Big Dreams for small businesses

--Outsourcing improve solution based on Fun Sports

Team: Continue

Ref: XB20211624

Case review > Clear case direction

Fun Sports: small B2C online store that specializes in sense training equipment
Founded: 2015
Own Brand: Fun Sports
Values of the product:
To produce safe and fun sensory training equipment that can scientifically improve children' s attention

R & D
Brand
Differentiation
Development

Light Assets + competitive products

Have had an impact in certain segments of the market

research and developm
Productio outsourcin g
expand online marketin

1. In recent years, **sales growth faster, but the increase in enterprises profits is not significant.**
2. At the same time, the production capacity of foundry companies is **limited**, and the cost of foundry production **increases**, resulting in **lower gross profit** rate of enterprises.

- Analyze the reasons for the increase of outsourcing cost during the peak season
- Adjustment of procurement budgeting methodology
- Improving enterprise production outsourcing program
- Make enterprise gross profit rate achieve reasonable target

Contents

Part1 Strategic analysis

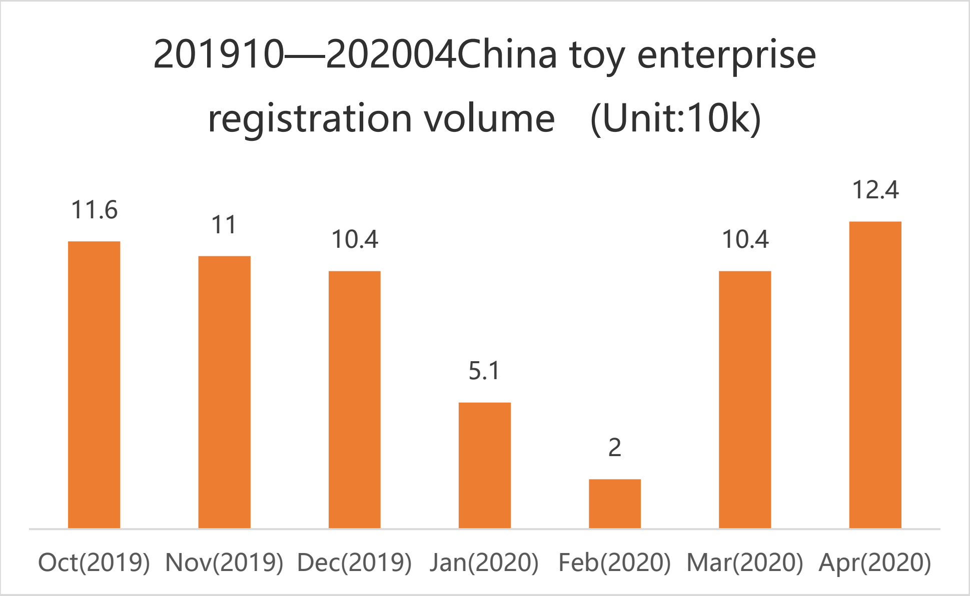
Strategic analysis > Pest macro-environment analysis

Politics

- Residents'disposable income continue to rise
- The introduction of the two-child policy and the three-child policy
- The introduction of double reduction policy

Economy

- The rapid development of the Internet age
- Platform economy and e-commerce economy rising



Technology

- 5G technology, big data and other emerging technologies mature application
- Digital content helps toy sales

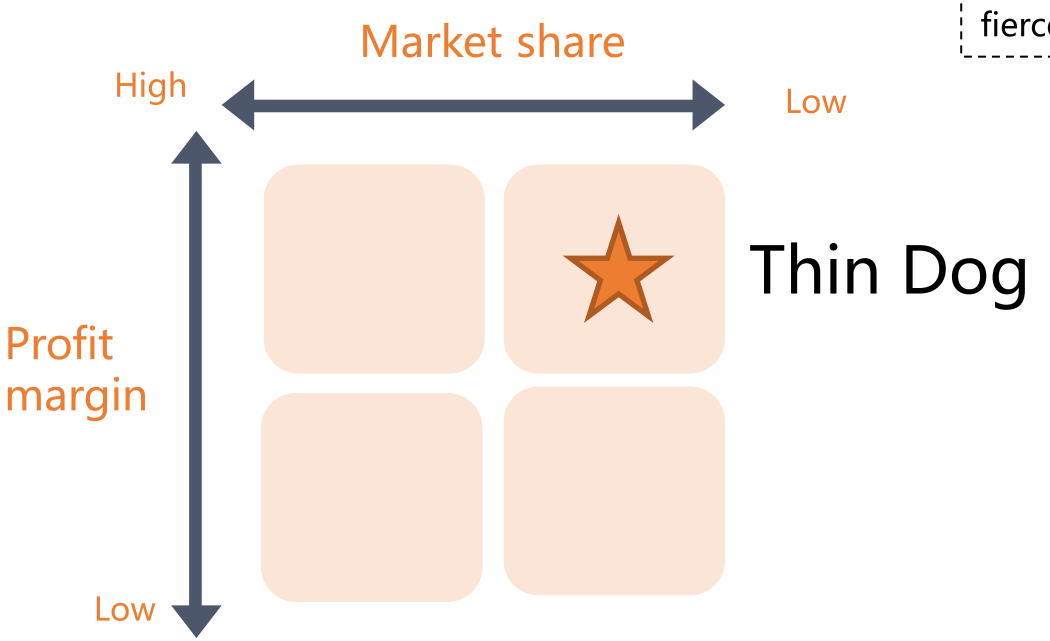
Society

- Pandemic affects e-commerce outbreak
- Record number of children in 2020
- All walks of life have accelerated the process of digital transformation

E-commerce is developing rapidly, digital transformation is the outlet
Toy market demand expansion, broad prospects for the industry

Strategic analysis > industry competition analysis

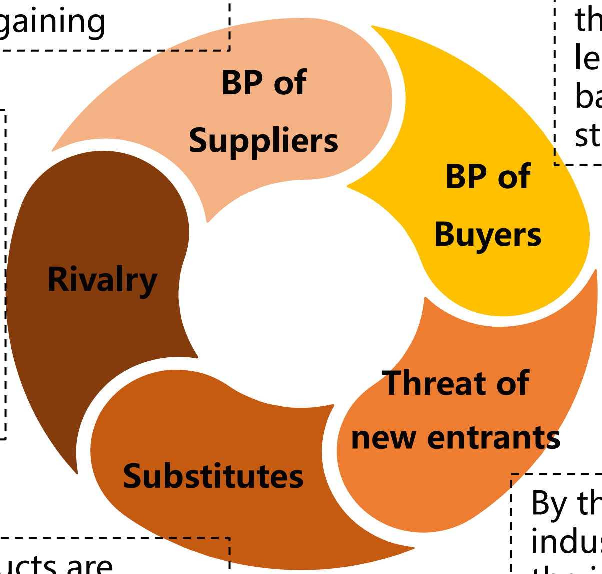
Market holder	Like competitor
Lego	Evebel
Bandai	Wepaly
Tomei	Smo - Moon
Hasbro	Tintin Sports



The surplus production capacity of the contract factory is weak to the supplier's bargaining power

Rich market products, there are large-scale leading enterprise buyers bargaining power is strong

The continuous expansion of the industry market, the existing domestic and foreign competitors have their own advantages, as well as the continuous expansion of new entrants, leading to extremely fierce competition in the industry



By the policy and industry market growth, the impact of more new entrants, a greater threat

The company's products are differentiated and recognized to a certain extent, and the threat of alternatives is less

- **Production capacity can not support the enterprise's market demand**
- **Weak bargaining power causes the cost to increase**
- **The product competitive ability is affeced**

Strategic analysis > value chain analysis

Industry model: OEM ODM OBM

R & D

Raw materials

Process ing

Sales

Consumers

After-sales service

The international enterprise occupies the market, the domestic enterprise is experiencing FS as relies on the e-commerce platform small enterprise, lies between the crack survival

Strategic analysis> SWOT analysis

Strength

- Product differentiation, makes competitive advantages
- High R & D efficiency, and creative
- With a great marketing team

Weakness

- Lack of supplier management mechanism
- The ability of informatization is backward
- Bargaining power with suppliers is not strong

Opportunity

- Online shopping is all the rage
- The national birth policy promotes the toy market to expand continuously

Threat

- As the outbreak bites, competition intensifies
- The cost of contract work continues to increase
- The quality of outsourcing is difficult to control

Strategy combination	Strategic description
SO	Improve product quality and differentiation level Strengthen online operation capacity Seize new market demand
ST	With the help of product competitive advantage and marketing ability, strengthen quality control
WO	Seize the national policy and market potential Optimize product structure and market segment Improve bargaining power
WT	Gradually improve management capacity Stable supply channels Increase market share Build brand advantage

Long-term optimistic market environment, but business performance can not meet the strategy

What makes this situation?

