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XXXXX Number: XXXXX XXXXX XXXX XXXXX XX – XX – The Smell of Success

In order to identify the best suited strategy to put the Lovely Scent Company back on a profitable track, the four options proposed are analyzed. The report aims at discussing the outcome of these options and the best strategy is chosen based on the estimated net income.

Reduction in Price:

Wally Workshard has suggested a price reduction by 20 % ($ 28 per unit) which will in turn increase the demand for the product. The increased demand is estimated to be 85, 000 additional units per year. The effect of these changes on the company's income is presented in Appendix 1. It is evident that the company will still incur a loss of $ 1. 72 million.

Repackaging in Designer Bottles:

The Chief Financial Officer of the company, Lester Ledger, feels that the product lacks the aesthetic appeal and suggests repackaging them in designer bottles. This will increase the variable cost per unit by $ 4. 75 and the fixed production costs will increase by $ 40, 000 per year. He predicts that the sales volume will increase by 32 % (264, 000 units). However, the increase in sales does not outdo the increased costs and the company will incur a loss of $ 1. 334 million (as shown in Appendix 2).

Reduction in the Bottle Size:

According to the Production Manager, Buster Bumble, the reduction in the standard size of the bottle by 10 % would drop the variable costs by $ 2. 65 (amounts to $ 13. 35 per unit). However, due to the reduced size, the sales will drop to $ 195, 500 units. Though the contribution margin is considerably increased, the company still incurs a loss of $ 549, 425 (as shown in Appendix 3).

Improved Marketing:

The marketing manager suggests that the product requires more promotion and an increase of marketing budget by $ 527, 000 will be appropriate. This, combined with a price increase by $4. 90 per unit will increase the sales volume by 17 % (234, 000 units). The contribution margin is considerably increased as both the sales volume and the unit prices are higher than before. The increase in the contribution margin is significantly higher than that of the fixed costs and hence results in a profit of $ 129, 600 (Appendix 4).

Recommendation:

It is evident from the above analysis that the first three proposals still result in a heavy loss for The Lovely Scent Perfume Company. The proposal made by the marketing manager indicates an estimated profit of $ 129, 600. Hence it is recommended that the company should increase the marketing budget (by $ 527, 000) and also increase the price by $ 4. 90 per unit.

Appendix 1 - Reduction in Price:

Inputs

Number of Units Produced and Sold

285, 000. 00

Revenue per unit

28. 00

Variable production costs per unit

16. 00

Fixed production costs per year

2, 750, 000. 00

Variable operating costs per unit

4. 00

Fixed operating costs per year

1, 250, 000. 00

Lovely Scent Perfume Company

Contribution Margin Income Statement

For the Year Ended December 31, 2006

Revenue

7, 980, 000. 00

Variable Costs

5, 700, 000. 00

Contribution Margin

2, 280, 000. 00

Fixed Costs

4, 000, 000. 00

Net Income

-1, 720, 000. 00

Appendix 2 - Repackaging in Designer Bottles:

Inputs

Number of Units Produced and Sold

264, 000. 00

Revenue per unit

35. 00

Variable production costs per unit

20. 75

Fixed production costs per year

2, 790, 000. 00

Variable operating costs per unit

4. 00

Fixed operating costs per year

1, 250, 000. 00

Lovely Scent Perfume Company

Contribution Margin Income Statement

For the Year Ended December 31, 2006

Revenue

9, 240, 000. 00

Variable Costs

6, 534, 000. 00

Contribution Margin

2, 706, 000. 00

Fixed Costs

4, 040, 000. 00

Net Income

-1, 334, 000. 00

Appendix 3 - Reduction in the Bottle Size:

Inputs

Number of Units Produced and Sold

195, 500. 00

Revenue per unit

35. 00

Variable production costs per unit

13. 35

Fixed production costs per year

2, 750, 000. 00

Variable operating costs per unit

4. 00

Fixed operating costs per year

1, 250, 000. 00

Lovely Scent Perfume Company

Contribution Margin Income Statement

For the Year Ended December 31, 2006

Revenue

6, 842, 500. 00

Variable Costs

3, 391, 925. 00

Contribution Margin

3, 450, 575. 00

Fixed Costs

4, 000, 000. 00

Net Income

-549, 425. 00

Appendix 4 - Improved Marketing:

Inputs

Number of Units Produced and Sold

234, 000. 00

Revenue per unit

39. 90

Variable production costs per unit

16. 00

Fixed production costs per year

2, 750, 000. 00

Variable operating costs per unit

4. 00

Fixed operating costs per year

1, 777, 000. 00

Lovely Scent Perfume Company

Contribution Margin Income Statement

For the Year Ended December 31, 2006

Revenue

9, 336, 600. 00

Variable Costs

4, 680, 000. 00

Contribution Margin

4, 656, 600. 00

Fixed Costs

4, 527, 000. 00

Net Income

129, 600. 00