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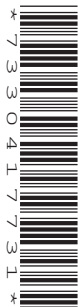
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A2 GCE APPLIED BUSINESS

F248/01/CS Strategic Decision-Making

PRE-RELEASE CASE STUDY

JUNE 2017



INSTRUCTIONS TO TEACHERS

- This Case Study **must** be opened and given to candidates on receipt.

INFORMATION FOR CANDIDATES

- You **must** make yourself familiar with the Case Study before you sit the examination.
- You **must not** take notes into the examination.
- A clean copy of the Case Study will be given to you with the Question Paper.
- This document consists of **8** pages. Any blank pages are indicated.

Traditional Timber Toys Ltd (TTT Ltd)

The business

Traditional Timber Toys Ltd (TTT Ltd) is a retailer of high quality, traditional toys for children. All of the toys it sells are made of wood. The toys primarily appeal to children under ten years of age. Whilst *TTT Ltd's* consumers are children, the vast majority of its customers are parents or grandparents wishing to purchase a beautifully crafted, timeless toy for a child. Many of these customers are ecologically aware and have a strong sense of environmental responsibility.

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TTT Ltd stocks a wide range of traditional wooden toys including trolleys of bricks, train sets, dolls' houses, work benches, play kitchens and ride-on vehicles; these are made exclusively for its stores. All toys are ready-made; none require assembly. Some of the toys are brightly painted; others have a natural wood finish. Shape sorters, jigsaws and board games are *TTT Ltd's* least expensive and best selling products. Its most expensive product, which retails for over £600, is a wax-finished, solid wood, hand-made rocking horse.

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Starting with a single store in Southampton in 1988, and a clear business aim to bring eco-friendly toys to the market, *TTT Ltd* grew into a national brand. Today, *TTT Ltd* has four stores in London and a further 36 stores located in town and city centres across the UK. The company's purchasing, logistics, marketing, human resources, finance and technical support functions are all organised centrally from its head office in Southampton. Benedict, the current Managing Director, firmly believes that *TTT Ltd's* success stems from the company's environmental focus. The company has always insisted that the toys it sells, and the methods by which the toys are produced, have minimal environmental impact.

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TTT Ltd is currently owned by seven shareholders, who comprise the executive board of directors. All seven directors remain committed to the company's environmentally-friendly trading practices. Whether hand-made or mass-produced, all toys must meet the company's 'eco-specification'. The wood must come from sustainable sources approved by the Forestry Stewardship Council; paints and varnishes must use natural rather than chemical solvents and any packaging must be made from recycled materials. In addition, supply chain logistics should be carbon neutral (or at the very least carbon offset). To reduce air miles, all of the toys *TTT Ltd* buys are made in the UK. Where possible, *TTT Ltd* sources toys directly from the manufacturer. This helps *TTT Ltd* ensure that environmentally-responsible production processes have been used, as well as potentially cutting costs.

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TTT Ltd relies on traditional marketing methods to target its audience. It does not have a website, nor does it use the Internet for marketing.

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All of *TTT Ltd's* stores are small. The design of its stores attempts to recreate the layout and ambience of the toy shops of yesteryear. The smaller toys are stacked on wall-mounted shelving around the sides of the store. The premium-priced, larger toys are displayed in the centre of the sales floor. The sales counter is located at the rear of the store. Each store is staffed by one store manager and a team of sales assistants. Sales assistants are required to wear a formal black and white uniform, reminiscent of days gone by. All of *TTT Ltd's* stores are open six days a week – Monday to Saturday, including most bank holidays.

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Store managers at *TTT Ltd* are well paid, reflecting the importance of their job role within the company. Since none of *TTT Ltd's* stores are large enough to carry the company's full product range, store managers must choose, from *TTT Ltd's* stock-list, which toys to stock in their particular branch and in what quantities. This is no easy task. What sells well in one branch does not necessarily sell well in another. Furthermore, customers frequently buy on impulse and consumer trends are not easy to predict, especially in the run up to Christmas. New product lines, when added to the stock-list by head office, also need to be introduced in branch to aid customer retention.

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Store managers must set the price for each toy on sale in their particular branch. They also need to decide how the products will be displayed and when promotional offers or price discounts should be used. Store managers must also minimise the risk of stock loss from theft or damage.

