Profit Revive

Your client is an owner of a toy store situated in a fairly busy area. The business is doing good. Revenues have increased and the cost has also not shown any alarming fluctuation. However, the profitability of the business is going down. Find out the reason and suggest remedies.

CASE TYPE
Profitability

COMPANY NAME
Accenture Strategy

DIFFICULTY LEVEL
★ ★ ★

Profit Revive

Growth Strategies Unleashed

Case Type	Company Name	Round	Difficulty Level
Profitability Case	Accenture	Partner	3 of 5

Problem Statement

Your client is an owner of a toy store situated in a fairly busy area. The business is doing good. Revenues have increased and the cost has also not shown any alarming fluctuation. However, the profitability of the business is going down. Find out the reason and suggest remedies.

Sir, may I know the types of toys sold by the store and the range of age of the children they cater to.

The store sells many different varieties of toys for infants and up to children of 12-13 years of age.

What has been the magnitude of decline in profitability and since when is the store facing this problem?

The decline in profitability has been noticed for the last year and the magnitude of decline is irrelevant for this case.

Furthermore, what about the competitors in the area? Have they noticed a similar decline?

The other stores are doing as usual.

Okay sir got it. I think I have enough information to begin with solving the case. So, profit is a function of Revenue and Cost (Profits = Revenue – Cost). I would like to start with the cost aspect first. Is that fine?

Yes, go ahead

So, I would divide cost into variable and fixed components. As you said there have not been any alarming fluctuations in cost, does that mean that variable cost per unit has remained constant?

Yes, the variable cost per unit is constant.

Has the fixed cost increased over the past year?

No, the fixed cost is also same as the years preceding the last year.

Fine, that means cost is not a problem here. Let's move on to revenues. Revenue is function of number of toys sold and average price per unit sold (Revenue = No. of toys sold x Average price per toy). Has there been any change in the price component?

No, the prices of the toys have remained same

You also mentioned that revenues have increased and as the prices of the toys have remained the same therefore, number of units sold must have increased

Yes, the number of units sold have increased

So, with an increase in revenue and the usual cost increase, profits must have increased in absolute terms. Therefore, the decline in profitability here does not signify an absolute decline in profits.

Yes, you are correct. Profitability here means profit margins. Let's suppose earlier the profit margin was 30% but now it has come down to 20%.

Okay, sir got it. I would now like to divide the number of toys sold component under revenue into volume and variety. As mentioned, volume i.e. the number of toys sold has increased so there must be a problem with the different varieties of toys sold.

Yes, you are quite close.

Now we know that the increase in revenue is not uniform across all the varieties of toys. Is there any particular category of toy whose sales volume has not increased proportionate to the overall increase in the number of toys.

Yes, the toys for age group 6-12 years have not seen a rise in their sales volume.

So, the increase in revenue is arising mostly from the rise in sales volume of toys catering to the age group 0-5 years.

Yes.

Do these toys (the one's catering to 0-5 years of age) have a lower profit margin than the others (toys for 6-12 years of age)

Yes, you have cracked the case. The toys for age group 0-5 years are smaller and hence have a lower profit margin. On other hand toys for the age group 6-12 years are larger and mostly electric like remote controlled cars, play stations etc. These have a higher profit margin.

That was a tough one. So, with an increase in the sales of toys with a lower PV Ratio and a decrease in sales of toys with a higher PV Ratio, the composite PV Ratio fell leading to an overall decline in profitability.

HERE'S A TIP!

Identify changes in product mix and profit margins to understand declining profitability. Focus on increasing sales of higher-margin products and optimizing product mix to maintain profitability. Monitor cost fluctuations and ensure they align with revenue growth for sustained profitability

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CASE FLOW

CASE FACTS

1. The store sells many different varieties of toys for infants and up to children of 12-13 years of age.
2. The variable cost per unit is constant.
3. The fixed cost is also the same as the years preceding the last year.
4. The number of units sold have increased.