

Tot Toys

Tot-Toys is a well established toy retailer located in a European country which has the Euro as its currency. From the information provided you need to identify three key challenges facing the business and suggest how to overcome them.

You have 60 minutes to work together as a team to explore and discuss your suggestions and how they may work. You will need to agree the recommendations; everyone will be expected to contribute and each team will give a 5 minute presentation on their analysis and recommendations.

Industry background

There are a large number of companies of various sizes which design and sell toys to retailers globally. Most toy companies outsource the manufacture of their toys and currently 86% of the world's toys are manufactured in China. Most of the rest of the world's toys are manufactured in other Asian countries, with only low volumes of products manufactured in Europe and the USA.

The toy market is divided up into a variety of sectors, by children's age range and the type of toy. There are different sectors with toys aimed at different year-groups, e.g. babies, 1 to 3 year olds and school-children of varying ages. Additionally the toy market is broken down into categories of toys. Research has shown that children aged 2 to 4 years old receive the most toys in quantity but that the most money is spent on toys for the 6 to 8 year age group.

The Tot-Toys brand was established in 1999 by husband and wife team John and Tania Smith. The company initially designed a small range of toys which were manufactured in their home European country. These toys proved to be very popular in their home country and John Smith then expanded the range of products.

By 2004, within five years of starting Tot-Toys, the founders were encouraged to see Tot-Toys' products ordered by many large toy retailers across Europe. By this stage the company had grown considerably, and had annual sales of almost €2 million. Commencing in 2005, Tot-Toys started outsourcing all of its manufacturing to a range of manufacturing companies in China in order to reduce its cost base and to enable the company to price its products more competitively. By the end of 2011 sales revenue exceeded €8 million and the company had achieved substantial sales revenue growth each year. Tot-Toys has seen its sales revenue grow by 16% in the year ended 31 December 2011 and by almost 18% in the year to 31 December 2012 (unaudited figures).

Tot-Toys has set itself an ambitious growth plan. Sales revenue is expected to grow 17% for 2013, and at 13% to 14% for a further 4 years, with a small growth in operating profit margin.

Financials and shares

Tot-Toys have achieved a high annual growth in sales, with sales revenue reaching €9,866,000 in the year ended 31 December 2012 (unaudited), a growth of 17.9% from 2010 (€8,371,000 sales revenue for year ended 31 December 2011). Additionally, it has achieved an operating profit margin of 5.58% in the year to 31 December 2012, a rise from the previous year's profit margin of 5.41%.

Tot-Toys is a young, growing company which is dependent on loan finance. Tot has three bank loans totalling €1,600,000, each at an interest rate of 10% per year, which are due for repayment as follows:

- Bank loan of €500,000 due in January 2015.
- Bank loan of €500,000 due in January 2016.
- Bank loan of €600,000 due in January 2021.

Tot-Toys' bank has been very responsive to the company's needs for cash in order to fund its growth but has indicated that at the present time it would not be able to provide any additional long-term finance.

Tot-Toys has an overdraft facility of €1,500,000, which the bank has stated is the maximum limit. The current cost of its overdraft is at an interest rate of 12% per year. At 31 December 2012, Tot-Toys' overdraft was €960,000.

Tot-Toys is a private limited company and not listed on any stock exchange. It has 40,000 shares in issue, each of €1 par value. The company has an authorised share capital of 200,000 shares.

To date, the Board of Tot-Toys has not declared any dividends. The shares are held as follows:

	Number of shares held at 31 December 2012	Percentage shareholding
John Smith (Managing Director)	12,000	30
Tania Smith (Finance & IT Director)	12,000	30
Alana Lotz (R&D Director)	8,000	20
Boris Hepp (Sales Director)	4,000	10
Michael Werner (Operations Director)	4,000	10
Total	40,000	100

Research & Development and Manufacture

Tot-Toys research and development team come up with the ideas for next season's toys. A European company specialising in prototype toys development and testing is then commissioned to

develop and test the initial prototypes. The successful prototypes are then contracted out to manufacturing companies in China to produce.

Currently, Tot-Toys uses 20 off-shore outsourced manufacturing companies in China. Some of the outsourced manufacturers are small companies each of which manufactures just one of Tot-Toys products.

Tot-Toys's designers and sales team will have already decided on an indicative selling price, so the unit price to be charged to Tot-Toys by the outsourced manufacturing company is often the determining factor when making the decision of which outsourced manufacturing company to use. Whilst other factors are considered, such as quality and ability to deliver the required volume of products to the required timescale, it is the unit price which is important in order to achieve the planned level of gross margin.

Sales

Tot's customers are mainly:

- Retailers – these include large toy retailers, as well as supermarket chains and other retailers
- Distributors – these distributors purchase Tot-Toys products and sell them on to a wide range of smaller retailers.

Tot-Toys' business is highly seasonal with a significant proportion of sales occurring in quarters 3 and 4. As Tot-Toys builds up its inventory in preparation for higher levels of sales in quarters 3 and 4, cash flow is negative during the second half of the year. This is because outsourced manufacturing for the majority of all products occurs mainly from the end of quarter 2, during all of quarter 3 and the beginning of quarter 4.

Tot-Toys sales are highly dependent on seven large retailers. These seven large companies comprise toy retailers, large international supermarket retailers, department stores and one on-line retailer. Over 68% of Tot-Toy's sales in the financial year ended 31 December 2012 were to these 7 customers based in Europe and the USA. These few large retailers often do not settle payment for at least 60 days. Tot-Toys has little influence on this and does not wish to jeopardise future sales to them.