Part 2 Current situation & reasons

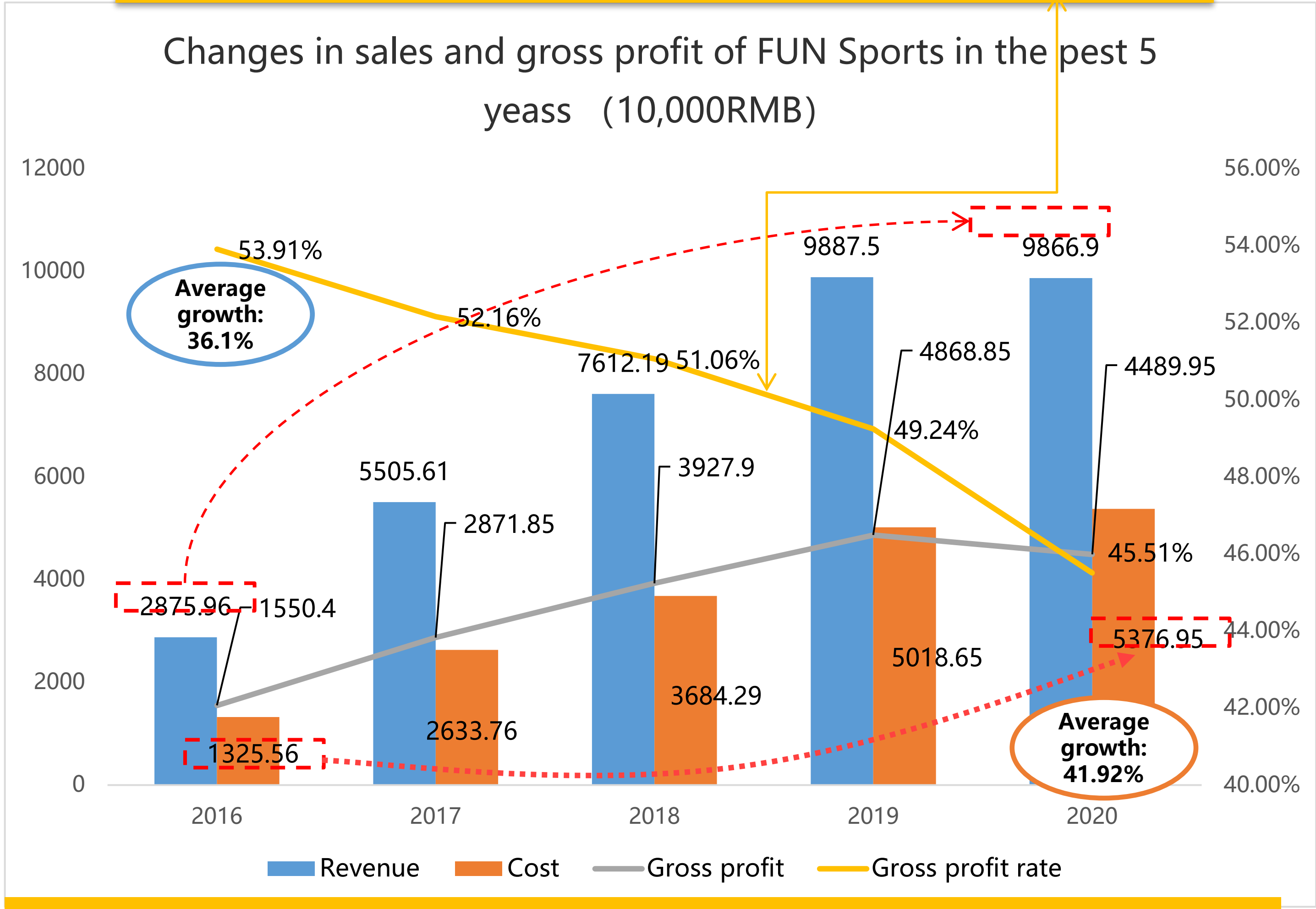
Current situation & reasons > FS business matters

Further attribution of these matters

- FS business matters
  - Finance
    - The increase in profits was not significant
    - Lower Gross Margin
  - Sales
    - The price of the sales promotion has been reduced considerably
    - Production capacity at the contract factory has not kept pace with sales growth
  - Purchasing
    - Unreasonable budgeting of procurement
    - Bargaining power is not strong for the contract factory
      - The frequency of small product cooperation is low
      - Large products only a single OEM, no competitive mechanism
    - Contract factory scattered, communication is not smooth, information can not be timely feedback
  - After-sales service
    - Increased percentage of goods returned
      - A lot of the product quality problems

Current situation & reasons>FS business matters>financial> profit growth is not significant

2016-2020, the cost has continued to rise, profit growth is not significant, gross profit rate has declined year by year



The reason why the profit increase is not obvious and the gross profit rate drops: the sales increase scope < the cost increase scope

Gross profit rate$=\frac{revenue-cost}{revenue}=1-\frac{cost}{revenue}$

Assumption：The annual growth rate of unit sales=A；The annual growth rate of unit costs=B

Income growth rate=（1+A）（1+Growth rate of sales volume）

$=\sqrt[4]{9866.9/2875.96}=36.1\%$

Cost growth rate=（1+B）（1+Growth rate of sales volume）

$=\sqrt[4]{5376.95/1425.56}=41.92\%$

B = 1.044A + 4.22%

Cost growth is greater than revenue growth, revenue growth of 1 percentage point, cost growth of 1.044 percentage points, and the growth of at least 4.22% .

Current situation & reasons>FS business matters>sales>Cost Analysis

In June and November 2020, gross margins fell by nearly **20%**
The sales discount strength is big, the cost increases high

Months / Projects	1	2	3	4	5	6	7	8	9	10	11	12
Revenue	423.12	293.75	490.48	585.61	678.86	1564.3	878.98	867.68	879.86	716.58	1889.3	598.34
Renenue share	4.29%	2.98%	4.97%	5.94%	6.88%	1585	8.91%	8.79%	8.92%	7.26%	19.15%	6.06%
Cost	202.59	140.32	234.99	279.22	322.39	1016	441.16	421.87	416.61	336.22	1261.1	304.44
Cost share	3.77%	2.61%	4.37%	5.19%	6.00%	1890	8.20%	7.85%	7.75%	6.25%	23.45%	5.66%
Gross profit	220.53	153.43	255.49	306.39	356.47	548.3	437.82	445.81	463.25	380.36	628.2	2939
Gross profit share	4.91%	3.42%	5.69%	6.82%	7.94%	1221	9.75%	9.93%	1032	8.47%	1399	6.55%
Gross profit rate	52.12%	52.23%	52.09%	52.32%	52.51%	35.05%	49.81%	51.38%	52.65%	53.08%	33.25%	49.12%

+130% (Revenue, 5 → 6) + 164% (Revenue, 10 → 11)
+215% (Cost, 5 → 6) + 275% (Cost, 10 → 11)
-17.46% (Gross profit rate, 5 → 6) -19.83% (Gross profit rate, 10 → 11)

Revenue = Sales Volume X unit price
Cost = Sales Volume X unit purchase cost

➡ **The ratio of income to cost is not reasonable**

Current situation & reasons> FS business matters> sales> big discounts & capacity limited

Unit purchase cost in May. $1,725.44

Difference (780-400) * 200/780 = $97.44

Normal unit cost $1,628

Difference 782-400 * 200/782 = $97.70

Unit purchase cost in Oct. $1,725.7

The increased costs are due to the production capacity of more than 400 units in the OEM partner

Promotion: the price reduction scope is relatively large

Capacity: the existing foundries is limited, resulting in 30% sales growth can't be met

Order volume: greatly exceeding OEM's normal capacity in the contract, causing a large amount of additional expenses raising the cost.

Conclusion: with the existing capacity and sales, the more sales in Jun. and Nov. the greater the drop in gross margins

Reasons for big discounts and production capacity not keeping up with sales: **restrictions on promotion in the online sales industry; lack of evaluation of OEM's capacity**

Current situation & reasons>FS business matters>procurement>unreasonable procurement budgeting

DK-008 procurement budget for 2020

Projects \ Months	1	2	3	4	5	6	7	8	9	10	11	12	Total
Forecast sales	220	260	310	320	300	720	320	360	370	280	726	270	4456
Opening Stock	208	208	248	256	240	720	256	288	296	224	726	216	3886
Ending Inventory	208	248	256	240	720	256	288	296	224	726	216	216	3894
Current purchase	220	300	318	304	780	256	352	368	298	782	216	270	4464
Unit cost	1628	1628	1628	1628	1725.44	1628	1628	1628	1628	1725.70	1628	1628	1662.14
Purchase amount	358,200	488400	517,700	494900	1345800	416800	573100	599,100	485,100	1349500	351,600	439600	7419800

Advance the production of those orders in May. and Oct. that exceed 400 and look for the lowest-cost procurement option while taking into account changes in storage costs.

