mode of distribution channel of distribution of company's products in the market. So, we will have to evaluate the two different channels and let us see that if company goes for the direct marketing what will happen when company goes for the indirect marketing what will happen. So, we have situation like we have information here that there is company which is manufacturing about say how much units?

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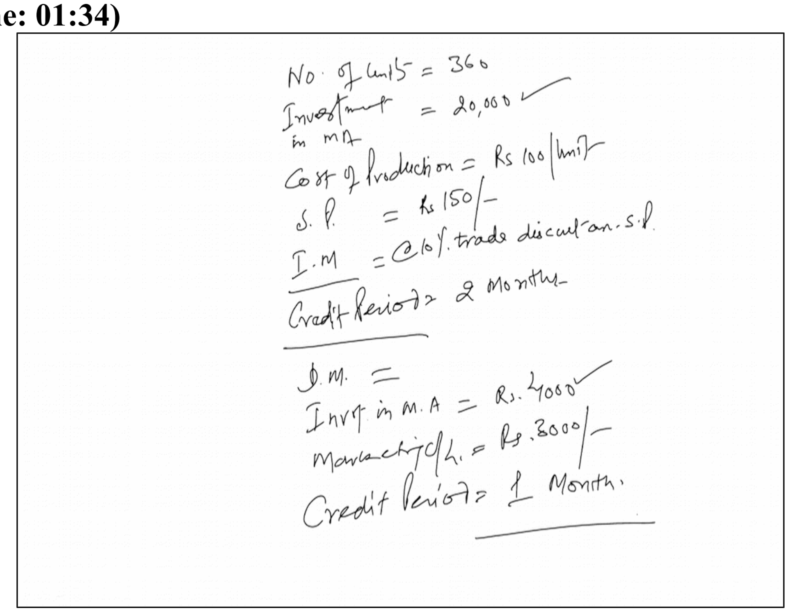

Number of unit's they are manufacturing in the market in a given period of time or maybe in a year is 360 right. And investment which the company has made that is in the manufacturing assets investment in manufacturing assets the company has made is that is, may be assume the smaller figure 20000 rupees and company manufacturing 360 units in a year.

And in this case the cost of production when you talk about the cost of production per unit is, cost of production is rupees 100 per unit. And the selling price which the company can fetch from the market or company can sell the product in the market is that is rupees 150 right. Now there are two channels possible company can go for the indirect marketing also or company can go for the direct marketing. Now the company goes for the indirect marketing it means if the company prefers to sell the product in the market through indirect channels or through indirect marketing channels.

So, there is a possibility that company can sell the product in the market at 10% trade discount. Company can give the 10% trade discount on selling price to a distributor or to a retailer and the product can go to the market this is at the 10% trade discount the company can sell the product and the credit period which the company has to give in this case is, credit period will be 2 months company has to give the credit period of 2 months.

So, at the 10% trade discount product can be sold in the market and credit period has to be given is 2 months. This is the information available if we go for the indirect marketing was selling the product in the market entire production can go to the market at 10% trade discount to be given to the channel and then he would be requesting for a credit period of the 2 months. There is another method also that direct marketing. If companies prefer to go for direct marketing they can have exclusive stores in that case what they have to do is they have to make further investment.

One investment which they have made is the investment in the manufacturing assets 20000 rupees and their make the; to make the further investment under the investment in manufacturing assets; marketing assets may be they have to make investment in the store or may be creating the network it has a cost and that investment is to be rupees 4000 which is additional investment this and this investment will be that you can see it is the capital investment.

And additional marketing overheads which is on the recurring basis marketing overheads will be how much rupees 3000 they have to incur additional cost of say marketing of overheads will be 3000. But credit period will come down to 1 month. So, here we are selling the product selling price is 150 which is decided by the market. Our cost is 100 and when we are selling into indirect marketing they are giving the product and 135 rupees to the channel.

And channel is selling for that the product in the market and the credit period which the channel is asking for his 2 months. If you go for the direct marketing the product will go to the market and 150 rupees and we have to make some additional investment in the marketing assets also and some marketing overheads we have to incur which is 4000 and 3000. But the major advantage of that is that credit period will be half that will come down to 1 month.

Here, one important information which I am not sharing with you is, I will add up later on that is the cost of say getting the market information or the credit information or the customers information that cost is we have to consider it later on. But let us see evaluate this situation the first of all we go for the say indirect marketing.

