

## **An Analysis of Toy Industry**

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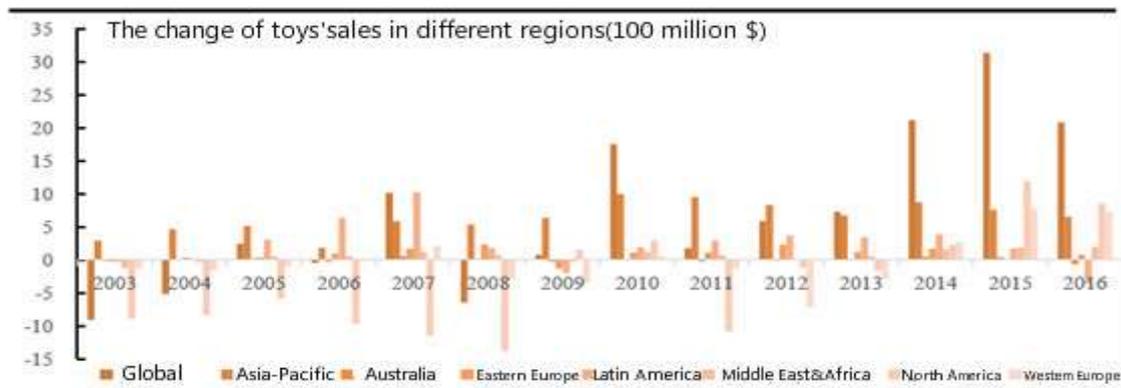
### **I. EXECUTIVE SUMMARY**

This report aims to evaluate the dilemma that Telly Toys Limited(TT Limited) is facing the sharply falling on profit compared with 2015. Based on the analysis of the company and the outlook of the toy industry, we put forward Recommendations and the implementation. The toys market is saturated in HK, but have huge potential in the mainland of China and other countries. The report is concluded the SWOT analysis which presents the basic problems TT Limited had. Next part is the proposal strategy TT Limited should choose. The ethical issues are addressed in the final part and a list of suggestions are given.

### **II. SITUATION ANALYSIS**

#### **2.1. Market Overview**

From 2002 to 2016, global toy industry was in a modest state of development. The sales of global toys reached \$ 82 billion in 2016. Although North America and Western Europe hold the market share of toy more than 60%, Asia-Pacific region, especially the mainland of China had a huge and durable potential.



#### **2.2. Company Analysis**

##### **2.2.1 STRENGTHS**

Good cooperate image with a certain reputation and customer resources.

Scale is large in HK which means a stronger competition.

Advanced IT system to save Inventory costs.

Reasonable division of labor and proper management.

##### **2.2.2 WEAKNESSES**

Inventory rate is high and sales turnover rate is low.

Product safety issues happened, affecting its sales and fame.

Cost of sales and gross profit rose, and the annual profit decline sharply.

E-commerce business is not yet mature.

##### **2.2.3 OPPORTUNITES**

Strong consumer demand for the increasingly growth of population.

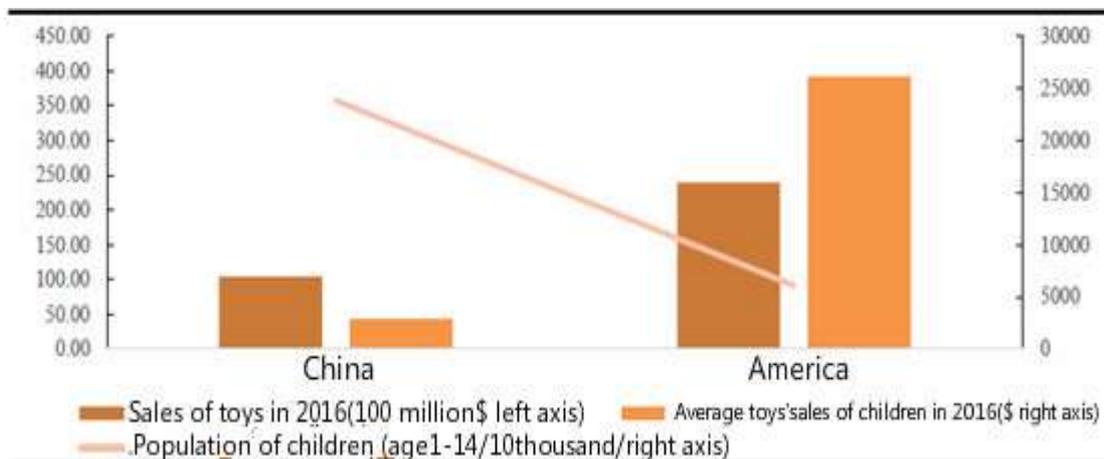
Large consumption potential in the mainland of China.