In the original plan, the volume of purchases in May. and Oct. was excessive, causing increased costs, and the new budget plan brought forward the excess.

Current situation & reasons>FS business matters> procurement>unreasonable procurement budgeting

Same as for May, but the reason for not bringing the extra 56 units forward to Jan.was that the extra ¥200 per unit cost was less than the storage cost from Jan. to Oct.

New procurement budget for DK-008 in 2020

Months / Projects	1	2	3	4	5	6	7	8	9	10	11	12	Total
Forecast sales	220	260	310	320	300	720	320	360	370	280	726	270	4456
Opening Stock	208	310	450	540	620	720	400	480	520	550	726	216	5740
Ending Inventory	310	450	540	620	720	400	480	520	550	726	216	216	5748
Current purchase	322	400	400	400	400	400	400	400	400	456	216	270	4464
Unit cost	1628	1628	1628	1628	1628	1628	1628	1628	1628	1652.56	1628	1628	1630.05
Purchase amount	524216	651,200	651,200	651,200	651,200	651,200	651,200	651,200	651,200	753567.36	351648	439560	7278591.36

Bring forward 380 of the more than 400 items ordered in May to Jan.-Apr. Considering account the cost of storage, the minimum cost for Jan. orders is min.

Product cost savings :(380 + 326) * 200 = 141200
Additional storage cost: 1854 * 30 = 55620
Increased revenue = reduced product costs-additional storage costs = $85,580
This suggests that a flexible inventory policy could add $85,580 to the earnings of FS.

Current situation & reasons>FS business matters>procurement>unreasonable procurement budgeting

Procurement budget for 2021

Projects \ Months	1	2	3	4	5	6	7	8	9	10	11	12	Total
Forecast sales	286	338	403	416	390	936	416	468	481	364	943	351	5792
Opening Stock	216	330	392	389	373	936	400	384	316	235	943	280	5194
Ending Inventory	330	392	389	373	936	400	384	316	235	943	280	298	5276
Current purchase	400	400	400	400	953	400	400	400	400	1072	280	369	5874
Unit cost	1628	1628	1628	1628	1744.05	1628	1628	1628	1628	1753.37	1628	1628	1648.11
Purchase amount	651,200	651,200	651,200	651,200	1662079.65	651,200	651,200	651,200	651,200	1879612.64	455840	600732	9807864.29

Growth : 1.11%

Even with the new procurement policy, unit procurement costs in the 2021 increased by 7.12% and 7.7% , respectively, and will become higher and higher as the year progresses, the new procurement policy can not solve the contradiction between the demand and the capacity of the contract factory, so it is urgent to adopt a new outsourcing plan.

Current situation & reasons> FS business matters >procurement>weak bargaining power

Fun Sports

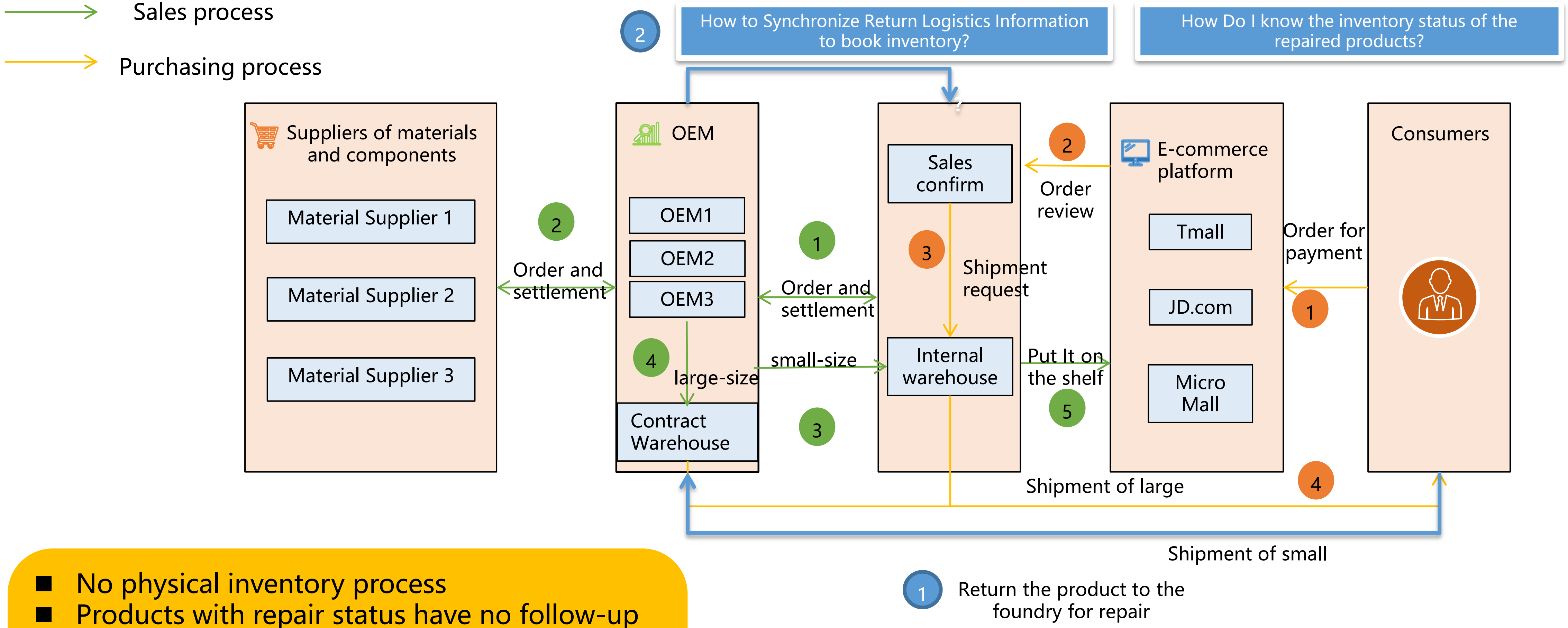
- Cooperation frequency is low, small-size products half a year or a year of cooperation
- Lack of competition mechanism, large-size products only a single corresponding OEM, no alternative suppliers
- The purchasing has not realized the scale effect, and the bargaining power is not high

OEM Partner

- Low switching costs, for most customers, make it easy to switch to new customers
- The production technology is more special, can substitute the factory to be few

The stock policy is not reasonable

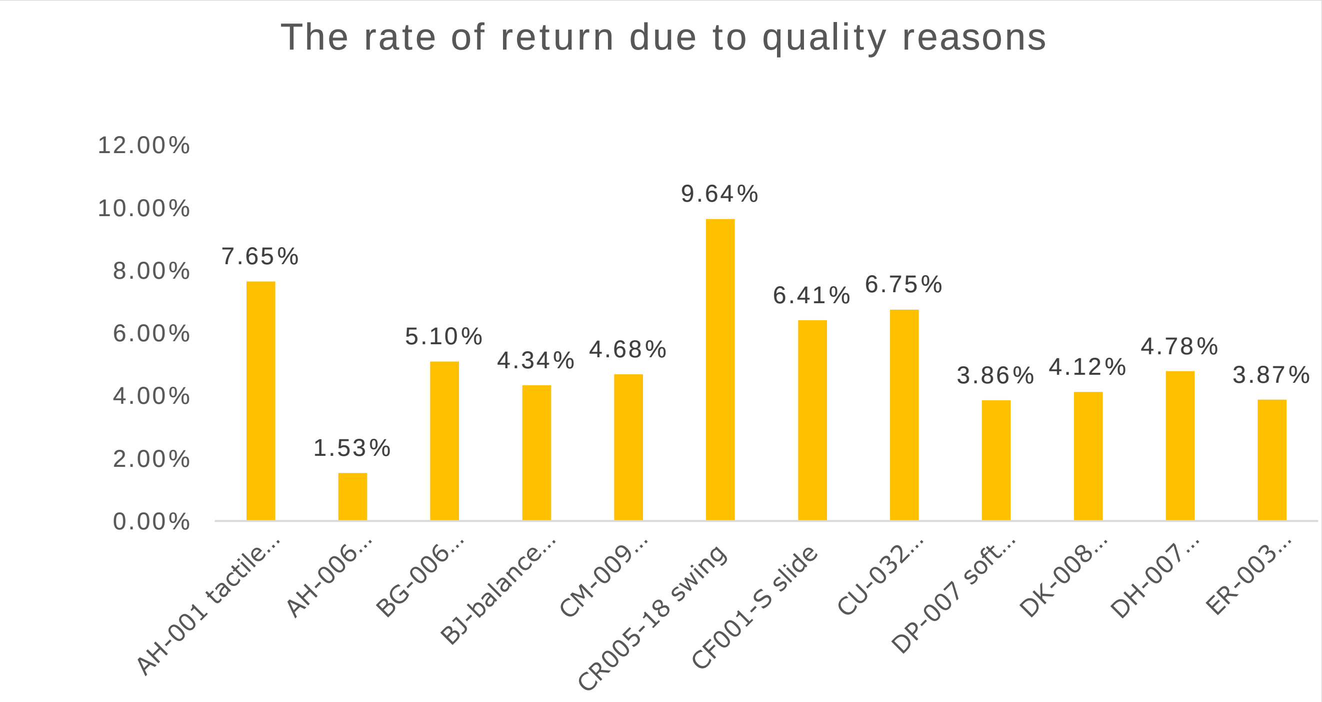
Current situation & reasons FS business matters >procurement>Communication in not timely