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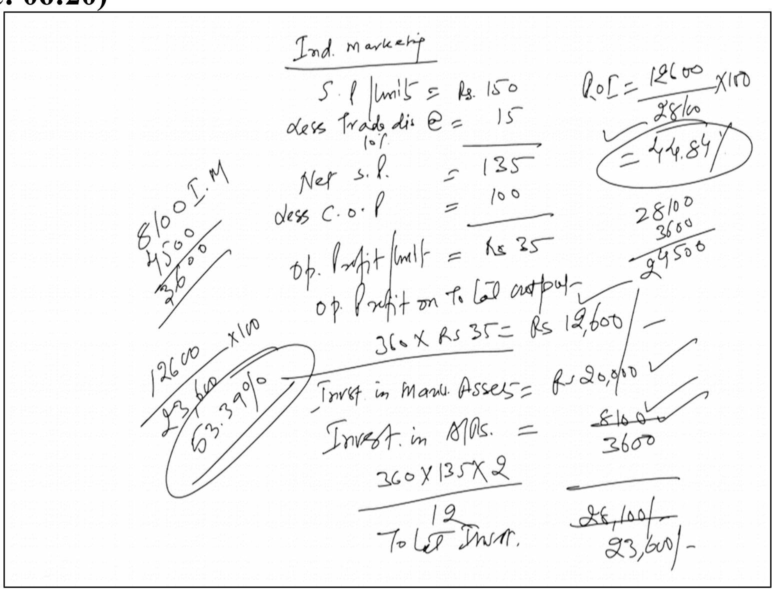

When we go for indirect marketing this channel if we are selecting so what will happen? What is the market price market? Market price per unit is, rupees 150 and how much are a trade discount less trade discount we are giving at the rate of 10%. So, that will be how much that will be somewhere 15 rupees so it means finally net sales price would be how much net selling price will be how much that is 135 rupees. And what is the cost of the product less cost per unit cost of the product of the cost of production per unit is 100 rupees.

So, it means you have how much the operating profit per unit is rupees 35 right. This is the operating profit available and how much is operating profit on a 360 units, operating profit on total production or total output this is how much this is a 360 units multiplied by rupees 35 this works out how much this is say rupees 12600 right. This much of the operating profit on the total annual sales is available to the company.

Now we go to the other part of the other side of the story that how much investment is required to meet in this case or this channel of distribution if you want to go for the investment accounting for the investment so it means here investment in the manufacturing assets investment in the manufacturing assets is how much rupees 20000 we to make the investment of 20000 which we have shown here.

This investment of 20000 we have to make in the manufacturing assets that is going to remain the same in both the channels direct or indirect one. And then what is going to be the additional investment here. Additional investment we are making here is that on account of the investment in investment in accounts receivables or sundry debtors that is going to be how much that is going to be something like 360 into 135 into the say how many months 2 months 2 by 12.

If you think this is going to be the investment here. So, this will work out as how much 8100. So, total investment will be how much? If you take the figure of the total investment total investment is going to be in this case is 28100 right. Now let us calculate the return on investment so it means if you calculate the ROI let us see the ROI that is return on investment that will be how much after profit is 12600 and other investment is 28100 so the return on investment for the company is how much if you calculate this, this works out as 44.884 % multiplied by 100.

This is 44.84 % if we are going to sell the product in the market through the indirect channel where we are going to manufacture say the marketing market price or maybe the selling price per unit may be something like 50 you can write it as the selling price also. So, selling price per unit is going to be something and then we have to; this is the selling price per unit is 150 trade discount is 15 given to the channel.

So, net price for the company's 135, cost of production of the company what we were assumed is 100. So, operating profit per unit is 35 operating profit on the total output is 360 into 35 is 12,600. Now let us talk about the investment when we walked out the investment two investments are required to be made investment in the manufacturing asset investment in the accounts receivables.

So, when you compare the operating profit with the investment we arrived at conclusion that the total investment you are going to make here is that is of 28100 and operating profit or ROI available is 44.84% this is the one part of the analysis of the calculation. Then we see the valuation of second channel that is the direct marketing.