Animation, online games and other related industries contribute to the development of toys industry.

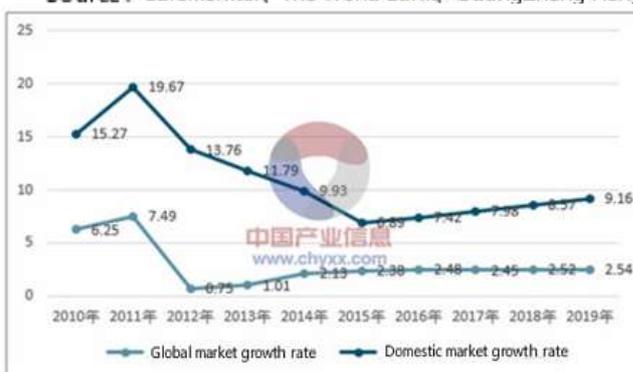
The development of the Internet makes the marketing channel more diversified.

2.2.4 THEATS

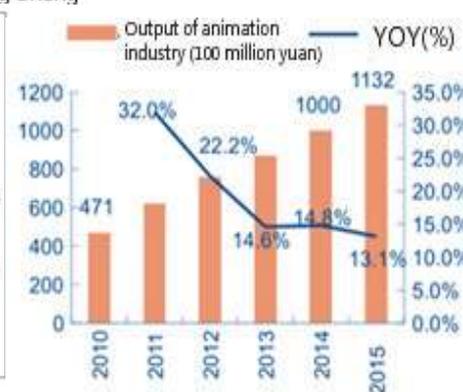
The consumer purchasing power weakened for the depressed economic conditions. It's difficult to predict demand quantities for quickly change of consumer's taste and shorter life cycle. Substitute threats like video games, computers, music and cosmetics. Product safety and requirements of environmental protection become stricter.



Source: Euromonitor, The World Bank, GuangZheng Heng Sheng



2009-2011 Chinese domestic toy retail sales and forecast (billion)



According to the above analysis, we suggested that Taking the advantage of the official website, Taobao, Jing Dong, WeChat platform to improve online sales channels, so that it can save the inventory costs. Improve the supplier management system and implement the supplier access system. (Retailers filter and eliminate the failure of the supplier at first, thereby improving the efficiency of the agreement system) Transfer Market Objectives: Mainland China, Southeast Asia. We will introduce more detail at "Strategy" part.

III. PROFITABILITY ANALYSIS

Years	TT Limited		Chinese Toys industries	
	2016	2015	2015	2016
Sales net profit margin	5.19%	10.31%	15.77%	17.85%
Sales gross margin	58.80%	61.75%	40.17%	42.14%
Operating Profit Margin	8%	14%	-	-
Ratio of Profits to Cost	6.62%	14.09%	-	-
ROA	5.97%	12.36%	7.45%	9.46%
ROE	12.17%	25.12%	10.66%	12.37%
EPS	0.04%	0.09%	-	-
Net asset value per share	0.37%	0.36%	-	-

**3.1. Sales net profit margin**

The net profit margin on sales in 2016 was nearly the half of 2015, which mainly due to the decrease of HK \$ 31,020 in revenue and the total cost of HK \$ 25,173. There are several reasons such as the economic downturn in Hong Kong, the decrease in foreign tourists, the increase in inventory and purchase costs. Therefore, companies can increase their net profit margins by developing new strategies such as developing new products or opening new markets. The net profit margins for case sales in 2015 and 2016 are smaller than those in the same industry, indicating the poorer profitability of the firm in the same industry.