- No physical inventory process
- Products with repair status have no follow-up tracking
- Return logistics information is not synchronized to book inventory
- The number of contract factories is large, and the scale is small, the communication cost is large

Procurement process set-up is not perfect

Current situation & reasons> after-sales service> high product return rate

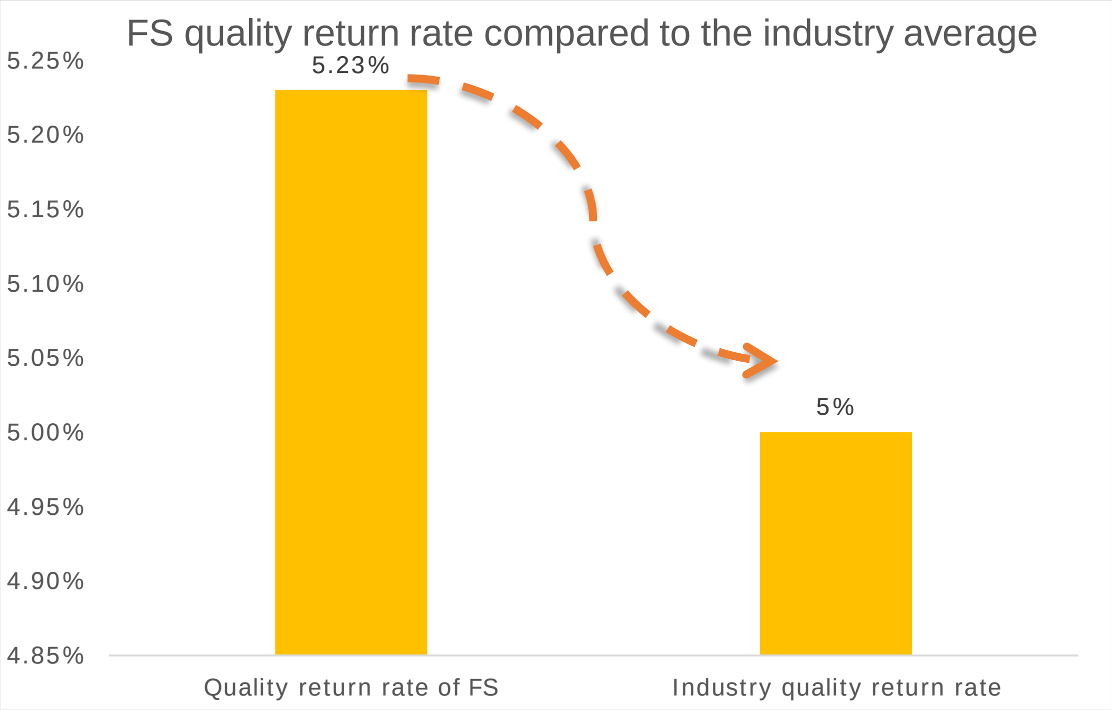


Nearly half of the product return rate of quality above the average level of the market

$$\textit{quality return rate} = \frac{\textit{Total number of products returned for quality reasons}}{\textit{Total number of orders}}$$

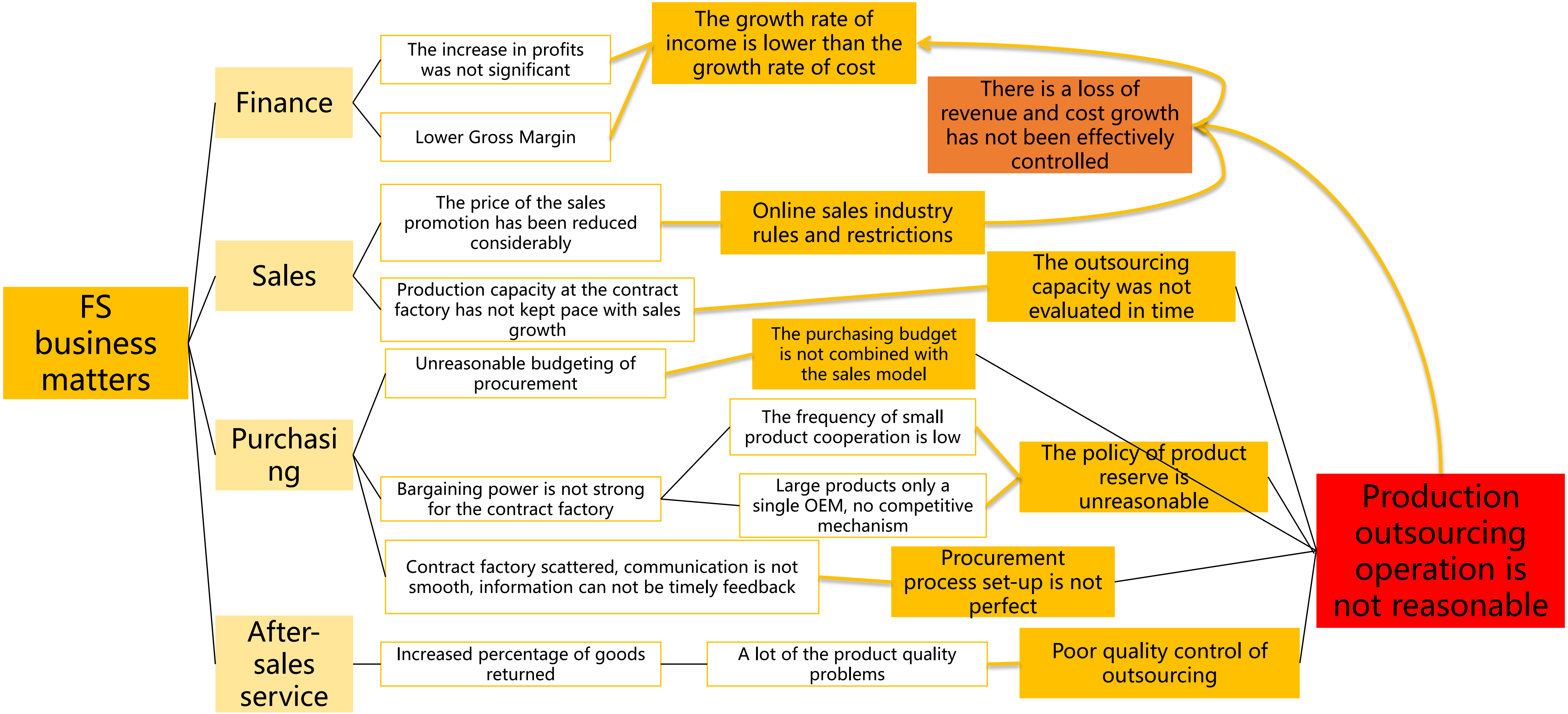
$$= \sum_{i=0}^{n}\left(\frac{\textit{Seven day no reason return rate} * 75\% + \textit{quality return rate}}{\textit{The total rate of return}}\right)$$

