

Toy world case study essay sample

[Business](#), [Management](#)



Background:

ToyWorld, Inc. was founded in 1973 by David Dunton. Before that, he had been employed as production manager by a large manufacturer of plastic toys. Mr. Dunton and his former assistant, Jack McClintock, established Toy World, Inc. with their savings in 1973. Originally a partnership, the firm was incorporated in 1974, with Mr. Dunton taking 75% of the capital stock and Mr. McClintock taking 25%. The latter served as production manager, and Mr. Dunton, as president, was responsible for overall direction of the company's affairs. After a series of illnesses, Mr. Dunton's health deteriorated, and he was forced to retire from active participation in the business in 1991. Mr. McClintock assumed the presidency at that time. In 1993, Mr. McClintock hired Dan Hoffman as production manager. ToyWorld, Inc. Manufacturer of plastic toys for children. Because it is a toys company, their production schedules had always been highly seasonal.

Case Facts:

Toy World, Inc. had experienced relatively rapid growth since its founding and had enjoyed profitable operations each year since 1976. Sales had been approximately \$8 million in 1993, and on the strength of a number of promising new product sales were projected at \$10 million for 1994. Net profits had reached \$270,000 in 1993 and were estimated at \$351,000 in 1994 under seasonal production. The cost of goods sold had averaged 70% of sales in the past and was expected to be the same in 1994 under seasonal production. However, the cost of goods sold under level monthly production will be 65.1% of sales. The company had periodically borrowed from its primary bank, City Trust Company, on an unsecured line of credit. A loan of

\$752, 000 was outstanding at the end of 1993. Mr. McClintock had been assured that the bank would be willing to extend a credit line of up to \$2 million in 1994, with the understanding that the loan would be completely repaid and off the books for at least a 30-day period during the year, and would be secured by the accounts receivable inventory of Toy World. Furthermore, changing to level monthly production will decrease our cost for overtime premium by \$225, 000.

Main Issues:

The first issue is should ToyWorld, Inc. change from seasonal production to level monthly production? We have to analyze this problem to decide whether we change to level monthly production, or we continue with seasonal production. The second issue is the financial arrangement with the bank, if we adopt the level monthly production then we have to renegotiate the arrangement with the bank to increase the limit on the \$2 million loan.

Analysis:

First, we were given the pro forma balance sheet and income statement for 1994 in the case under seasonal production, so we had to do the pro forma balance sheet and income statement under level monthly production for 1994 to have a clear vision of what it will be like if we change to level monthly production. Pro Forma Balance Sheet under Level monthly Production, 1994 (thousands of dollars).

We can see from the balance sheet above that the inventory will increase sharply if we change to level monthly production, and that's because in the first months we will produce more than what we will sell so we well end up

with an increasing inventory, after July our inventory will start decreasing as we approach to the holiday season. The other thing we interested in, is the notes payable. We can notice that the notes payable have increased when we changed to level monthly production, and that's why we need a bigger loan from the bank.

Pro Forma Income Statement under Level Production, 1994 (thousands of dollars).

In the income statement under level monthly production, we can see the decrease in the cost of goods sold. Because under seasonal production our cost of goods sold was 70% of the sales, but under level monthly production it is 65.1% of the sales. Also, we can see that the operating expense will increase under level monthly production. Because, in first months we will produce more than what we will sell so the expense for storage and inventory will increase under the level monthly production. Overall, the most important figure in the income statement is the net income which increased from \$351,000 under seasonal production to \$521,000 under level monthly production.

Cost savings under level monthly production.

If we change to level monthly production, we can save up to \$169,000. Mainly, this savings come from reducing overtime premium by \$225,000 and other direct labor savings by \$265,000. Although, the storage costs will increase by \$115,000 but we still will end up with \$169,000 as savings.

Advantages:

The main advantages of adopting level monthly production are: - Net income increases by \$169, 000 as we showed above. - ToyWorld is approaching full capacity during seasonal production peak, the adoption of level monthly production postpones the need for additional investments in fixed assets.

Disadvantages:

Any change even if it is a good one, has to come along with some disadvantages. The main disadvantages of adopting level monthly production are: - Required bank borrowing from June to November is above the \$2 million limit set by the bank. So loan renegotiation is needed. - Risk is higher if expected sales are not realized. The firm may end up with unsold inventory, while having to repay a larger loan. - Firm become riskier from bank's perspective.

Conclusion:

Finally, it is feasible for the company to follow the level monthly production system as net profits (due to reduced costs) show an increase of approximately \$169, 000 in 1994. Besides the financial benefits the company would enjoy certain non monetary benefits out of balanced production such as uniform usage of machine, operational efficiencies and high employee morale.