**3.2. Sales gross margin**

Sales gross margin fell more than 2015, which is the same with the overall decline in the industry basically, but the ratio is much higher than the toy industry. Sales margins and sales margins vary greatly, indicating higher operating costs and operational risk than previous years. In 2015 and 2016, the gross margin of the case firms was significantly higher than that of the toy industry, which demonstrates that the case companies are more competitive than the same industry companies.

**3.3. Operating Profit Margin**

TT operating margin just the half of 2015, indicating the worse business profitability. As a result, firms need to have a new breakthrough or develop new markets because of poor operating conditions.

**3.4. Ratio of Profits to Cost**

	2016	2015	Balance	Percentage
Employee costs	-221,768	-211,861	-9,907	104.68%
Occupancy costs	-108,325	-106,167	-2,158	102.03%
Property repairs and maintenance	-16,730	-18,080	1,350	92.53%
Depreciation	-77,621	-77,594	-27	100.03%
Other costs	-102,130	-96,295	-5,835	106.06%
Total operating costs	-102,130	-96,295	-5,835	106.06%

✓ TT's ratio of profit to cost dropped from 28.92% to 15.49% in 2016, indicating that a significant decline in economic efficiency in 2016 compared with 2015. The main reason is the profit of 2016 decreased while the cost increased.

✓ The staff costs and other costs increased the most while property maintenance decreased, which eventually leading to increase the total operating costs.

**3.5. Asset profitability**

✓ The return on asset and return on equity had a significant decline in 2016. Compared with 2015, asset turnover decreased, the number of inventories increased, the average selling price of toys decreased, and the sales of most kinds of toys declined, so the sales revenue and net operating profit decreased, which resulting in a decline in return on assets.

✓ The return on equity is equal to the return on assets and the equity multiplier. A slight increase in equity in 2016, a small increase in debt, leading to equity multiplier decreased slightly over the previous year. The decrease in return on assets and the decrease in equity multiplier resulted in a decrease in the rate of return on equity

✓ TT's return on asset in 2016 was lower than other companies in the same industry, while it was higher than other company in 2015. From this statistic, we can know that TT's capital usage efficiency not only became lower but also lower than many companies in such industry. Therefore, the company should speed up the cash flow and improve the level of business management.

✓ The return on equity of TT was higher than others in toys industry, indicating that the common stock investors commissioned the company's managers to use their funds and they received higher returns than other investors.