$$= 5.23\%$$



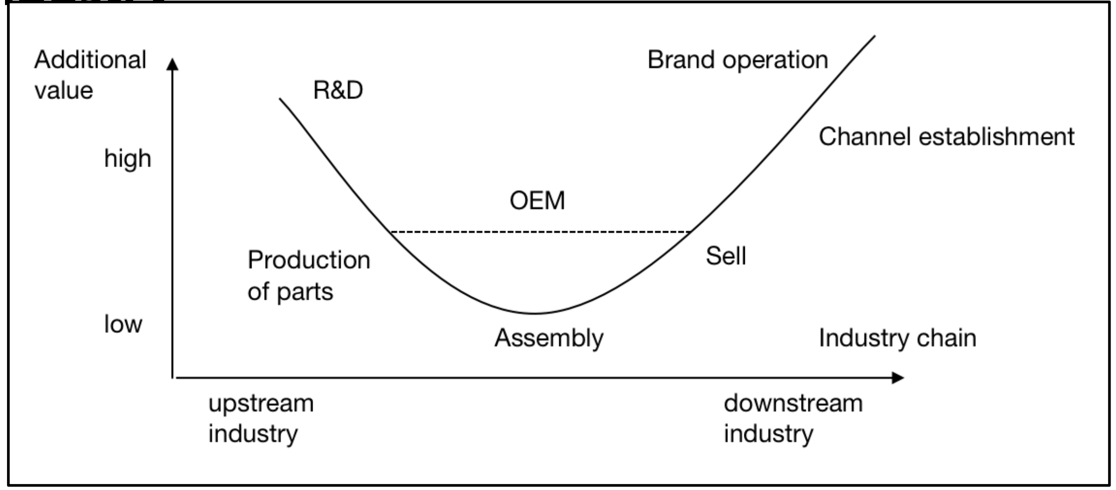
Poor quality control of outsourcing

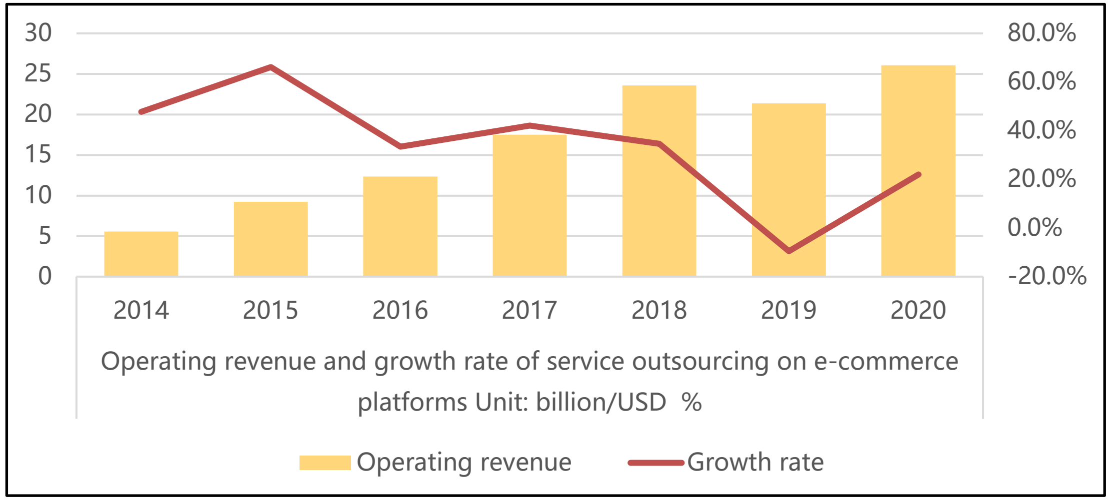
Current situation & reasons> FS business matters > causes of matters determination



Part3 Solution

Solution> analysis of advantages and disadvantages of outsourcing industry





Advantages

- Reduce the investment in financial and human resources and increase the rate of return on capital
- Enterprises focus on core technologies and high value-added businesses
- Reducing the risks of seasonal and sudden production's employment
- Reducing labor disputes
- Avoid the result of inefficient operation caused by overstaffed organization

Disadvantages

- Product quality control ability is not enough
- Output can only on a small scale, with the risk of a seasonal surge in demand
- A company with small sales has no bargaining power relative to its suppliers

R&D and brand management as the core of its competition, and the relatively difficult to deal with the manufacturing outsourcing.
Through the advanced production technology and cost control ability of the OEM, it is helpful for the brand to develop and produce new products in a short time, speed up the market of new products and improve market share.

Solution > Comparison of outsourcing models

HUAWEI

01	02	03
OEM (Original equipment manufacturer) Manufacturers accept commissions from brands to manufacture products, where the brand company is responsible for the design and development of the product, while the OEM manufacturer is solely responsible for processing and production, and usually the brand company provides the raw materials	**OBM** (Original brand manufacturer) OBM manufacturers develop their own brands while serving other brands, designing, sourcing, producing and selling to distributors, wholesalers or consumers	**ODM** (Original design manufacturer) The manufacturer accepts the entrustment of the brand, puts forward the product design plan according to the product request of the brand, purchases the raw material, organizes the production and manufacture, finally delivers the complete machine to the brand

OEM

Advantages:

1. Save most of the production costs, focus on R&D and marketing, get most of the sales profits;
2. Low operating risk, low investment in production capital.

Disadvantages:

1. Lack of quality control and quality assurance;
2.The cost is increasing year by year, and the price performance ratio is decreasing year by year.

OBM

Advantages:

1. To enable enterprises in the promotion of packaging advertising and other marketing communication to implement unified activities, reduce marketing costs;
2. Manufacturers have perfect logistics distribution and after-sales management, can share the brand's logistics and after-sales pressure and costs.

Disadvantages:

Channel construction costs are high, operating difficulties are far higher than OEM and ODM business.

ODM

Advantages:

1. Make the conceptual design of products more closely connected to the manufacturing process;
2. The brand business can well achieve the quality control and the high performance-to-price ratio, guarantees own commodity the high quality.

Disadvantages:

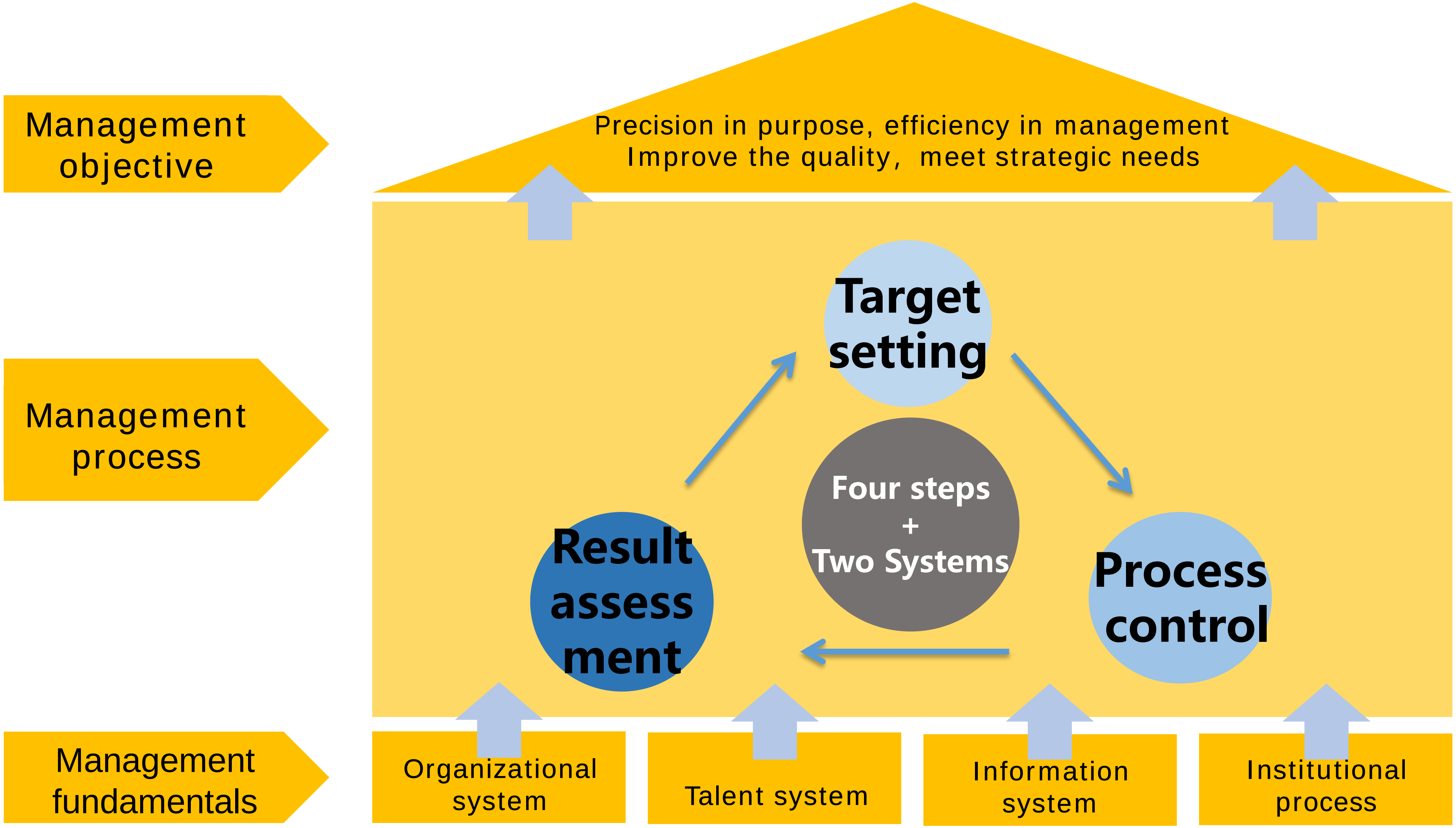
1. The bigger the business, the harder it is to control suppliers and goods
2. ODM model has the risk of infringement under Information asymmetry.

