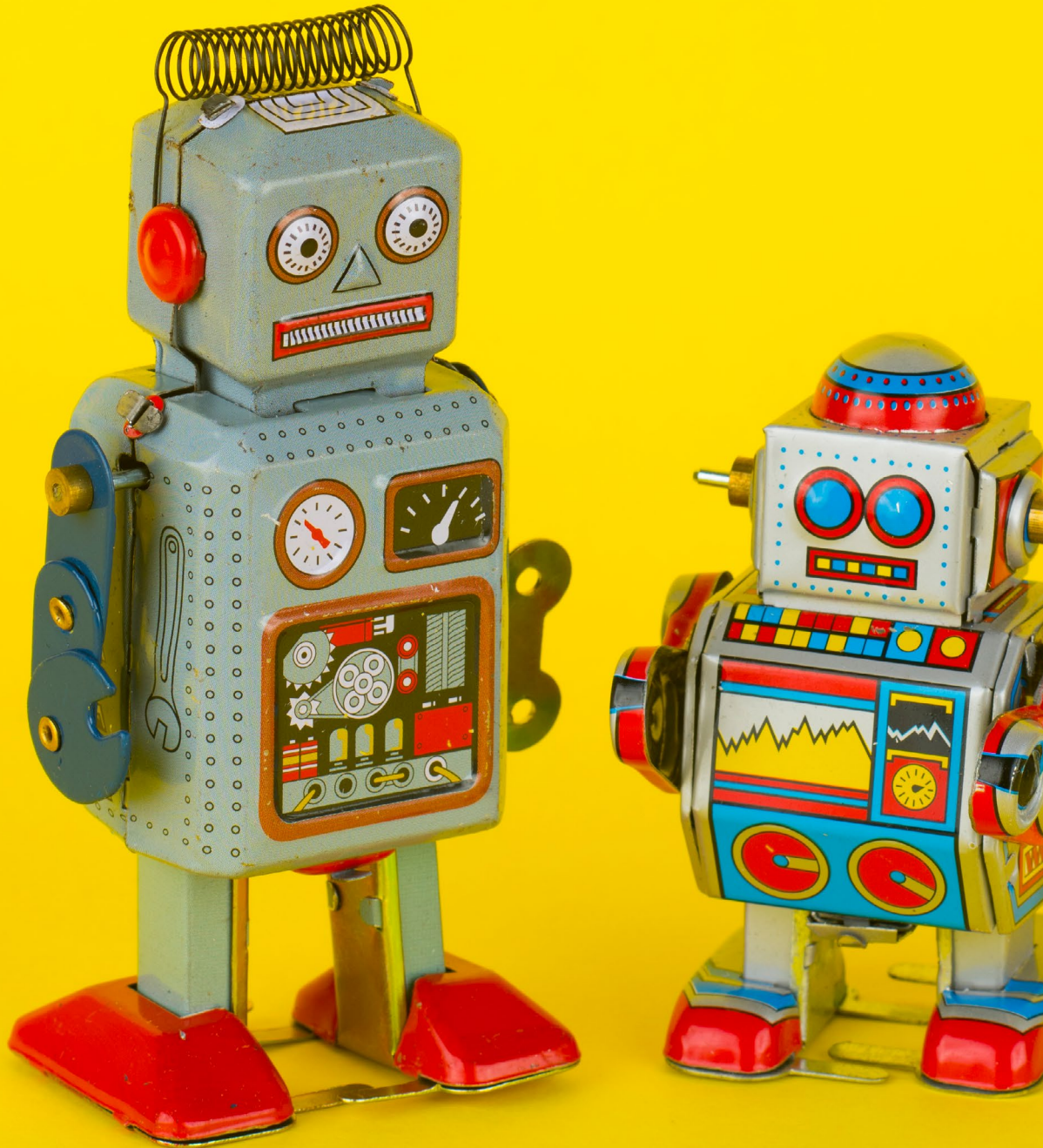


JOT Toy Company

Scenario and requirement

Ethical dilemma



Background

There is 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 for babies under one year old, children aged 1 to 3 years and pre-school children of 3 to 5 years. There is a further sector for children of school age of 5 years and upwards. 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 current trend in toy sales is towards electronic toys and computer assisted learning.

The toy market is highly seasonal and is dominated by the pre-Christmas sales period. Typically, around 30% to 55% of toy sales occur in the fourth quarter of the calendar year (October to December). There are several global toy fairs each year which attract buyers from toy retailers across the world. At these toy fairs, buyers will assess and choose which of the new toys may achieve high sales. The toy fairs attract a wide range of exhibitors which are launching new toys, both large listed companies and small companies. The level of sales achieved by many toy companies will often depend on orders generated from buyers attending these international toy fairs.