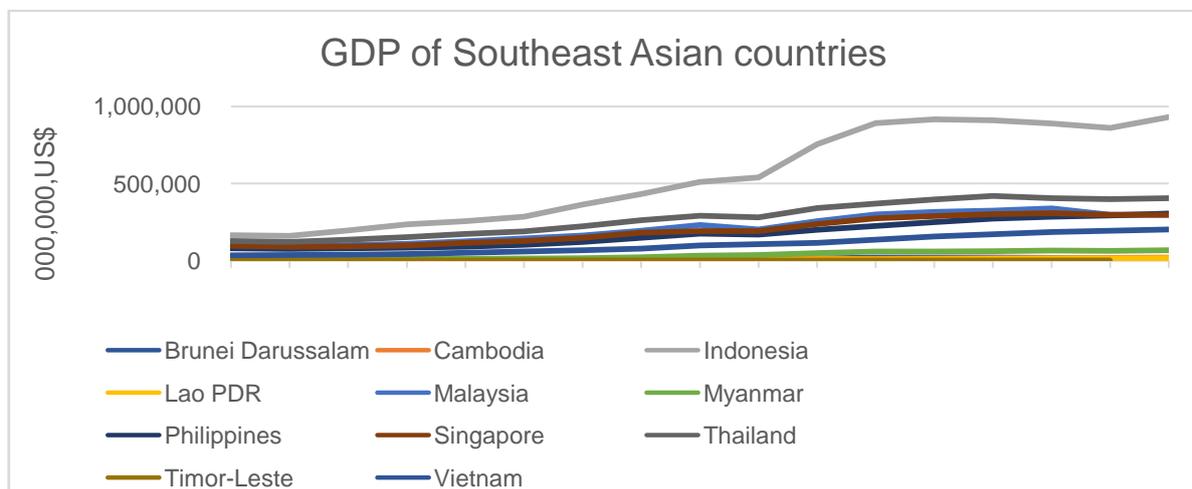
#### IV. PROPOSAL STRATEGY

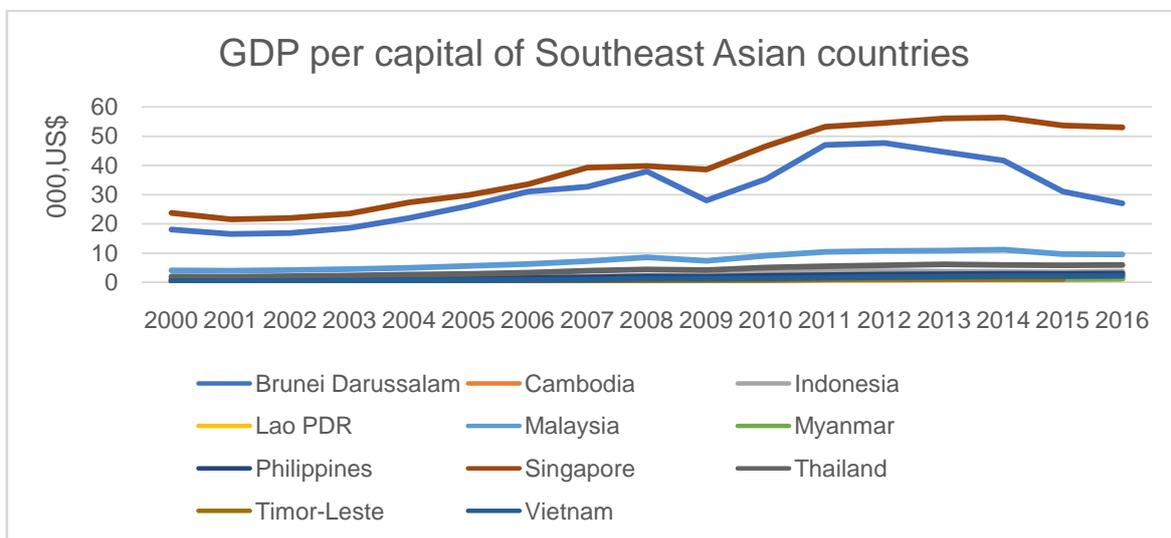
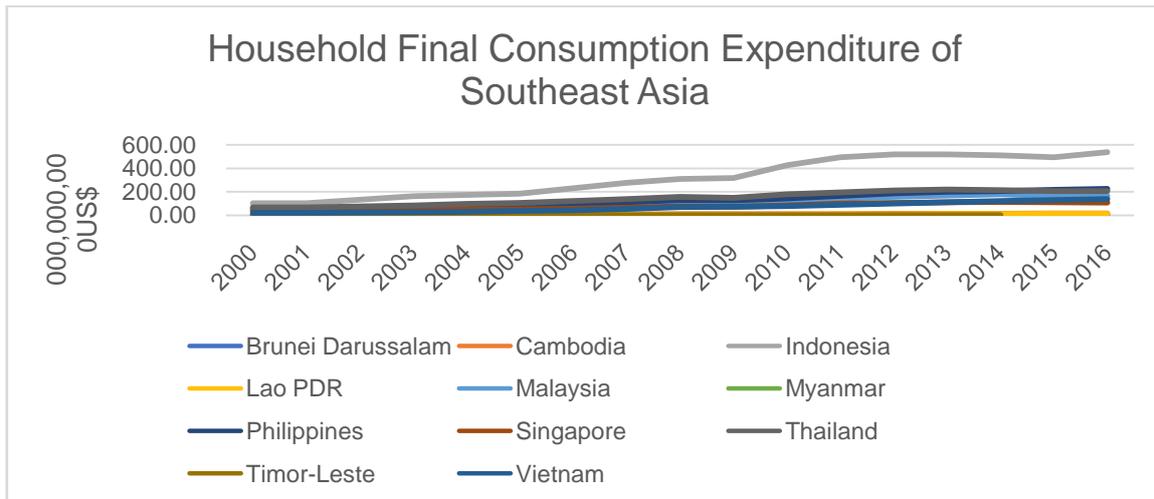
According to the financial statements, we have adopted market development strategy to improve our profitability by expanding the growth of current products in new markets. The Market Development Strategy we select is the "snowball strategy", that is, to expand a special region market for enterprise market expansion of the "base" and "base camp", and make the "base" and "base camp" market bigger, stronger. Penetrate the target market thoroughly, and the market will become the foundation and backing for we company to further expand the other market. After the "base" market has an absolute advantage and stability, then it will act as a base to penetrate the neighboring areas gradually just like the snow roll forward. Finally, we reach our aim the occupy the whole target market.