Solution > Construction Ideas

The outsourcing plan is unreasonable

	FS Company Features	question	Solutions
cost	**FS is in the middle of the industry value chain** Raw material suppliers and product manufacturers is upstream E-commerce platform and consumers is downstream Major costs include: Raw material purchase cost; warehousing cost; Supply chain operating costs; R&D cost; cost of sales	execution cost ︾ structural cost	■ Seeking cost control strategies from upstream companies ■ Improving operational efficiency and execution costs
model	**FS's existing outsourcing model is OEM model** Responsible for designing and developing new products with the key core technologies mastered by oneself Control sales channels, and entrust other manufacturers of similar products to produce specific processing tasks through contract ordering	Cooperation cycle with supplieris is short ✚ Quality and cost are difficult to control	■ Finding long-term suppliers for cooperation and establishing strategic partnerships ■ Enhancing control of product quality
product	**The existing product structure of FS is "Attract traffic + Profit"** Small-size products mainly as an attract traffic products Larg-siza product as a profitable product for the company Highly competitive ability of product design	Small-size product profitability has not been tapped ✚ Large-size products have longer life cycles	■ Mining the profitability of small-size products ■ Extending the product life cycle of large-size products

Solution> General framework



Solution > improvement objectives

Optimize the production outsourcing process

- Improve the smoothness of the process
- To realize the whole process management of production outsourcing

Evaluate supplier capacity

- Improve the stock mode
- Reduce the purchase cost

Strengthening the quality management of production outsourcing

- Comprehensive Evaluation of suppliers
- Improve the quality of production outsourcing products

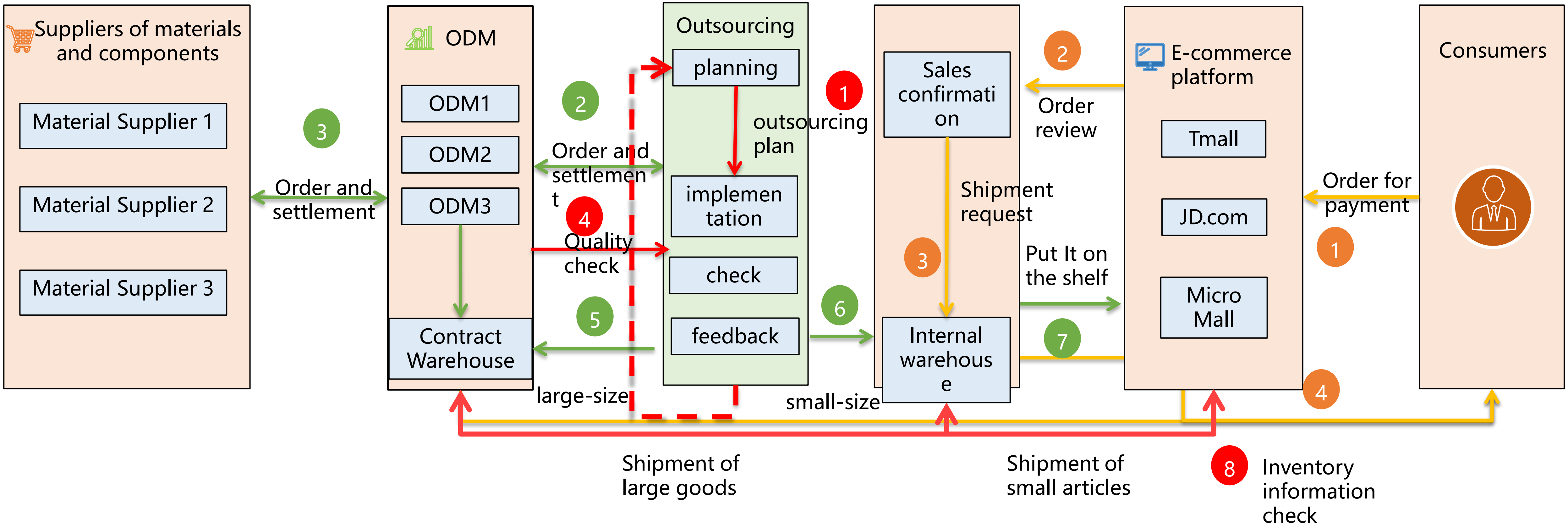
Strengthen the construction of information communication

- Inventory check and track the status of products regularly
- Improve information accuracy and timeliness

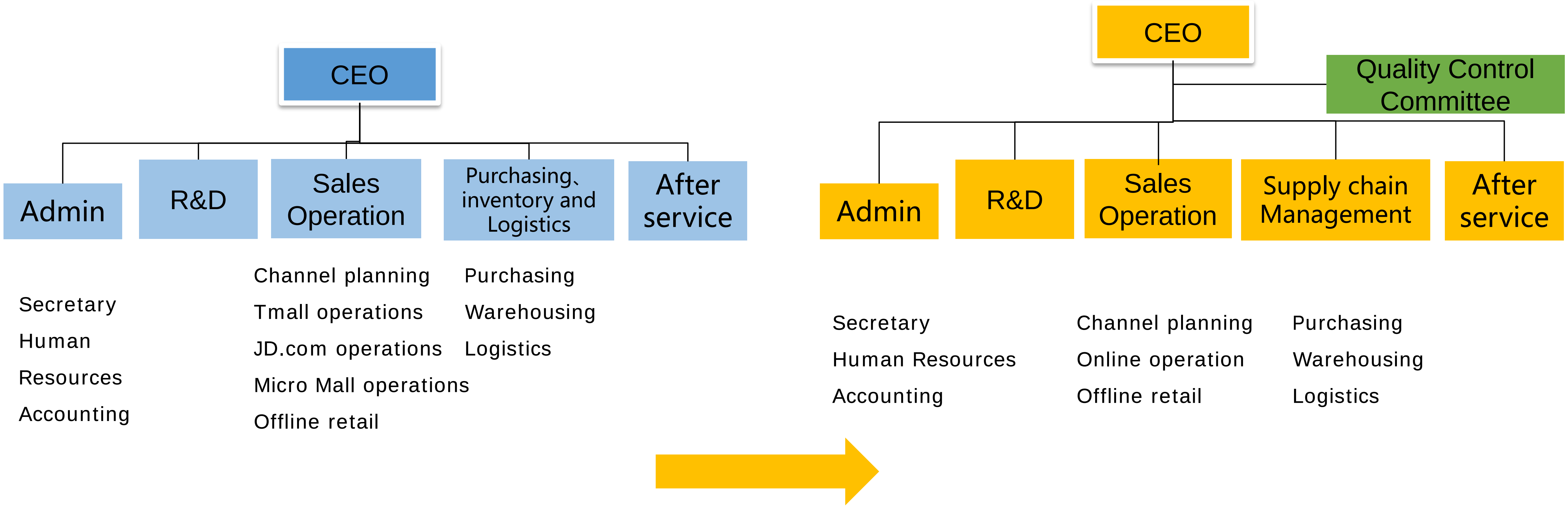
Solution > process improvement

Purchasing process
Added process
Sales process

New production outsourcing management process and improve the whole process management of production outsourcing
New inventory information check procedures to improve the accuracy of inventory information



Solution > implementation > organizational structure optimization



One person from each department shall form a quality management committee to conduct regular and comprehensive evaluation of outsourcing quality

Tmall, JD.com, Micro Mall Operations Group, integrated into an online operations group, improve communication efficiency, maintain accurate inventory information

Solution> Implementation Plan > talent system optimization

R&D staff → **Sales staff** → **Quality control staff**

- Continuously improve the quantity and quality of R & D staff:
- Acceptance rate of new products;
- Percentage of key designers