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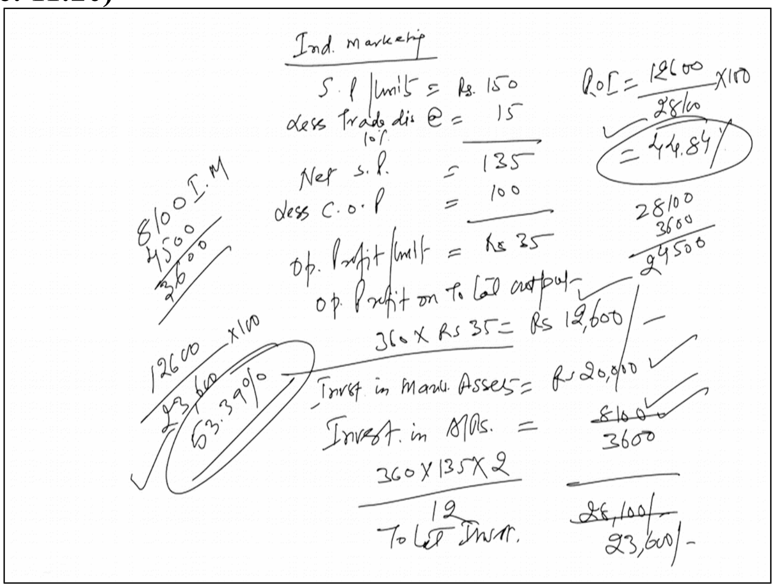

If company goes direct marketing channel right directing marketing channel if the company goes for again selling price per unit that is rupees how much 150 right and less cost selling price is 150. And here now we will be called less cost, now the cost will becomes cost of say cost per unit here the cost per unit is it means we are not talking about now the cost of production. We are talking about that earlier the 15 rupees difference which was going to the; which was going to the distribution network now it is being retained by the company.

So, we are assuming that remaining amount that 135 is a cost per unit and that is 135 so it means return per unit is extra 10 per unit is how much return for unit rupees 15 and how much is a gross return? Gross return is going to be 360 units into 15 so that is going to be something like 5400 rupees. Here what we see that when we go for the direct marketing we have to make an investment in the revenue or in the recurring expenses also. So, at or would say here gross return is 5400 here.

But now here we have to make our cost will increase, so in this case what we will do here we are going to incur some additional expenses on the marketing overheads so you have to subtract that less marketing overheads and if you subtract the marketing overheads of how much 3000 rupees.

So, your returns capital in operating profit becomes how much? Operating profit is operating profit is 2400 we are left with 2400 rupees.

Now we talk about the investment part how much investment we are going to make. So, let us talk about that part investment part and if you see the investment in case of the direct channel, how much investment we are making investment? We are not talking the manufacturing investment that is already made that is common in both the channels 20000 rupees we are not talking about.

When we are going to sell directly in the market what additional investment we are going to make here and that will be say capital investment first thing is the capital investment in the marketing assets. How much that investment? We are assuming that we are going to spend extra 4000 rupees to create the marketing assets of the exclusive stores. And second investment where is going to be how much that is investment in the receivables.

Accounts receivables are going to be how much they are going to come down to one month from the two months. So, it means that will be how much that is 150 rupees selling price 150 mind it now. And this is 360 number of units divided by 12 so this will come down as this will be come as how much 4500 rupees. So, it means how much is a total investment both in the marketing assets and in the accounts receivables.

Total investment is going to be totally investment is 8500 this is investment here. So, now let us calculate the ROI, if you calculate the ROI, in this case we have found the ROI here is 2400 and divided by 8500 into 100, so this is how much is 28.24% this is the new rate of return. So, now if you compare from this information only, if you compare the two channels we find the direct marketing is less productive unless profitable as compared to the indirect marketing where we have the ROI which is much higher that is 44.84 %.

So, I think we should go for the indirect marketing but the decision does not come here we will have to go for the further analysis also.