##### 4.1 General Evaluation

With the implementation of "The belt and road" strategy, Chinese corporate make benefits from the convenient transport and the rapid development of the countries along the way. On the current pattern of the world's major consumer toys market, the main consumer market is still the EU and North America. Most of the countries along the "Belt and Road" are not toys consumption powers, but they are the main emerging markets which have great potential of toys consumption. From 1 to 4 months of this year, China's toys export to South Asian countries and areas value 530 million US dollars, an increase of 57.41% of that in the same period in the last year. The amount of exports to the Middle East 180 million US dollars, an increase of 47.64%. In the long run, "Belt and Road" construction will effectively increase employment and promote commodity circulation of the relevant countries and regions, as a result, it can improve people's economic income and greatly stimulate the consumption demand for toys. The population of the countries along the "Belt and Road" accounts for 63% of the world's population, so we predict that with the "Belt and Road" positive impact on these countries, people's life will be improved greatly, resulting in the steady and rapid growth demand for Chinese toys. These markets are immeasurable.

Southeast Asia, an area along the "Belt and Road" nearing Hong Kong, has a geographical advantage since many Chinese people have immigrated and built their own business there. Moreover, GDP of Southeast Asian countries has grown fast with per capita GDP shows growth trends since 2000 - 2016, making Southeast Asian area a good potential market. At the same time, household consumption in Southeast Asian countries is also increasing year by year because of people's increased spending power. Therefore, we select the Southeast Asian market as the first target of overseas market expansion. Based on the limited funds, GDP and consumption of the 11 countries in South Asia, we select two countries (Indonesia and Malaysia) as the target market to develop in the first step.





## 4.2 Market Analysis

### 4.2.1 Indonesia

The potential of emerging markets. Indonesia is a market with good development potential. Since the new president Zoco Wei took office, the Indonesian economy has been in a period of rapid development. Indonesia 2016 GDP growth rate reached 5%. In addition, as a market with 250 million people, though most Indonesian are at a low-income level, they tend to consume a lot. Obvious cost advantage lists as follows.

Types of Cost	Advantage
Human Costs	The average monthly wage of workers engaged in manual labors is about 800-1000 yuan in Indonesian capital, and other cities have lower labor costs.
Land costs	Generally, the wholesale market about 30 square meters of the monthly rent of the shop in Jakarta is of 2000-10000 yuan for it's rich in land resources
Taxation	The Indonesian government has given preferential treatment to foreign-invested enterprises.

