

Case Study on Physical Distribution (Strategic Marketing, MBA IV)

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Q. Arvind Sood, like most entrepreneurs, dreamt a lot. He dreamt customers would eagerly phone Woodstock Acoustic Systems in India. To order the latest, custom made stereo speakers. He saw demand rising and rising, cash flowing, and his technicians producing superior quality products that were delightful and appreciated by the Woodstock customers, and favourable word-of-mouth spreading.

All through, Arvind had focused on creating something delightful for “audio addicts,” – the people who love to listen to music and appreciate high-quality stereo equipment at a reasonable price. These people were fastidious about sound quality but were unable to afford very expensive brands of well-known companies such as Bose or others. They were young, well educated, upwardly mobile in their careers, and would be affluent in about 6-10 years, and would prefer to buy a set of speakers now rather than wait.

As scheduled, Ajay Suri arrived at the appointed time. He said he had heard about Woodstock Acoustic Systems from a friend of a friend. He wanted to have a first-hand experience of his stereo speakers. Arvind took him to his garage office and played couple of Indian classical music tapes. Ajay Suri afterwards asked Arvind if he was interested in selling these two pairs of speakers, and how much is the price for each pair. Arvind said, “These are the latest that I have designed and are of very high-quality. I have not decided about the price yet but might sell, but it depends on how much you are prepared to pay for a pair.” Arvind put his hand in his trouser pocket and touched a 10-Rupee note. He was thinking if Suri says he would buy a pair for ` 1500, he would sell. He thought, “I need some money.” Suri was silent and thinking. Arvind was feeling nervous and stared at something that was not there on the floor.

Suri spoke, “I will buy both the sets for ` 8000 each, cash. But there is a condition.” “And what is that condition?” asked Arvind reflexively, not really believing his ears. His heart seemed to be racing at 100 km per hour.

“Well, every month you will sell me five such pairs at this price for six months. You will not sign contract with anyone else during this period in Delhi market. I might ask for more number of pairs, but that we will see later.” “Further, I will give an advance for the next two pairs that I will pick up in about two weeks, or may be earlier. So, keep them ready by the end of the next week.” He paused for a moment then said, “If it suits you.” “In fact, I will call you after about ten days to learn when should I really come to collect the pieces.” That was the evening, three years ago.

For the first year, he sold his speakers only to Suri, who had a music equipment showroom in South Extension. After the first two months, Arvind employed two qualified workers and his supply of speakers to Suri's showroom had climbed to 120 pairs per month in six months time. He learnt that Suri was also attracting customers to his showroom from adjoining areas of Delhi.

In two years Arvind had established his manufacturing unit in Okhla Industrial Area and had 30 full time workers. He personally tested each pair of speakers produced and was stickler to quality. Now Woodstock Acoustic Systems was supplying to six music showrooms in Delhi and sold to trade customers approaching directly from other states. So far he had not established system of distribution in any market, except for six regular showrooms of Delhi.

Arvind had been for some time, thinking about establishing some streamlined distribution system. He knew that most manufacturers distribute their equipment primarily through stereo dealers. Whatever little experience he had gained, Arvind did not think much of this, he felt that the dealers too often played hardball with producers, and forced them to accept thin margins. In general, the dealers concentrated on a handful of well-known manufacturers who provided mass produced models. This kept those firms that offered high quality customised products from gaining access to the market. Perhaps most disturbing, Arvind felt that the established dealers often sold not what was best for customers, but whatever they had in inventory in a given period.

Arvind's dream was to provide high-end stereo speakers directly to audio-obsessed, and devise a method of bypassing the established dealer network. It was clear that he wanted to go directly to end customers, thereby avoiding dealer mark-ups and offer top quality products and service at reasonable price.

Arvind was now 28 years of age and set out to turn his dream into reality. Some customers who know about Arvind's work and Woodstock Acoustic Systems had become enthusiastic supporters and invested ` 4.5 million in Woodstock.

Approximately 370 stereo-speaker makers compete for ` 5000 crore market in the country for audio equipment. Nearly 230 of these manufacturers sell to the low-and-mid-range segments of the market. This accounts for 90 per cent of the market's unit volume and about 50 per cent of its value. In addition to competing with each other, Indian manufacturers also compete with Japanese and American firms that offer products at affordable prices. The remaining 140 or so producers compete for the remaining 10 per cent of the market's volume and 50 per cent of the value – the high end – where Arvind hopes to find his customers.