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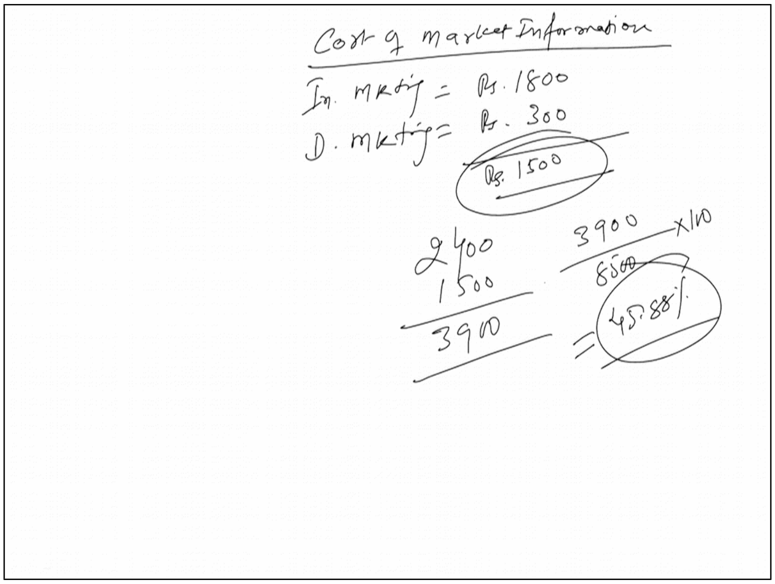

Say for example the important benefit which I have discussed with you is that the major benefit of the direct marketing is that is the cost of the credit information or you can we talk so it about that is the cost of the say the market information. When you talk about the cost of the credit information or the market information in that case when we have directly selling in the market the information about company's product about the customers requirement about any kind of the changes in the product, design, quality price or any kind of the customer’s choice is there directly available to us right.

We did not to spend anything extra on that but when we sell indirectly in the market that what happens we are manufacturing somebody else is selling in the market and customer is at the third level. So, when the customer wants to communicate anything to the company, company has to depend upon somebody either the distribution network. Since the distribution network is selling the products of many companies same product of many companies.

So, it means sometime the correct information reaches to some company sometime the correct information does not reach to the companies. In that case they have to spend some extra money companies were selling their products in the market they have through indirect channels they have to shell out extra money to get the customer information. Regularly companies keep on conducting that customer service or the market survey and their specialised companies specialise firms are there who are into the marketing research.

And companies depend upon them and they had to spend lot of money in say getting that desired information for making their project product as the best acceptable product in the market. So, in our analysis we make some changes and we see that for example when they are going for the when we are talking about the cost of market information cost of market information when you talk about the cost of market information which includes the credit information also.

In case of the indirect marketing the cost is rupees 1800 right and in case of the direct marketing the cost that cost comes down to 300 rupees that cost is still there, but not very high, so there is a clear cut difference of how much rupees 1500 in both modes. When we are going for the direct marketing we are saving how much money that is 1500 rupees we are going to save up on. So, that will be adding up on the return on investment of the company.

So, here how much we have here this of operating profit is 2400, so in this 2400 rupees in case of direct marketing if you are going to add this 2400 rupees into this 1500 also so this is becoming how much 3900 and this is 3900, now if you compare this that is 3900 is the operating profit against 8500. So, finally I think what is going to be return that the return is going to cross the limit now and this will be now 45% or 45.88% or almost 46%.

Now this is becoming 45.88% and in case of the indirect marketing it was 44.84% so it means we are saying that it is better for us to go for the direct marketing and not to depend upon the indirect marketing. But in this case when we are talking with indirect marketing this return is not 44.84% because you missed out one point here that see, when they are selling through two channels will be direct or indirect marketing what is happening here that say amount of accounts receivables.

We have accounts receivables equal to 1 month sales in case of direct marketing. We have accounts receivable equal to 2 month sales in case of direct and indirect marketing the only difference. So, it means how much investment we are making in the accounts receivable when it is the direct marketing, the investment in the accounts receivable when we are making in the direct marketing that is 4500. So, this 4500 is constant this is a minimum investment we are making.

When we are moving from the direct marketing to indirect marketing so what investment we are making here that is 8100. So, what additional investment we are making here additional investment we are making here is that is something like say 8100 this is under indirect marketing and under the direct marketing how much we were spending this is the cost of the accounts receivables is investment in the account receivable is 4500 right.

So, the difference comes out here is of work this additional investment which we are making here is that is of 45 4500 we are already investing under the direct marketing here this is the investment into the accounts receivable at this investment is there. Under this case the investment here is 8100 so it means out of this if this is the minimum we are going to make here how much additional investment in the accounts receivables we are making this much is the additional investment in the accounts receivables we are making and this is say 00 and then 5, 11 -5 is 6 and then it is 7 - 4 is 3600.