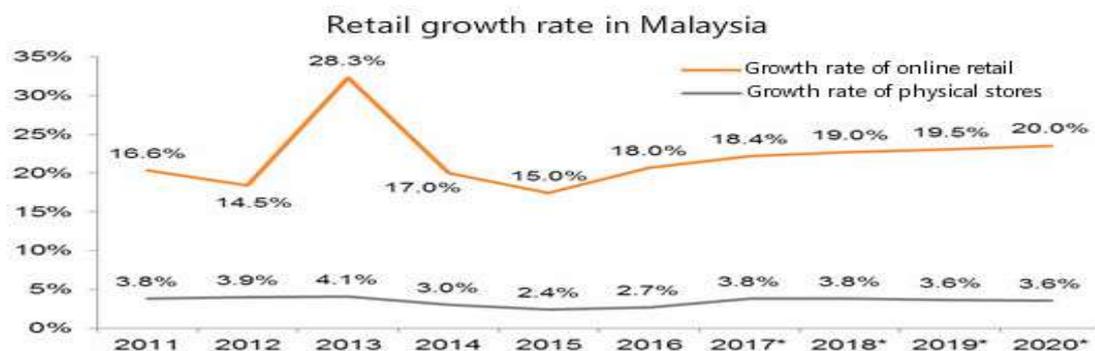
Competitive rivalry: <b>Medium</b>	<ol style="list-style-type: none"> <li>1. Nearly all popular toys in Indonesia's are imported from China, and there are only 3 to 5 large-scale toy retailers in the local.</li> <li>2. There are three major stores in the field of toy monopoly department stores, DT MITRATRADA, DT DWIBRAS DARMA and DT MITRA ADIPERKASA, which are now committed to becoming the market leader.</li> </ol>
Threat of new entrants: <b>Weak</b>	<ol style="list-style-type: none"> <li>1. Less Chinese citizens currently engaged in the toy retail trade industry in Indonesia because of the larger finance compared with restaurants, clothing and other items.</li> <li>2. New entrepreneurs lack experience and they need to take a long time to adapt to the toy retail market.</li> </ol>
Threat of new substitutes: <b>Medium</b>	<ol style="list-style-type: none"> <li>1. Nowadays, children are more precocious and children over 12 have turned to non-traditional stuff such as video games, computers, music and cosmetics.</li> <li>2. Indonesia is not as developed than HK, the products out of fashion in HK are still popular in Indonesia.</li> <li>3. HK's low-priced purchase of products can have been eliminated to the use of discounted prices in Indonesia sales, accessing to huge profits.</li> </ol>
Bargaining power of suppliers: <b>Weak</b>	<ol style="list-style-type: none"> <li>1. With a number of small and medium-sized wholesalers from Guangzhou, Yiwu and another commodity distribution center sporadic toy, toy wholesalers can't have the absolute control of the market.</li> <li>2. Companies in Indonesia engaged in toy wholesale trade can obtain the supplier's multi-directional support.</li> </ol>
Bargaining power of buyers: <b>Strong</b>	<ol style="list-style-type: none"> <li>1. Most people in Indonesia buy toys in supermarket. In Jakarta, Bogor, BEKASI and other regions there are about 134 outlets of 20 department stores for low- and middle-income consumers, so our buyers have a certain bargaining power.</li> </ol>

