Alfin: marketing and cosmetic industry assignment

[Art & Culture]

Case summary Alfin Fragrance Inc. was a US based importer and marketer of high end French perfumes and cosmetics. The company was going to introduce an industry breakthrough product ??? Glycel, which was acted like an anti aging creme. The product would be demonstrated and sold at the best departmental and Glycel was expected to provide Alfin Fragrance a fortune as an annual sales of $ 30 million was expected in 1987. The industry observers speculated that Alfin Fragrance needs some external financing to support its growth.

But Alfin had to make its financing choice ??? whether the company will go for external debt or it will issue equity. Problems Statement: In this case, we are going to analyze the following problems which are relevant to the case: ??? How Alfin Fragrance Inc. would finance its growth if it introduced the highly anticipated anti aging cosmetic miracle ??? Glycel. Should Alfin go for debt or it should issue new equity capital to finance the growth? ??? How Alfin Fragrance Inc. would manage its problematic working capital? ??? Trademark and licensing infringements were very common in the industry.

Was there any possibility that Alfin might face any legal suit? ??? The marketing campaign of Alfin Fragrance was very traditional and their focus was only niche market. Was a traditional marketing effort enough for Alfin to sustain in the market? Macroeconomic and Market overview in USA in 1985: Overall economy and the market was not so stable in 1985 but economy and market speculators view that the depression of the economy and the market would turned to a growing one in 1986 because of the changing pattern among the American consumers.

Many industries observed downturn because customers were reluctant to buy nondurable. Though this happened in 1985, some industry observers estimated that the cosmetic industry would turn around in 1986 because of the possibilities of introducing industry breakthrough products like Glycel and others cosmetic firms. Another observation toward the positive future trends of cosmetic industry is the Baby boomers (who were born during the Post-World War II) were aging then and they showed their interest in skin care and antiaging products. The following graph shows the stock price changes during June 1984 ??? December 1985.

During that time we can address some unusual trend in December 1985 where both the cosmetic industry and aggregate stock index roar because of the positive expectation among the investors and marketers toward the cosmetic industry. Some favorable information like introducing new anti aging lotion and sun protection creme were available then. [pic] Cosmetic Industry overview of USA in 1985: The cosmetic industry of USA has the following characteristics: ??? Market Size: The cosmetic and toiletries industries were huge and consisted of at least 150 companies. Market Growth Rate: Sales of all toiletries and cosmetic companies were growing at an average rate of 2% to 3% per year. ??? Average profitability of the industry was $13. 3 million. ??? Brand loyalty and product proliferation ignited the competition of the industry. ??? Companies relied heavily on advertising for selling their product. ??? There was a tendency among the companies in the cosmetic and toiletries industry to copy other’s product. That’s why trademark infringement suits were common in the industry. Most of the companies in the industry were sold their product in departmental stores, discount shops or in drug stores. Analysis of Porter's Five Factors Model: Here, we are going to analyze the cosmetic and toiletries industry by analyzing the elements of Porter's five factors model below: Rivalry among the competing firms: The rivalry between the companies of cosmetic and toiletries industry is very high because of the following reasons: ??? Large number of competitors because more that 150 companies were competing in the industry ??? Industry sales growth rate was only 2%-3% Competitors were heavily relied on advertising to compete against the rivals ??? Bandwagon production by most of the companies ??? Because of the existence of identical product customer's switching cost was low ??? Because of large fixed cost in trademark and licensing rights, entry barrier was also high ??? Companies tried to improve their market position by branding and new product launch Threat of new entrants:

The threat of new entrants in the industry was not so high because of the following reasons: ??? The industry was already captured by hundreds of firms and some large pharmaceutical firms also had their subsidiary share in the cosmetic industry ??? Not so lucrative industry growth rate ??? Another most tough barrier for the new entrants were the existing brand preference and product line by the competing firms ??? Companies had to have large resource capabilities for compensating large initial fixed cost was needed to have trademark and licensing rights ??? Access to distribution channel was not easy by the newcomers

Threat of substitute products: The threat of substitute product was low because of the following reasons: ??? Substitute of cosmetic and toiletries were possibly some skin and health care drugs which were costly and not a subject to frequent buy ??? Substitute product manufacturers had not campaign much advertising for their products ??? Largely available cosmetic product in terms of substitutes Bargaining power of the suppliers:

