

Task 4 a)

The Sales Director's argument that offering customers a package deal to include a footstool and scatter cushions will increase sales is not correct.

Whilst many customers currently just buy sofas and armchairs, other customers already buy the full range of furniture, including footstools and scatter cushions. For the customers who already buy the full range of furniture, offering a discount will decrease sales revenue from them. Other customers will just not purchase the additional items, regardless of the level of discount offered.

The current selling price of a sofa and an armchair is £948 (£699 + £249) and the current selling price of a sofa, an armchair, a footstool and five scatter cushions is £1,122 (£699 + £249 + £99 + £75). With the 10% discount applied to the full price for the full range of furniture, the selling price would be £1,009.80; an increase in sales revenue of £61.80 over the sales revenue from just the sofa and armchair. With the 15% discount applied to the full price for the full range of furniture, the selling price would be £953.70; which is only £5.70 higher than the current selling price of £948 for just the sofa and armchair.

The Production Director says that offering discounts will reduce profit margins and decrease profits.

As the total cost for the footstool and five scatter cushions is £103.40 (£53.40 + £50.00), the Production Director is correct, as offering either 10% or 15% discount will result in lower profits, especially where customers would have purchased these additional items at full cost.

However, the total cost figure includes fixed costs. The fixed cost per unit has been calculated on the estimated sales level for footstools and scatter cushions and this should not be included in calculations for additional units sold as it has already been taken into account.

The Finance Director says that she will back any proposal which increases the firm's total contribution earned per customer.

Contribution is the excess of sales revenue over variable (marginal) costs. Maximising contribution will also maximise profit, as fixed costs do not change.

The contribution from a sofa and an armchair is £374.55 (£699 + £249 - £436.75 - £136.70). The total variable cost for a sofa, an armchair, a footstool and five scatter cushions is £633.10. The normal selling price for these items is £1,122.

With 10% discount applied, the selling price will be £1,009.80 - £633.10 = £376.70 contribution. This is only £2.15 higher than the contribution generated from selling the sofa and armchair at full cost.

With 15% discount applied, the selling price will be £953.70 - £633.10 = £320.60 contribution. This is £53.95 less than the contribution generated from selling the sofa and armchair at full cost.

In addition, some customers would have already bought the full range of furniture at full price which would result in further loss of contribution.

It is therefore recommended that the Sales Director's suggestion is not implemented as overall it will result in lower contribution and therefore less profit. The company should find out more about how many customers buy the sofa and armchair and how many buy the full range of furniture and why this is the case – for instance, it may be that they did not know about the availability of the footstool and scatter cushions or the sales person did not 'upsell' the full package of furniture effectively.

The company may also want to consider just discounting the footstool and the scatter cushions for customers who purchase the sofa and armchair.

Task 4 b)

Budgetary control systems allow for total cost variances to be calculated in the management accounts for a company.

The budgeted material cost for February is £4,620 (440 metres x £10.50 per metre) and the actual material cost for February is £4,690. This gives a budget variance of £70 Adverse, which is 1.5% of the budget amount and likely to not be significant.

Standard costing systems also allow for both total variances and sub variances to be calculated.

For materials, it is possible to calculate the materials total variance (shown above) along with the two materials sub variances which are the materials price variance and the materials usage variance. This gives much more detailed management information as to the reasons behind the variance.

The materials price variance is £266 Favourable (£4,956 - £4,690).

The materials usage variance is £336 Adverse (32 metres x £10.50 per metre).

The favourable materials price variance suggests that cheaper materials have been bought than were planned, but the adverse materials usage variance suggests that the materials bought were cheaper due to being of a lower quality than would normally be bought which has resulted in more material needing to be used due to, for instance, wastage and quality defects.