## V. CONCLUSION

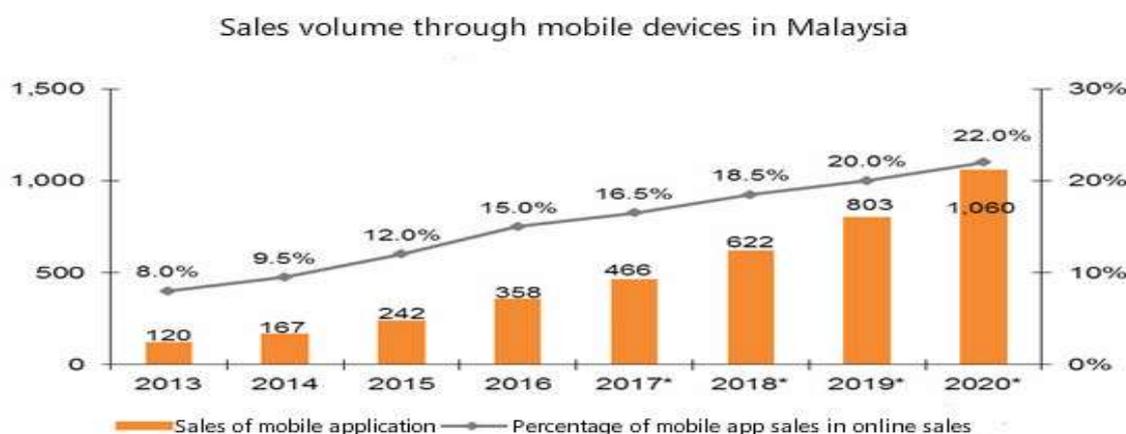
Except the buyer's bargaining power is strong, the other four are medium or weak. Since Indonesia is an emerging market, coupled with the 1998 riots, the Chinese people still have much negative impression of Indonesia. As a result, the country's current market competition is not high, and even there are a number of market gaps.

### 4.2.2 Malaysia

Advantages and Opportunities. Good location: becoming a bridge between the ASEAN market and the Middle East and Australia. The high quality of human resources and the low wage cost. Stable economy, bright economic growth prospects, harmonious ethnic relations, and low political turmoil, Malaysia is a potential market for toys with political support. Electronic retail: becoming increasingly popular, the Internet penetration rate of more than 70%. Online sales drive retail growth.



Source : Euromonitor



Source : Euromonitor

### 4.3 Implementation plan

Store and online sales combined. At present, the Indonesian and Malaysian online retail industry is still in the early stages of development, competition is not fierce online sales. We consider cooperating with the electricity providers platform operators of the higher views. The latter also handle logistics and payment arrangements. Store focuses on user experience and after-sales service.

Make full use of social media such as Facebook, Google+, Instagram, Twitter and LinkedIn to develop our brands, promote products and publish promotion activities. Use promotional promotions as a main means of promotion. In Malaysia, retailers rely heavily on price reductions as a promotional tool. The turnover of the discount period is often a large proportion of the total year, affecting local consumers' shopping patterns. Its considerable discount rate also attracts many foreign visitors to travel. It is possible for us to select the local toys manufacturing companies to reduce labor costs and transportation costs.

## VI. ETHICAL ISSUES

### Problem 1: Cover-up of the problem

Daniel Tong is a CEO and Operations Officer of TT, who had discovered that the latest batch of Jungle Land figurines had quality problem. However, he asked Aimee Chan, the second in command of TT, who carried out the investigation, not to do anything.

### Problem 2: Threat

Daniel Tong, the superior of Aimee, was closely linked to her interest in this company, such as promotion, which seems a kind of threats. Therefore, when she had asked Aimee to do nothing, although she had known that it was wrong or illegal, she might still listen to him to do nothing because of such threat.

### Action

Aimee Chan, as a CPA, should “represents the facts accurately and completely in all material respects” (COE Section 320.3C). When she found out the problem and the products were still in the inventory, she should trace and stop selling the products and report the issue to superior or relevant authorities instead of listening to Daniel to do nothing, but If the products had been already in the market, she should have informed the public, made an open apology, recalled products and gave customers compensation.

When Aimee had had different opinion with Daniel, she should have consulted the issue with him, or reported it to the board of directors directly (COE Section 100.21). However, if the board of directors have known the issue, they still wouldn't have informed the public, recalled and stopped selling the products, Aimee can also withdraw from this company. According to (COE Section 100.24) "If, after exhausting all relevant possibilities, the ethical conflict remains unresolved, a professional accountant shall, where possible, refuse to remain associated with the matter creating the conflict. It is appropriate to withdraw from the engagement team or specific assignment, or to resign altogether from the engagement, the firm or the employing organization".

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