JOT Toy Company

The JOT brand was established in 1998 and the company initially designed a small range of toys which were manufactured in their home European country. By 2003, within five years of starting JOT, the founders were encouraged to see JOT's 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 2004, JOT 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 2016 sales revenue exceeded €8 million and the company had achieved substantial sales revenue growth each year.

JOT currently has a relatively small range of 34 products aimed at only 2 age groups. These are the pre-school age group of 3 to 5 year olds and the next age group of 5 to 8 year olds. The JOT brand name is synonymous with quality electronic toys. JOT's management team is aware of the importance of its corporate social responsibilities. It is the responsibility of the toy company and the manufacturer to ensure that the product meets all of the EU safety regulations.

JOT's products are sold to toy retailers for between €7 and €38 for the current highest priced product. These are JOT's selling prices to toy retailers. Most of the retailers will then sell these toys at a large mark-up, which can be as much as 50% to 100%, i.e. a toy procured from JOT at €10 could be retailed to the end customer at €20.

Financing of JOT

JOT is a private limited company and not listed on any stock exchange. It is therefore very dependent on loan finance. JOT currently has a bank loan totalling €1,600,000. JOT's 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. JOT 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.

JOT's business is highly seasonal with a significant proportion of sales occurring towards the second half of each calendar year. As JOT builds up its inventory in preparation for higher levels of sales in the second half of each year, cash flow is negative. This is due to the cost of outsourced manufacturing for the majority of all products occurs between April and October each year, whereas sales revenues occur at the end of each year and the beginning of the next year, after the Christmas period.



Outsourced manufacturers

Currently JOT uses 20 off-shore outsourced manufacturing companies. Off-shore outsourced manufacturing is defined as shifting work to foreign, distant companies in order to reduce production costs. Some of the outsourced manufacturers are small companies each of which manufactures just one of JOT's products. Some of the larger outsourced manufacturing companies make several of JOT's products. All of these outsourced manufacturing companies do not work exclusively for JOT but manufacture toys, as well as other products, for a number of international companies. All of JOT's outsourced manufacturers are based in China.

Sales

JOT's sales are highly dependent on just 7 large retailers. These 7 large companies comprise toy retailers, large international supermarket retailers, department stores and one on-line retailer. Last year over 68% of JOT's sales were to these 7 customers based in Europe and the USA. The remaining 32% of sales are to distributors as well as small and medium sized retailers around the world. JOT currently has around 350 customers in total, including the 7 large customers.

IT System problems

JOT's Finance and IT Director, is concerned that JOT's different IT systems are not integrated and there is much repetition of data and conflict of data in different IT systems.

JOT's Sales Director was aware that a recent sales order for 5,000 units of a particular product could not be fulfilled, despite the inventory IT system showing inventory levels for this as 5,240 units. When the order was being prepared only 4,980 units of this product could be found in JOT's three warehouses.

Furthermore, some customers have queried and not settled their sales invoices as the volumes of products invoiced do not agree with the volume of products they have received. This is causing some conflict between JOT's Finance Department, which is chasing overdue trade debtors, and the Sales Department which is trying to keep customers satisfied.

Apparently, one of the problems is that JOT appears to have invoiced customers for some quantities of products which are actually replacement products due to faults or damage. This can arise where a product is faulty and additional replacement products are despatched to the customer and the faulty products are returned to either the manufacturer or to one of JOT's warehouses for testing. Whilst the movement of these products is fully updated on JOT's inventory system, the despatch notes of the replacement products generate additional invoices by the Finance Department.

JOT's Finance and IT Director is concerned that JOT is not operating in an ethical way and has concerns that this could impact on JOT's profitability and cash flow, and has asked for your advice.

CIMA's Code of Ethics

1. Integrity – to be straightforward and honest in all professional and business relationships.
2. Objectivity – to not allow bias, conflict of interest or undue influence of other to override professional or business judgements.
3. Professional Competence and Due Care – to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation and techniques and acts diligently and in accordance with available technical and professional standards.
4. Confidentiality – To respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right to disclose, nor use the information for the personal advantage of the professional accountant or third parties.
5. Professional behaviour – to comply with relevant laws and regulations and avoid any action that discredits the profession.

Requirement

You are required to draft an email to JOT's Finance Director covering the following:

- ▶ What the ethical dilemmas are.
- ▶ Why you consider these to have ethical dimensions.
- ▶ Your recommendations on what actions should be taken to address the ethical dilemmas.
- ▶ Your justification of why you have made these recommendations.

Your email should contain no more than 10 short sentences.



Consultancy advice for JOT Toy Company

Blank answer document

Draft email on Ethical dilemma concerning JOT's IT system problems.

What the ethical issue is:

1.

2.

Why I consider this problem to have an ethical dimension:

3.

4.

Recommendations for this ethical issue:

5.

6.

7.

Justification of why I am making these recommendations

8.

9.

10.