So, it means information, investment we are making in the accounts receivables here additional investment that we are making the accounts receivable here is that is only 3600. So, what we will do here is we will have to subtract that if we subtract that from 28100 and then this in our investment is how much investment in the accounts receivables is only we should talk about the additional investment that is 3600, so this is 3600 so it means the difference we are making here is 4500.

So, a total investment which we are made here is that is 28000-3603 if we calculate this amount this will work out as how much this will work out as 00 then it is 5, so then it is 4 then it will work out as 24500 it is not 20000 but it is 24500 so it means how much additional investment we are making here we have not counted for that. So, final investment will be we have said here that investment we are making in the manufacturing asset is 20000 and investment in the accounts receivables is 8100 right.

But it is not 8100 additional investment is because of 4500 is already made an in the first analysis additional investment we are making here is that it would call it has not this much but only 3600 this in addition investment we are making so this amount becomes how much this amount becomes 23600 this amount is 23600 if you compare now what is your operating profit this is same 12600 and your investment has come down to 23600. So, it means what is now the changed profit that is 53.39%.

And if you compare this return with the return from the direct marketing that return from the direct marketing was this much that is returned from the direct marketing we have calculated is 45.88 % and here the return if you calculate is this is 53.39% it means we can say indirect marketing is much better as compared to the direct marketing because of number of reasons that you are not to make any investment into the marketing assets will be able to save this 4000 rupees.

We are not going to make an investment we will have not to make any expenses on the marketing overheads we can save this 3000 rupees right. When we are talking about the accounts receivables level even under the direct marketing also accounts receivables level is 4500 rupees and in this case in the indirect marketing when you talk about we are making the no additional investment for passing of the product to the channel and how much investment we are making the accounts receivable that additional investment in the accounts as well we are making is 3600 rupees only.

And if you talk about this the so in manufacturing asset is 20000 and additional investment in this is 3600 so it means total investment we are making is 23600 and from this if you compare the return that return works out as 53.39%. So, it means we have seen here that as it was expected there are much better results from the indirect marketing as compared to the direct marketing. So, we should depend more upon the indirect marketing rather than of on that direct marketing because of many other advantages of the indirect marketing.

Because here is it important to; major is we are running into is let us say building as a marketing assets. Though we have assume it as 4000 it can be 4 crore or say 400 crore anything. When we built up own marketing network our marketing distribution channels. Tomorrow if the market changes are you the company loosing sales in the market. Company goes out of the market recently was seen is Reebok is not the brand which is no more in existence. So, you can think about those stores which were created by Reebok of the partners of the Reebok.

Now what is there fate so that may create a problem? We have made investment in the marketing assets. But in those marketing assets are marketing assets are becoming useless. In that case it will be a big problem for the company under indirect marketing there is no such a risk only of to manufacture and sell in the market through the channels. So, there is a problem of the information but that information can be collected from any other sources also. And there is another point that when we are selling through indirect channels our receivables or investment in the accounts receivables increases.

But that can be taken care of by many other means because in the direct marketing also some investment we have to make in the receivables. So, we can find out that is much better to sell in directly in the market order them directly in the market. Some people say that which is sometime considered as a negative part in case of the indirect marketing that when we go for selling of distributing our product in the market indirectly.

The company's destiny is locked in the hands of distribution channels companies destiny is locked in the hands of distribution channels in distribution channels want to support the company they can support the company if they do not want to support the company then there is a problem sometimes. Many times we might have seen that when the companies give the incentive to the channels distribution channels.

And when the customers come to the retailers maybe the first channel which is directly related to the customers, we might have seen or we might have experience many times that form our place when you go to the market or to the store or to the retailer we are made up our mind that people by this particular product of this company. But when we reach at the store retailer of the shopkeeper the store owner or their salesman they totally changed your mind.

And say account so much of the properties of the other products in which they are interested to sell or pass on to the customer against the product which you have already decide in your mind to buy. So, because of those reasons because of those factors customers buying preferences changed and if that happens in that case ultimate it is in the hands of the retailer or the store owner or his sales force that which companies project product they can promote and which company's product they do not want to promote they cannot or they may not promote.