The bargaining power of the suppliers in the cosmetic and toiletries industries of USA in 1986 was high because of the following reasons: ??? Suppliers were generally the original manufacturers of branded perfume and the country origin of the brands were in France, Switzerland, Italy or Germany. US firms are the licensee of those brands in USA. So, in providing selective licensing original companies had the bargaining power. ??? The supplier companies had the bargaining power to forward integration in the US cosmetic industry. Suppliers of foreign cosmetic brands were small in number Bargaining power of the buyers: The bargaining power of the suppliers in the cosmetic and toiletries industries of USA in 1986 was very high because of the following reasons: ??? The switching cost of the buyer from one company’s product to other company’s product was very low because of identical products by the companies. ??? Buyers were well informed of the products because of large scale advertisements by major companies. Strategic Group Map of the competitors in the Cosmetic and Toiletries industry of USA in 1985:

We know that industry driving forces and competitive pressures favor some strategic groups and hurt others. Here, we can see the 1986 Cosmetic industry strategic map where low cost and high-priced domestic and foreign cosmetic brands by the major manufacturers and licensees. Company Overview: Alfin Fragrances, Inc Alfin Fragrances, Inc. was a U. S. based importer and marketer of high priced French perfumes and other cosmetic products. It was founded in 1976. All the products of this company were manufactured by France, Italy, or Switzerland. By 1985 the company was operating through its distributors in 31 countries.

Alfin sold its products only with the aid of specially trained demonstrators through prestigious department and specialty stores. The company also owned 80 percent of an exclusive worldwide perfume venture with an American designer. ‘ Ombre Rose’ one of two fragrances of Alfin had continued to set domestic and foreign sales records in 1985. Alfin was also the worldwide manufacturer and distributor of the Irma Shorell, a brand of skin care products. Almost all the members of Alfin management had significant experience from other renowned cosmetic companies.

In February 1986, Alfin introduced a line of skin care creams called ‘ Glycel’. Glycel was a cell-regenerating skin cream, stemmed from research done by South African Heart surgeon Christian Barnard. Glycel was considered a breakthrough by many in the cosmetic industry, because it worked at the cell level and help to make older skin behave and look like younger skin. Alfin’s major supply chain partners were prestigious departmental stores like Saks-fifth Avenue, Bergdorf Goodman, Bloomingdale’s, Bonwit Teller, Lord & Taylor, Macy’s, Marshall Field, Neiman-Marcus etc. Company Analysis: It focuses on firms in an industry that are positioned to benefit from the economic trends. ??? It concentrates on a firm’s stock intrinsic value based on growth and risk. ??? It reinvested its earnings and the management was reluctant to give any dividend SWOT Analysis of Alfin Fragrance Inc. Strength 1. Alfin’s successes build on its strong distribution channel through 31 countries. 2. Almost all the members of Alfin’s management were highly skilled due to their experience from other renowned companies. 3. Alfin also held exclusive, worldwide manufacturing and distribution rights to a number of French and Italian designer fragrances.

Weakness 1. The company did little advertising compared to other companies of this industry. 2. Alfin sold its products only with the aid of demonstrators through only prestigious departments & specialty stores. 3. Alfin Fragrance had a traditional marketing mix 4. Alfin’s working capital management was poor Opportunities 1. Market relatively large for diversification. 2. Alfin can create a long term brand loyalty through mass advertising and direct contact with the customers. 3. Positive economic climate. 4. Baby boomers were aging and conscious about health care Threats 1.

Alfin had managed to get steady sale with only two fragrances which might cause reduction in sales if other company introduced new substitute products and did the heavy advertising. 2. Alfin paid a little concentration on advertising of its products that might increase the chance of their product less popular. 3. Low market growth rate. Ratio Analysis of Alfin Fragrances Inc. : From the following chart we can see the different ratios of Alfin Fragrance. | | 1984 | 1985 | Changes | | | Current Ratio | 4. 6 | 3. 49 |-23. 55% |% | | Quick Ratio | 3. 52 | 2. 50 |-29. 02% |% | | Cash Ratio | 2. 91 | 1. 84 |-36. 92% |% | | Receivables Turnover | 1. 21 | 1. 08 |-10. 37% |(Times) | | Inventory Turnover |- | 1. 35 |- |(Times) | | Payables Turnover Ratio |- | 2. 0 |- |(Times) | | Total Asset Turnover Ratio |- | 1. 05 |- |(Times) | | Fixed Asset Turnover |- | 13. 22 |- |(Times) | | Equity Turnover |- | 1. 48 |- |(Times) | | Gross Profit Margin | 0. 73 | 0. 75 | 2. 87% |% | | Operating Profit Margin | 0.