Each individual store manager is held accountable for the profitability and performance of their own particular branch. Fiona, *TTT Ltd's* Finance Director, sets specific and measurable objectives for each of the company's stores on a monthly basis. As long as the store managers meet their objectives, they can run their branches as they wish. However, any store manager who fails to deliver will be subjected to intense scrutiny from head office. 50

Store managers are responsible for the appointment of sales assistants at their branch. They are free to choose the number of sales assistants to employ and to devise the selection criteria. Store managers must train, motivate and manage their sales assistants for the benefit of the branch. However, the terms and conditions of employment for each sales assistant (including pay rate) is set by head office. 55

Store managers are required to travel to head office six times a year for training. They receive training in financial management, health and safety, product selection, stock control and the art of selling. They do not, however, receive training in communication skills or staff management. Halep, *TTT Ltd's* Human Resources Director, insists that the store managers should be free to manage their staff in the way that best matches each individual manager's personality and the needs of their staff. 60
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Challenging times

Audited figures for 2015 show an annual turnover of £25 million with shareholders' equity in excess of £42 million. On the face of it *TTT Ltd* is doing well. However, *TTT Ltd* has seen its cash-flow position worsen significantly in the last three years. In 2015 the company's bank account was overdrawn for $8\frac{1}{2}$ months of the year. Recent months have shown no sign of improvement. In July 2016 Fiona was forced to approach the bank for an extension of the company's overdraft facility, from £1.5 million to £4 million. The bank warned that, whilst it would extend the overdraft facility to £4 million, it would be unlikely to agree to any further requests in the near future. 70

A closer study of *TTT Ltd's* sales figures shows a worrying trend; turnover has fallen by approximately 4% in each of the past three years. More detailed inspection reveals significant cause for concern, 55% of customers surveyed rated the company's in-store customer service as 'poor'. Halep is especially concerned. It was only five years ago that the company won a customer service award for its exceptionally obliging and knowledgeable staff. Complaints that the stores are dirty, the shelves untidy and the staff rude or unhelpful are becoming more commonplace. Store managers have also reported an increase in the number of customers tripping over partially unpacked stock or being injured by the dangerous positioning of the larger, premium-priced toys displayed in the centre of the sales floor. 75
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In addition, rapidly rising rents (especially for its London stores) and the increased cost associated with traditional methods of marketing have had a significant impact on profit margins. Where once the company enjoyed a net profit margin well above the 6% industrial average for UK toy retailers, it is now operating well below this level. 85

Benedict's thoughts

While away on annual leave Benedict's thoughts turned to the future of the company. A change of corporate strategy was required. He sent an email to Fiona.

“Fiona - I want to discuss the following options at our board meeting next week. Please prepare capital investment appraisal figures as best you can in the time available. I will be back in the UK in three days’ time; if you have any questions please contact me. 90

Option 1 – Online presence

We could bolster the sales revenue of our 40 traditional stores by launching our own website. The website would provide a supplementary marketing channel for our retail stores. Moreover, we could develop an online trading platform. An e-commerce website would allow customers to view our product range and make purchases online. Additionally, we could exploit the popularity of the Internet by using search engine optimisation and banner advertising. We could even harness the power of social media to drive the business forward. 95

The e-commerce operation would be run jointly by our technical support and logistics functions. There is plenty of space at head office to accommodate the additional demands of this option.

Option 2 – Relocation

We could relocate our 40 stores to less expensive out-of-town retail parks. Each store would be relocated at the end of its current lease. Since most of our leases have a one-year notice period, the relocation process would be gradual, taking two to three years to complete. This option would allow us to continue to trade exclusively from physical stores. The new premises are likely to be larger than our current stores. So, in addition to wooden toys we could also sell toys made of bamboo (Option 2a) or introduce our own range of build-it-yourself kits to make wooden mechanical models (Option 2b). 100 105

Option 2a – Bamboo toys

Bamboo is a species of grass rather than a type of wood. It is harder than maple and lighter than oak. It is the fastest growing plant in the world and can grow a metre or more in just 24 hours. There are several producers in China that could supply us with an innovative range of well designed, robust, colourful children’s toys made from high quality bamboo. We would need an extensive marketing campaign to alert potential customers to our new range of toys. 110

Option 2b – Mechanical kits

Do you remember the wooden mechanical models I brought back from my holiday in Paraguay last year? The rotating water wheel, the pedalling cyclist and the animated organ player were my favourites. We could manufacture our own range of build-it-yourself kits containing all of the components needed to make a wooden mechanical model similar to these. We would need to set up a production facility and employ product designers. There is plenty of space at head office to do this. These kits would contain small parts and would be too complicated for children to assemble. We would need to market these kits appropriately. 115

I apologise for the short notice. See you next week. Benedict.”

The figures

Fiona prepared the figures and emailed the following table to Benedict as soon as she was able. 120

	Option 1 Online presence	Option 2 Relocation	
		Option 2a Bamboo toys	Option 2b Mechanical kits
Estimated capital spend	£900 000	£21 000 000	£28 000 000
Payback period	2 years 4 months	3 years	3 years 2 months
ARR (over 4 years)	44%	11%	18%
NPV (discount factor 10%)	£965 000	£2 233 000	£7 964 000
Proposed funding method	Rights issue	Venture capitalist	Public flotation

Further developments

Two days before the board meeting Fiona attended a networking event hosted by the local Chamber of Commerce. Fiona emailed Benedict as soon as the event was over.