So, that kind of the situations are going to be there so companies handle these situations also by giving extra incentives to the distribution channels to the distributors to the wholesalers to the retailers so that they motivate the customers or their channels remain motivated so that they can maximize the sales of the companies that normally happens.

And when you talk about the direct marketing and indirect marketing there are number of other things also to be to be considered in mind. One thing is that say for example if the companies are selling directly in the market we have a situation where we assume a situation here.

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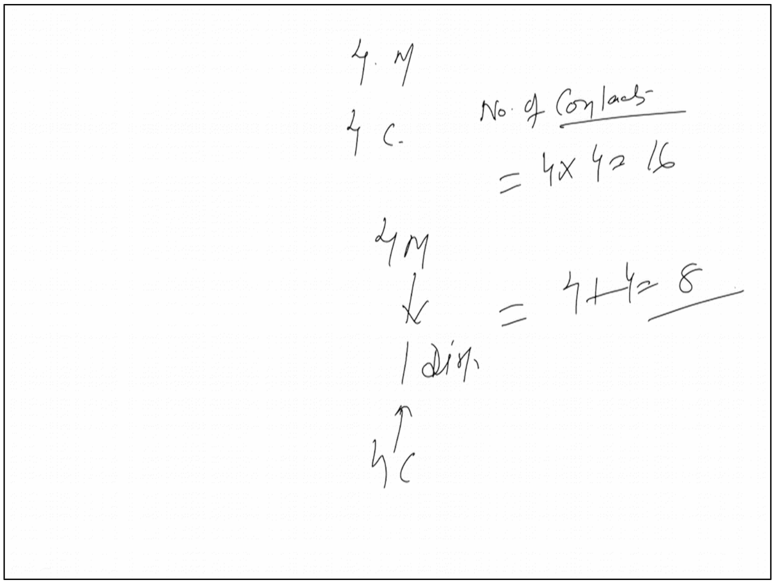

For example there are the 4 manufacturers right and there are the 4 customers in the market. These manufacturers have to sell their products to the 4 customers in the market in this case what will happen number of contacts will be how much number of contacts for contract sequence a will be how much that is 4 into 4 that is 16 contacts will be maintained they have to be the 16 contacts not contract but it is your contacts we have to maintain 16 contacts will come up will be appearing because will be appearing.

Because individual manufacturer all the four manufacturers had to go to the individual for customers, 4 companies have to go to the 4 customer it means 16 contacts will arise. But for example this 4 manufacturers sell through one distributor or the retailer in the market so what will happen? All the 4 companies they sell their product to one distributor and all the 4 customers they can also go to the one distributor.

So, in this case number of the contacts will be 4 + 4 that is 8. So, that is again the simplification of the selling process reaching up to the customer and selling their product in the market that is also very positive point. It is major important or the major benefit of the indirect marketing is the serious receiving upon the cost. If you saved up on the course seriously means if you are going to sell indirectly in the market and rather than maintaining a full-fledged store.

If you are able to sell in directly with the help of the existing distribution channels cost of the production distribution and marketing comes down seriously and when the cost of any product comes on seriously price also comes down and the benefit of that lowered price or lesser price can be passed on to the consumers and when you lowered on the price of the product same kind of the product the lesser price.

Then their loyalty towards the company to other companies products increases. Many times you will see that if you want to buy the Nike shoes and if you go to the retail outlet of the company all outlet specialised company owned outlet exclusive store you find the product is expensive, shoes are expensive. But when you want to buy the same to same Nike shoes from a store which keeps the product of multiple companies are different companies.

There you will find the product is at the same as much lesser rate and certainly there will be the difference in the price because in that case the marketing or the distributions overheads of that channel are getting say distributed to the different companies and their products. If there is exclusive store then entire has to be recovered by the store from the customer only so that is the major difference.

And then you start selling in the market indirectly what happens your receivables will go down sorry receivables go up investment in the receivables will increase. But there will be so many other benefits which will certainly out smart or outweigh the investment in accounts receivables and if a company's product is excellent and it very reasonable price in that case even under indirect marketing also the accounts receivables level can be brought down.

So, ultimately we conclude here that accounts receivables are largely affected by the selection of the channel of distribution and the company should decide it very carefully which channel of the distribution they should adopt or they should use and they should sell the product in the market by falling or by sail through which channel of distribution. So, I stopped here and then further discussion on the receivables we will carry on in the classes to come. Thank you very much.