31 | 0. 34 | 8. 9% |% | | Net Profit Margin | 0. 19 | 0. 20 | 7. 48% |% | | Return on Total Equity |- | 0. 21 |- |% | | Return on Owner's Equity |- | 0. 30 |- |% | Liquidity and solvency ratio declines in 1985 from 1984 due to the increase in current liability and decrease in liquid assets like cash. We are unable to find some ratios in 1984 due to the unavailability of information. On the ther hand, profitability ratios increased as sales and operating profit increased in 1985. So, there is a positive change in the profitability ratio. Estimated product life cycle of Glycel From the given predictions in the case, we can speculate some further estimation on the product life cycle of Glycel. In our estimation, the sales of Glycel would reach its peak at the last quarter of 1986. Then the sales became matured in 1987. And after 1987, we've predicted that other companies in the industry would introduce competitive products of Glycel, as they did many times before in case of other products.

Assumptions ??? WACC Calculation: 1) Tax rate as indicated in the Case was 48% 2) Risk free rate of return = 8. 984333% which is calculated from the annual treasury bill yield 3) Debt to equity ratio = 13% was given in the case 4) Interest rate was assumed (as rounded) 10% 5) WACC is calculated as 13. 44% ??? Valuation without the Glycel project: 1) Avg. Sales Growth Rate = 34. 75% 2) COGS as % of Sales = 27. 07% 3) Gross Margin = 72. 93% 4) SG&A as % of Sales = 41. 94% 5) Operating Profit as % of Sales = 30. 99% 6) Tax Rate = 48. 00% Valuation with the Glycel project: 1) Avg. Sales Growth Rate = 34. 75% 2) COGS as % of Sales = 30. 00% 3) Gross Margin = 72. 93% 4) SG&A as % of Sales = 47. 94% 5) Operating Profit as % of Sales = 30. 99% 6) Tax Rate = 48. 00% ??? Incremental Cash Flow Determination: Incremental cash flow = Cash flow with the project ??? Cash flow without the project NPV of incremental cash flow = – Initial cash outflow + PV of All incremental cash inflows Financing Choice of Alfin Fragrances Inc. After analyzing the incremental cash flow of Alfin we finally reached Year | Cash Flow with the Glycel | Cash Flow without Glycel | Incremental Cash Flow | | Year | Cash Flow with the Glycel | Cash Flow without Glycel | Incremental Cash Flow | | 1986 | 3068 | 4445 |-1376 | | 1987 | 6143 | 5724 | 418 | | 1988 | 9789 | 6713 | 3076 | | 1989 | 16195 | 10078 | 6116 | | 1990 | 21479 | 13446 | 8032 | | Terminal | 211915 | 132679 | 79236 | NPV of Glycel Project: + (PV of all Incremental Cash Flow with Glycel ??? PV of all Incremental Cash Flows without Glycel) Scenario Analysis: Scenario Summary | | | | | | | | Current | Debt 25% and Equity 75% | Debt 50% and Equity 50% | Debt 75% and Equity 25% | | | | Values: | | | | | Changing Cells: | | | | | | | WACC | 13. 44% | 12. 30% | 9. 94% | 7. 57% | | Result Cells: | | | | | | | NPV | 50, 863 | 72, 577 | 140, 843 | 281, 812 | Here, we see that as the proportion of debt is increasing in the capital structure the WACC is decreasing. This has been happening due to Alfin’s being under high tax bracket. Simulation Output: [pic]

Simulation Output: Forecast: NPV | Statistic | Forecast values | | Trials | 1, 000 | | Mean | 54, 220. 56 | | Median | 50, 670. 06 | | Standard Deviation | 24, 872. 29 | | Variance | 618, 630, 611. 91 | | Skewness | 0. 7894 | | Kurtosis | 4. 0 | | Coeff. of Variability | 0. 4587 | | Minimum |-9, 995. 43 | | Maximum | 166, 523. 46 | | Mean Std. Error | 786. 53 | From the simulation output by using Crystal Ball??? we see that the coefficient of variability is 45. 87% which is relatively higher and this denotes high riskyness of Glycel. In fact this is the result of sales variability as we can see that from the estimated product life cycle and intra industry rivalry. .