To serve the audio-addicts segment, Arvind offers only the highest-quality speakers. Woodstock has two models: the Elite and Percy. The Elite stands 18 inches high, weighs 8 kg and designed for

stand mounting. The floor standing Percy is 46 inches high and weighs 38 kg. Both models feature custom-made cabinets that come in natural or black oak, and walnut. Arvind can build and ship two pairs of Elite speakers or one pair of Percy speakers all by himself in a single day. In order to have adequate parts inventory, Arvind has to spend ` 1.5 million of his capital on the expensive components.

Arvind set the price of Elite and Percy at ` 35,000 and 73,000 per pair respectively. He selected these prices to provide a 50 per cent gross margin. Arvind believes that traditional dealers would sell equivalent speakers at retail at nearly twice those prices. Customers can call Woodstock on a toll-free number to order speakers or get advice directly from Arvind. Woodstock pays for shipping or any return freight via First Flight. Round trip freight for a pair of Percy costs ` 9,500.

Arvind offers to pay for the return freight because a key of his promotional strategy is a 30-day, in-home, no obligation trial. This trial period allows customers to listen to the speakers in their actual listening environment. In a dealer's showroom, the customer must listen in the environment that is at best artificial and often feels pressure to make a quick decision.

Arvind believes that typical high-end customers may buy speakers more for "non-rational" reasons. They want a quality product and good reproduction of sound, and also to convey an image. For these reasons, Arvind has tried to create a unique image through the appearance of Woodstock speakers and to reflect the image in all of company's marketing. He has spent money on distinctive stationery, business cards, a brochure, and a single display ad. He also designed a laminated label he places just above the gold-plated input jack on each speaker. The label reads, "This speaker was hand crafted by (the technician's name who assembled the speaker goes here in her/his own handwriting). Made in India by Woodstock Acoustic Systems, Delhi."

To spread the word, Arvind concentrates on producer reviews in trade magazines and on-trade shows organised for high-end Hi-Fi systems (including foreign brands). Those who attend the show cast ballots to select the, "Best Sound at the Show." In the balloting, among 160 brands, Percy finished twelfth. Among the top ten brands, the least expensive was priced at ` 94,900, and four of the systems were priced from ` 340,000 to ` 735,000. A reviewer of Hi-Fi systems in an issue of industry magazine Stereoline evaluated Woodstock's speakers and noted, "The overall sound was robust and dynamic, with a particularly potent low end. Parts and construction quality of speakers appeared to be first rate. Definitely a company to watch."

Arvind made plans to invest in a slick, four-colour display ad in Stereo Review magazine with highest circulation. He also expected another favourable review in Stereoline magazine.

Reflecting on his first year of operations and the difficulties Arvind faced, he realised that he has learned a lot. He faced typical challenges an entrepreneur encounters. There were quality problems with the first cabinet supplier. Then, he ran short of a key component after a mix up with a second supplier. He tried hard to avoid debt, but had to borrow 2.5 million from a bank. Prices for his cabinets and some components had risen, and product returns had been higher than expected. The price and cost increases put pressure on his margins, forcing Arvind to raise his prices (to those mentioned above). Despite the price increases, his margins were less than the targeted 50%.

All things considered, Arvind felt good about his progress. The price increase does not seem to have affected demand. The few ads and particularly word-of-mouth seem to be working. Arvind receives an average of five calls per day, with one in six calls leading to a sale. Arvind also feels the stress of long hours and the low pay. He is not able to pay himself a high salary. His total salary for the year was ₹ 480,000.

Arvind reaches over his table and picks up his most recent projections. It seems this year will earn a profit of about ₹ 9 lakhs. Perhaps he is going to make it. As he puts back the projections on the table, Arvind's mind drifts to his plans of introducing two new models Minnow (₹ 168,000 per pair) and the Rostuk (₹ 340,000 per pair). He knows that there is a considerable potential in the foreign market for his speakers. Should he use the same direct marketing strategy for foreign markets, or should he consider distributors. The dreamer is visualising.

Questions

1. Why did Arvind establish a direct marketing channel?
2. What objectives and constraints have shaped his channel decision? If you were a consultant, what distribution channel strategy would you recommend Arvind for domestic and foreign markets