“Benedict, I have just been approached by Jan Pascal, an eco-textile entrepreneur. Jan owns an internationally-acclaimed children’s fashion label with revenue in excess of £4 million. The label specialises in using recycled textiles and herbal dyeing techniques to produce top-quality, designer and bespoke children’s clothing. The label is currently web-based but Jan would like to progress the brand through physical retail outlets, initially entering the market through a concession. She is seeking a concession agreement with a suitable retailer that operates from town and city centre locations across the UK. She has asked whether *TTT Ltd* might be interested. This is another option which we could consider at the board meeting.

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Option 3 – Concession agreement

We could offer Jan Pascal a concession agreement to operate her label in all 40 of our current stores. In return for a fixed monthly fee, we could supply Jan’s label with display space and a small service counter in each of our stores. Jan’s staff would be responsible for displaying samples of its eco-friendly range of children’s clothing. They would also be responsible for all business transactions relating to Jan’s label including dealing with customer enquiries, taking orders for both designer and bespoke clothing, processing payments, contacting customers when orders arrive and dealing with any complaints.

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Not sure whether I will have time to work out all of the figures in time for the board meeting, but I will do my best. Fiona.”

Appendix 1

Best Toys Guide: Wooden toys

Wooden toys have been around for generations and we don't see them ever going out of style. There is something to be said about toys that are made from natural products, and not manufactured from synthetic materials. The next time you are given a choice between a toy made of wood or a toy made of plastic, take a good look at the craftsmanship and we know which you'll choose.

Toys made out of wood are better value for your hard-earned money, mainly because they are timeless. Wooden toys can take a beating that synthetic-based toys just can't handle. Children can drop them, throw them or stomp on them and unlike plastic toys that break, crack and shatter, the wooden toys hold up. They are also environmentally-friendly and you do not have to use batteries or electricity.

Top ten wooden toys of all time

- Building blocks
- Vehicles and garages
- Rocking horses
- Train sets
- Dolls' houses
- Artists' easels
- Workbenches
- Play kitchens
- Pull- and push-along toys
- Ride-on toys

Appendix 2

The toy retail market: Market outlook

Competition on price and innovativeness are likely to remain intense in the dynamic toy retail market. In terms of product segments of traditional toys and games, construction toys have shown the highest growth and are expected to continue to do so. This may be related to the importance of a toy's play value for parents. Parents continue to be an important factor in the choice of toys. Construction toys are considered to stimulate creativity and can be used differently each time a child plays with them. At the same time, board games and puzzles show stable market share forecasts, even though they face direct competition from video games, tablets and smart phone applications.

Trends that provide room for niche markets for traditional toys are emerging. These toys, often wooden toys, are linked to the theme of sustainability in terms of labour conditions and the environment.

One emerging segment in the toy industry is fair trade toys. This segment could provide additional opportunities for the games and toys market because there are specific distribution outlets for fair trade toys. In addition, there is usually professional or monetary support for businesses as long as they comply with the environmental and human resource management conditions as required to be classified as 'fair trade'.

A different dimension of sustainability that could do well, in terms of appealing to some parents and thereby establishing a market niche, is eco-design. This is especially applicable to wooden toys which are manufactured using responsible production processes which have the added value of a lower environmental impact.

Appendix 3

Social media

Too many businesses enter into social media because it's 'the done thing' – they feel they should have a presence purely because their competitors do. There are a number of real benefits to getting involved with social media, provided it is properly planned and executed.

Potential advantages to businesses of the effective use of social media:

- makes it possible to grab the attention of potential customers and increase brand visibility with compelling and relevant content
- being able to respond almost instantly to industry developments
- it can be much cheaper than traditional advertising and promotional activities
- it can indirectly boost links to website content by appearing in universal search results, increasing search traffic and online sales
- feedback can be responded to effectively leading to improved customer service
- more leads can be generated through new platforms
- increased loyalty and advocacy from the customers.

Potential disadvantages include:

- the need to commit resources to managing social media presence, responding to feedback and producing new content
- it can be difficult to quantify the return on investment and the value of one platform over another
- ineffective use, for example failing to respond to negative feedback may damage your reputation.

Appendix 4

Trends in fashion retail

In the current economic climate, it is understandable that owners of emerging brands may be thinking long and hard about entering retail. After all, is a physical retail presence more significant than a virtual retail presence? How and where should a fashion label set up shop to reap the most benefit?

What feels like aeons ago, the only way to purchase was to physically walk into a store. Today, we are in a digital age driven by the Internet and many fashion brands either launch themselves on the Internet first or sell exclusively on the Internet.

Customers are spending more and more time browsing online at their own convenience rather than physically visiting retail stores. On the other hand, the increasing number of new retail stores opening would seem to suggest that physical retail presence remains an important channel for brands to reach customers directly.

Retailers of emerging fashion brands who are considering a physical retail presence may wish to enter the market through a concession rather than open their own retail premises.

A concession is a business operated under a contract or a licence to occupy a space within another store. Concessions are operated from fixed internal areas. The owner of the concession (the brand) pays a fixed sum or a percentage of the revenue to the owner of the space in which the concession is located (the retailer). However, a concession may be fairly restricted; for example a department store would want to maintain its own in-house standard of appearance and presentation.



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