Working Capital Position of Alfin Fragrance Inc. Working capital is a very crucial and important component of a firm’s short term investment and source of short term financing. It is important in the sense that a firm’s solvency is dependent on efficient management of working capital comprising of current assets and liabilities. After analyzing the solvency ratios of Alfin we’ve reached the following decisions: ??? Current ratio, Quick ratio and Cash ratio of Alfin Fragrance is deteriorating because of increase of current liabilities in terms of current assets. Alfin’s short term assets portfolio consisted more illiquid assets and for that reasons its quick ratio was not satisfactory.

On the other hand its cash is decreasing because it made some capital expenditure in tangible and intangible assets (Trademark and Licensing) and increase in Accounts Receivables and Inventories also reduces the cash flow from operation. This resulted diminishing cash ratio in 1985. ??? Alfin’s increasing accounts receivables means it had a flexible credit policy due to the competition but the change was almost double in 1985 from the previous year. So we the credit policy flexibility is a problem which may harm its solvency and cash collection to meet growing accounts payables. ??? As Alfin had to make its products available to almost 1200 shops, it had to maintain a large number of inventories. But this was not satisfactory because the amount became almost double in 1985 from 1984 due to the impact of competition.

Other reasons for growing inventories were high priced products and traditional direct relationship marketing. ??? If we compare the current assets position of Alfin Fragrance we’ve found that the firm had risky investment in accounts receivables and in inventories. So, it should take care of that risky position. ??? In its current liability position we've found that its current portion of mortgage and notes payable as well as accounts payable was increasing with large amount which may create pressure on the solvency of Alfin Fragrance. Possibilities for Legal suit for Alfin: Lots of trademark and licensing infringement were observed in the cosmetic industry. Alfin also got licensing agreement from the developers of Glycel at a cost of $3 or $4 billion.

As Alfin wanted to launce Glycel imminently it has marketed Glycel as a cosmetic because it would take less time to launch Glycel as a cosmetic rather than an anti aging drug. As Alfin wanted to launched Glycel as a cosmetic product it didn't take any lengthy testing in the lab or the approval of Food and Drug Administration of USA. But if the Food and Drug Administration would take it as a violation of law then it might create huge problem for Alfin and all of its profit projection will be hampered. Traditional and static marketing effort of Alfin Fragrance Inc. Traditionally Alfin Fragrances relied heavily on specialized demonstrator of their products who demonstrated the quality and usefulness of its products to the ultimate customers who visited different departmental stores.

Alfin argued that it tried to create a direct long term relationship with their customers. But major players in the cosmetic industry then heavily invest in advertising because they tried to create superior brands among numerous companies. Even heavy advertising didn't give the companies a better profit. In that circumstance, only direct relationship marketing is too niche and traditional to compete against the broad aspect. We believe that its traditional marketing effort was responsible for its inventory piling up and other problems related to sales. Policy Recommendations & Conclusion: After analyzing the whole we strongly recommend the following recommendations for Alfin Fragrances Inc. below: ??? About Financing Choice:

From the above discussion and prior observation it is very apparent that the company should finance its Glycel project through debt financing. There are in fact three justifications for doing it. ??? Firstly, the firm is an unlevered having only 13% debt to equity ratio. So it can well afford the debt financing. ??? Secondly, the firm is under heavy tax bracket about 48% of tax. So debt would be much cheaper for it. And previously we saw that more debt in the capital structure increases the NPV. ??? Thirdly, we find the Glycel project is a bit risky, because of its sales variability which arises from the fierce intra industry rivalry, again the market growth is very sluggish.

So by using debt we can also be able to diversify the risk among the outsiders as well. ??? About Working Capital Management: ??? Alfin's cash position is not satisfactory. For this it should speed up the collection form debtors through departmental stores ??? The management of Alfin should be more specific in determining the optimum level of inventory. Efficiently controlled inventories make the firm flexible. Alfin can adopt the EOQ method to manage inventories more efficiently. It can also follow Just-in-time (JIT) order/production system, which will also minimize the holding cost of unutilized inventory. ??? Short term assets should be managed properly to trade off the solvency risk at the maturity of short term debt.

So, Alfin should think of its current liability maturity to avoid solvency risk and improve current assets management. ??? About Lawsuit: ??? It should develop good relationship with Food and Drug Administration and other legal body that protects Intellectual Property right to avoid legal risk ??? About marketing campaign: ??? It should deploy innovative marketing and advertising campaign i. e. TV commercials, Bill boarding and newspaper ad to foster sales. ??? It should encourage debtors for cash payments by increasing commission We believe that if Alfin would take care of the suggested issues it could be concluded that the Glycel project would become a successful one and assist Alfin to occupy the leading market position in this highly competitive cosmetics market.