- Keep the sales force stable
- Train the sales staff on the sales strategy of live and offline experience store

- Add quality management staff
- From the customer's point of view, analyze the product, identify the product itself and the consistency of quality standards

Solution > Implementation Plan > production outsourcing management closed loop > outsourcing planning

Mode selection of outsourcing

Determination of quality standard

Comprehensive evaluation method for suppliers

OEM → ODM

Quality standards for raw materials:

Record and control the key raw materials which directly affect the product function, performance index and service life, such as **material specification applicability, material model integrity, material quality standard rate**

Access standards for production suppliers:

Evaluate outsourcing supplier's production **qualification, scale, Price, delivery ability, similar material supply ability**

Acceptance standards:

On-site audit production process specification, sample rate of compliance, Completion of mass production control plan and safety clearance rate of product trial

Establishing dynamic supplier management mechanism

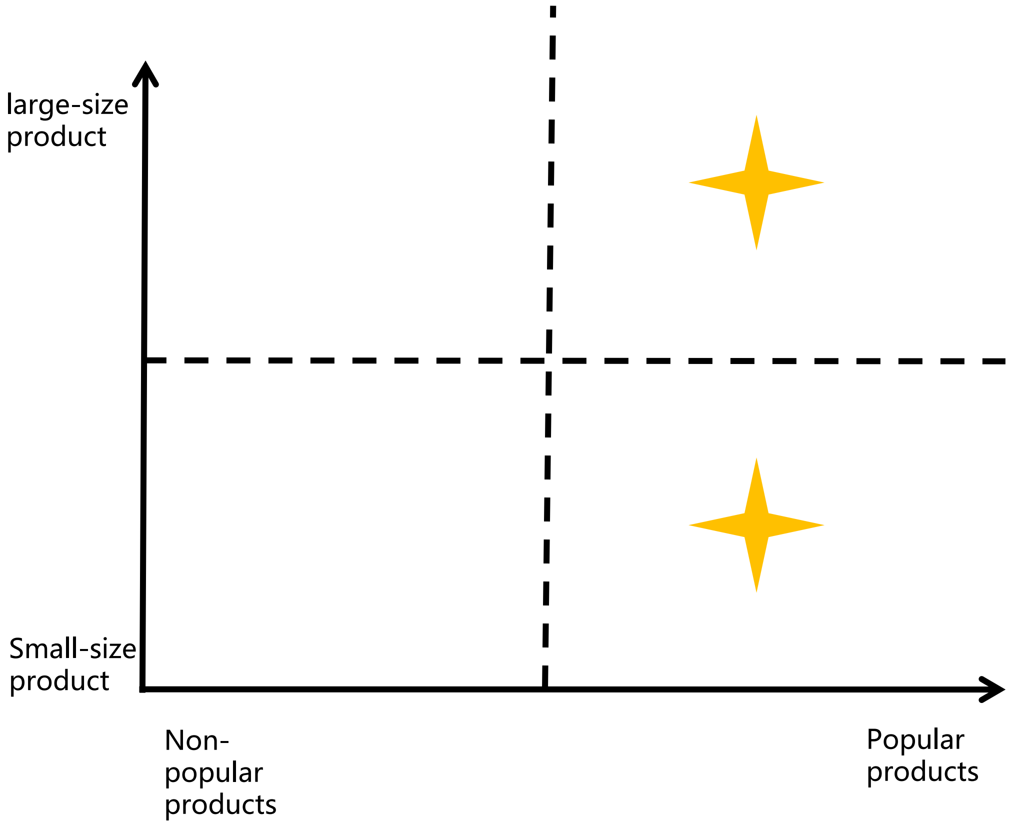
Solution>Implementation Plan>production outsourcing management closed loop> outsourcing Implementation

Working with a large-scale ODM partner

Realize economies of scale and gradually increase the level of bargaining
Seek long-term cooperation with foundries

Co-research and design with foundry
Fast product launch
It is easier to create popular products and increase product sales and profits

Quality committee participates in product quality control
Lower final cost of goods



Online marketing, forecast sales through pre-sale and other methods
According to the market response, orders(small quantities) are placed with the foundry, and determine whether the product is a popular product according to the sales speed

Small-batch production and sales
The company's inventory pressure is small and inventory costs are low, ensuring continuous supply of products

Combine sales strategy Improve stocking methods

How to stock up on popular products?
Increase offline experience stores and expand sales channels
Fast, multi-batch turn over orders, keep up with sales orders, and ensure continuous supply

How to stock up on non-explosive products?
The offline experience store is out of stock
Online on-demand stocking, low inventory cost

Implement flexible supply chain
(Small batch production and sales)

Products will be launched quickly
Products in vogue will be discovered
The profit growth point will be enlarged
Ensure the continuous supply of products the quality of products, with low inventory costs and pressure

Solution > Implementation Plan > production outsourcing management closed loop > outsourcing chec

Item weight table of supplier evaluation

Quality (40% , 15%)

Quality check and evaluation

After-service evaluation

Cost (20%)

Cost control

Business fit

Delivery (15%)

Delivery support fit

Services (10%)

Technical support fit

Comprehensive Evaluation Index for suppliers

Evaluation indicators	Evaluation basis	Evaluation benchmark
Quality indicators	Quality Audit and evaluation of production process	Production process check, quality system certification, material quality check
Technical Specification	Evaluation of technical level	Take the industry average technical production level as the benchmark
Cost indicators	Level of price competitiveness	Price level: better than the industry average level or FS company's average historical purchase price
		Accounting period: whether with FS company stipulated accounting period or better
		Payment terms: are they consistent with or superior to FS payment terms
Business integration	Ability to finance, deliver, etc	Have certain advance capital, financing ability, outstanding delivery ability

Solution > Implementation Plan > production outsourcing management closed loop > outsourcing feedback

Hierarchical management of suppliers

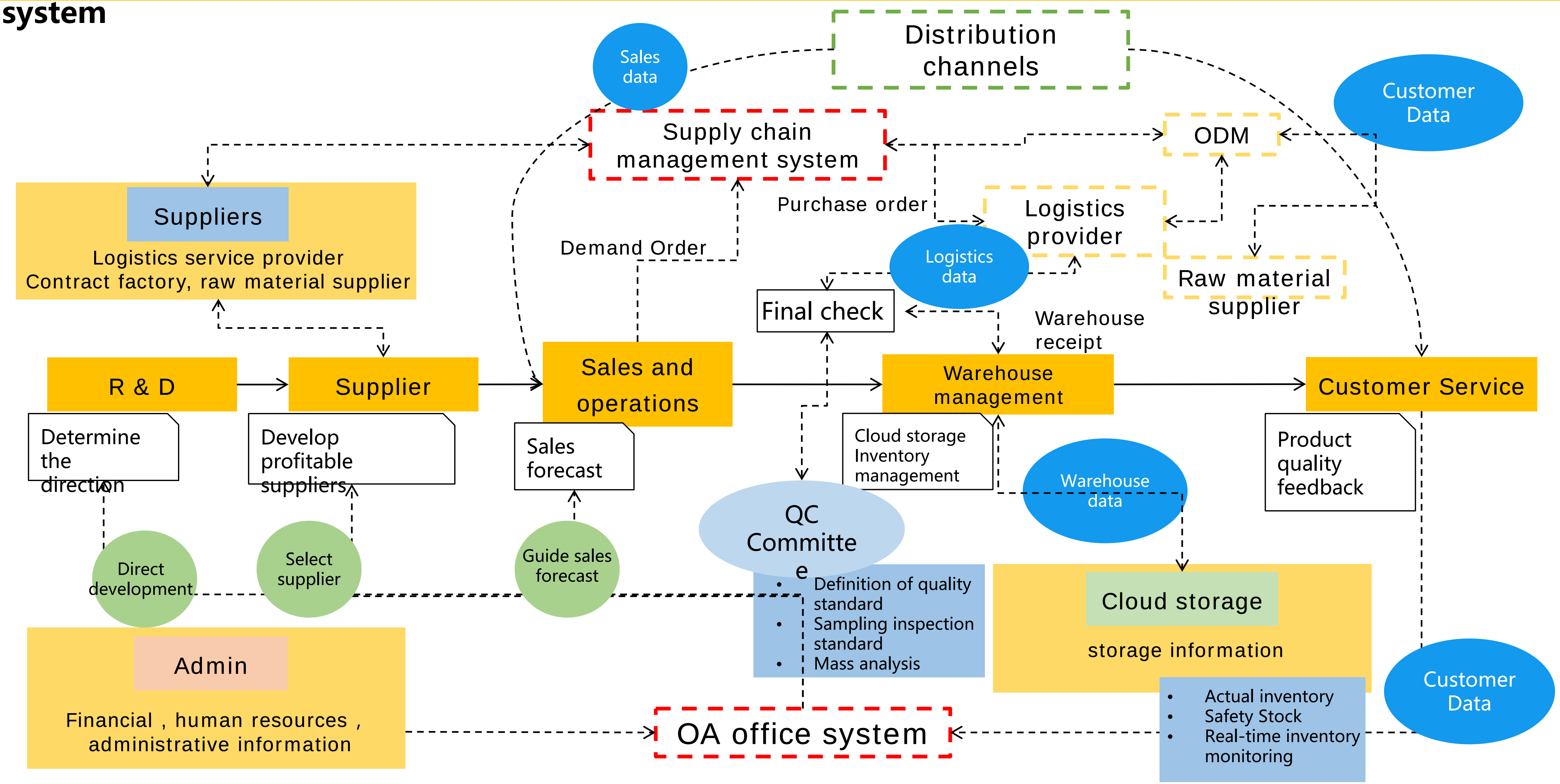
Supplier hierarchical management:

