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INFORMATION

- This insert contains the case study.
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Traditional Toys (TT)

TT is a private limited company established in 1980. It is owned by the original twenty shareholders. TT makes and sells wooden toys, including toy trains, puzzles and building blocks. TT's factory and head office are based in a large European country, which is a member of the Eurozone single currency area. In recent years, the euro has depreciated against other major currencies such as the US dollar. The European Central Bank has indicated that interest rates are likely to start rising next year.

TT uses wood from sustainable sources in its home country. It also imports some components from outside Europe. TT's mission statement includes the promise 'we only use sustainable sources of raw material'. This is also used as a Unique Selling Point (USP) for the toys. Many of TT's toys, including the toy trains and building blocks, are protected by design patents. All toys comply with international safety standards. TT toys are marketed with their distinctive brand name.

Production methods are labour-intensive, with the use of basic cutting tools. Toys are assembled and then painted by hand. TT has a loyal workforce and some workers have been employed for more than ten years. However, more recently labour turnover has been increasing, with those leaving complaining about lack of delegation and few opportunities to suggest ideas. Workers are closely supervised and a piece rate pay system is used, with a bonus at the end of the year if production and quality targets are achieved. To maintain standards, quality inspectors check each finished toy.

TT's sales have grown steadily over the last few years and the shareholders are happy with this performance. TT sells its toys in a niche market to consumers who are prepared to pay premium prices for high-quality handmade toys. TT believes that this market is growing. 60% of TT's sales are through retailers within the European Union (EU), with the other 40% exported to the US and countries in the Far East. TT owns the factory and other non-current assets and has no non-current liabilities.

Marketing

Much of TT's promotion is through personal recommendation by retailers and 'word of mouth' from satisfied customers. TT also has a basic website giving information about the company and products. At present the company does not employ a Marketing manager.

Last year a celebrity football star mentioned in an interview how much his children liked TT's toys. A news photograph of this celebrity and his family included one of TT's wooden toy trains. This publicity has led to a significant increase in demand for TT's products, especially the toy trains. TT's inventory level of toy trains is low and retailers are asking for more supplies.

A special order

The biggest toy retailer in the US has made contact with TT and would like to place a special order for toy trains to be delivered in batches within the next nine months. This order, for a total of 50 000 units, would mean doubling the annual output of this product. The usual unit selling price of toy trains to retailers is $35 but the US toy retailer is demanding a price of $30 per unit. A summary of relevant costs is shown in Appendix 1.

Board meeting

Nico, the Managing Director, opened the most recent Board meeting by saying: 'I think we need to take the opportunity of rising demand to expand and modernise our operations'. TT's Operations Director replied: 'There are two possible approaches: use of Computer Aided Manufacturing (CAM) or outsourcing part of our production'. The Operations Director also raised the issue of quality control. 'If we increase production, we should introduce a system of Total Quality Management (TQM).' At the end of the meeting a decision was made to investigate the implications of these issues. The Board also decided to recruit a Marketing manager, whose first

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task will be to research a possible marketing strategy which might be used in the future to launch TT's toys into the mass market.

Expanding and modernising operations

Following the Board meeting the Operations Director has found that to purchase a suitable new automated CAM system would cost $2.5 million. This would significantly increase total capacity. It would also potentially reduce the average cost of production of the toy trains and other toys by 20%. Financial projections for the CAM option are shown in Appendix 2. The outsourcing option would involve using a company in a low-cost country, 3000 kilometres away.

Recruitment of a new Marketing manager

The response to the advertisement for a new Marketing manager was very good. After examining the applications, the Board interviewed two candidates. A summary of their qualifications, experience and response to interview questions is shown in Appendix 3. The Board decided to appoint candidate Y.

Future strategy – joint venture or merger?

TT has been approached by two companies, company A and company B, based in other European countries. TT's shareholders are now considering the offers made by these companies and how TT may develop in the long term. Nico has emphasised that any decision taken will have serious consequences for the company's future and its shareholders.

Company A makes toys for children who are older than TT's target market. Company A is about the same size as TT, with similar working practices and organisational structure. Company A's directors would like to cooperate with TT in a joint manufacturing venture in a neighbouring country. The new factory would produce wooden educational equipment for schools. The initial investment needed from TT would be $3.5 million, which is half of the total required. These new products would be marketed under the TT brand name.

Company B is a toy retailer with shops in several countries. Company B's directors would like to merge with TT. The infrastructure and employees of both companies would not be changed. The TT brand name would join other brands owned by company B. The current TT shareholders would receive either cash or shares in the newly merged company. The culture of company B is very different to TT's, with much more delegation to lower level employees and an established teamwork structure in its shops.

Appendix 1: TT's operations data for toy train production

Maximum factory capacity for toy train production	100 000 units per year
Allocated factory fixed cost per unit at maximum capacity	$3.00
Packaging and labelling cost per unit	$2.50
Variable production cost per unit, including painting	$24.00
Transport cost per 100 units	$150.00

Appendix 2: Forecast net cash flows if CAM equipment is purchased

Year	Net cash flows ($m)
0	(2.5)
1	0.4
2	0.6
3	0.7
4	0.7
5	0.8
6	0.9

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Appendix 3: Data from applications and interviews of candidates for Marketing manager vacancy

	Candidate X	Candidate Y
Qualifications	Marketing degree from a university in the US	Marketing degree from a university in Europe
Current job	Marketing manager for a large sports clothing company whose products sell throughout Europe	Marketing assistant for a multinational computer games company
Current salary	$35 000 per year	$28 000 per year
Previous jobs	Marketing assistant for a children's clothing company	None
Key strength	Good team player	Attention to detail
Areas for development	Will need training in use of information technology, such as use of website	Little knowledge of market for childrens' toys
Reasons for wanting to join TT	Would like to return to working for a company that targets the children's market	Looking for promotion
Career plans	To settle down into a Marketing manager job that I enjoy, with a plan to stay long term	To move up the career ladder and become Marketing Director with a large multinational company

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