- Through the supplier performance appraisal to implement a hierarchical management system, in the supplier management of the allocation of resources, the allocation of supply shares will be taken to hierarchical management.
- FS supplier performance evaluation is divided into four levels: A, B, C, D, a level for strategic suppliers, B level for preferred suppliers, C level for general suppliers, D level for eliminated suppliers.

According to the check result feedback, carry on dynamic management to the supplier

Supplier classification	Graded target	Partnership	Management Strategy
Class A strategic supplier	Enhance competitiveness	Long-term strategy	Give priority to winning the bid; strengthen high-level communication; increase the proportion of outsourcing
Class B preferred supplier	Profit maximization	Long-term cooperation	Maintain competitive bidding, enhance high-level communication, keep quality continuously, profit by volume, optimize daily expenditure, cost-effectiveness
Class C general supplier	Optimize quality cost	Phased competition and cooperation	Control supplier access quantity and quality; monitor supply continuity and timeliness
Class D suppliers eliminated	Reduce risk	Less co-operation	Find a new alternative supplier

Solution > Implementation Plan > production outsourcing management closed loop > information system



PART4 Future & risks

Future & risks > building key objectives

Key objectives to be achieved in the production outsourcing improvement solution

Plans	Compared to before the change
Predictive accuracy	20% higher
Planning cycle (forecasting and re-planning)	Five times faster
Outsourcing-related costs (as a percentage of sales)	36% lower

Purchasing	Compared to before the improvements
Availability of raw materials for production	Nine times faster
Purchase cost of raw materials	54% lower

Delivered	Compared to before the improvements
successfully fulfilled orders	19% higher
Accounts Receivable Turnover Days	49% less
Order management cost	58% lower

Future & risks > in the future

Star Enterprise -- FS Company

FS company has high-level resources including organization ability, Brand Value, technical standard, customer relationship, etc. . It is the "Star" in the whole value galaxy

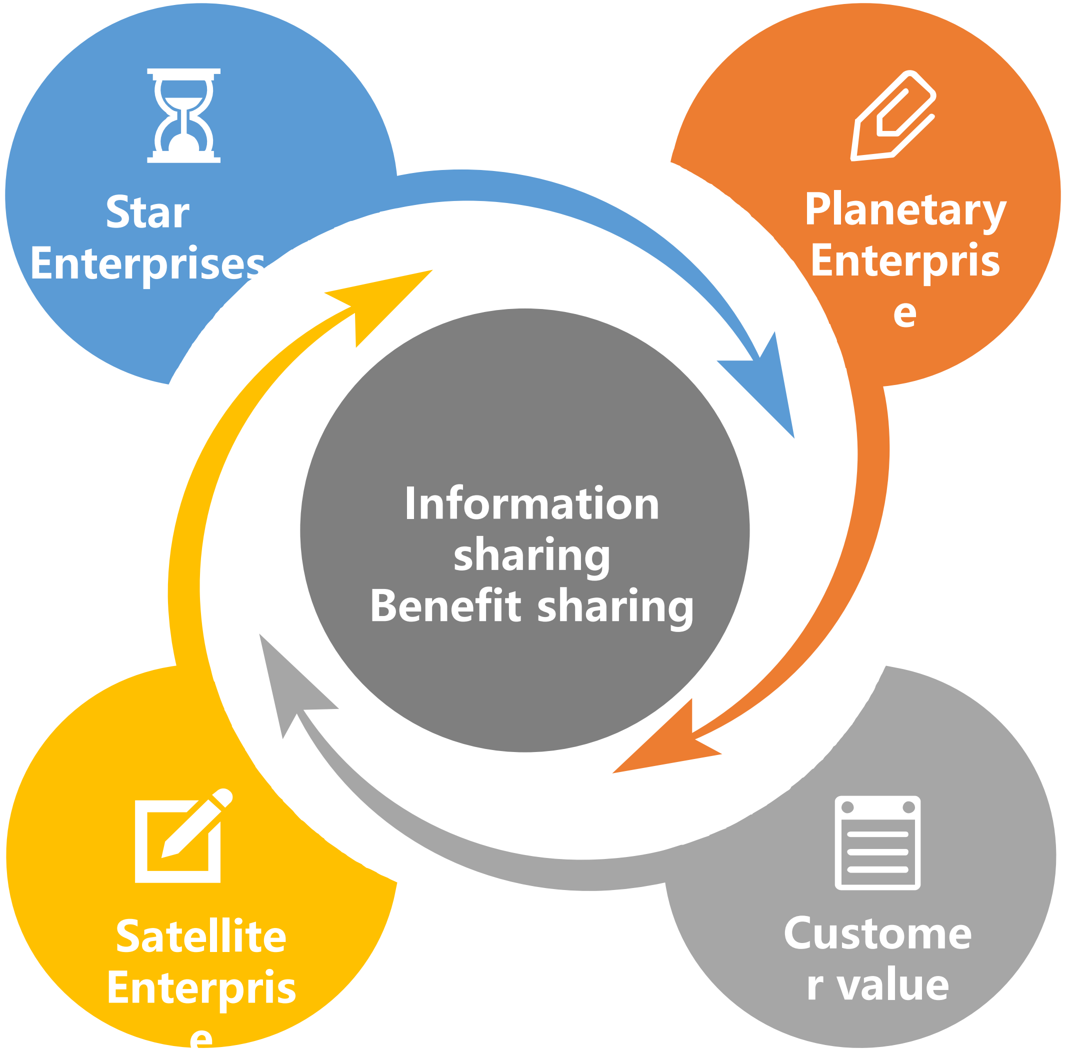
Planetary Enterprise -- external cooperation

An enterprise that provides medium resources such as know-how to FS Company

Satellite Enterprises -- external cooperation

FS company to provide material goods and other low-level resources of the enterprise

Dominant position	As a "star enterprise", FS is in the dominant position in the value galaxy, has the ability to control the **information and resources** of the value flow path in the galaxy, and also has the responsibility to **coordinate the relationships among the enterprises in the galaxy.**



Future & risks > risk warning

Strategic Risk:

Strategic Planning Risks:

- Plan failed to formulate a scientific and reasonable strategic pro based on the macro environment, industrial policy, development needs, company resources and capabilities of the B2C online store

Financial Risk:

Cash flow risk :

- Lack of capital liquidity analysis, resulting in inaccurate capital plan , which in turn affects the overall arrangemen of capital plant

Cost management risk:

- Cost prediction risks, such as procurement without scale advantage and poor bargaining power, resulting in high procurement costs; the forecaste of e-commerce platform sales is inaccurate, inventory backlog is large or virtual inventory exceeds the standard, and processing costs are high

Operational Risk:

Quality Risk:

- Quality management responsibilities of supplier are not clear, the implementation is inadequate, and the supervision and control of quality is not strict
- Inadequate quality control of the outsourced production process and unstable product quality

Market risk:

- Market competition risk: the entry of new competitors to seize market share
- Brand management risk: lack of clear brand management strategy, lack of brand awareness, and lack of effective brand building methods
- Contract risk: the foundry may not be able to complete the agreed tasks as required

R&D property rights risks:

- The daily management of intellectual property rights is imperfect, resulting in the leakage of the company's R&D technology and damage to the company's interests
- Insufficient protection measures for R&D achievements and the loss of key professionals leading to the leakage or diffusion of core technologies

Information Systems Management Risks:

- The system of internal information and the supplier's information are not associated in time, resulting in wasted investment

Team: Continue

Thank you !