

ever. Customers love our product and respect our quality. There must be a way to make this business work and turn a profit, too. The budget variances should provide some insights. Could you do an analysis of the budget variances?"

BACKGROUND

The Berkshire Toy Company was founded by Franklin Berkshire, Janet McKinley's father, in 1974. Berkshire was an industrial artist who enjoyed making stuffed animals in his spare time. His first creation, a teddy bear that he presented to Janet on her seventh birthday, occupies a place of honor at Berkshire Toy Company's headquarters. In 1974, Frank Berkshire acquired an old pneumatic pump that had been used to fill life-jackets for the Navy during World War II. He modified the machine to mass produce stuffed animals, and the Berkshire Toy Company was born.

The company started small at first, but grew quickly as Berkshire's reputation for quality spread. By 1996, annual sales exceeded a million dollars for the first time. Janet McKinley had learned the business from the bottom up. She had started out with the company in the mail room as a part-time summer employee. As a college student, she had spent summers and Christmas vacations working on the production floor, in the sales department, and finally in the accounting department. She was named Assistant to the President in 1988 after receiving her M.B.A..

In 1991, at her urging, the company launched an initial public offering (IPO) of common stock and became publicly traded on the NASDAQ. Janet McKinley became CEO of the company on July 1, 1993 when her father retired. On March 17, 1995, Berkshire Toys was acquired by the Quality Prod-

ucts Corporation in a friendly exchange of common stock valued at \$23.2 million.² The terms of the acquisition included an agreement to employ McKinley for no fewer than five years at an annual salary of \$120,000.

The Berkshire Toy Company produces the Berkshire Bear, a fifteen-inch teddy bear enjoyed by children and adult toy collectors around the world. The company touts the handcrafted features of the bear and advertises its product as the only teddy bear made in America. The bears are fully jointed, constructed of washable acrylic pile fabric, and stuffed with a polyester fiber filling. The toys are dressed in various accessories, such as bow ties, sports jerseys, or character and occupational costumes. Thus, the product can be personalized for numerous occasions. The Berkshire Bear is sold with an unconditional lifetime guarantee. In communicating with customers, the company refers to its repair center as the "bear hospital." A damaged bear may be returned by the customer and repaired (or replaced, at the company's discretion) free of charge.

The Berkshire Toy Company's 241 employees are organized into three departments: purchasing, production, and marketing. The purchasing department consists of David Hall, the purchasing manager, and a staff of ten. The department is responsible for acquiring and maintaining the supply of production materials. Bill Wilford manages 174 employees in the production department, where the manufacture

² In a friendly acquisition, the terms of the exchange are negotiated by the acquiring company and the incumbent management of the target (acquired) firm. This method of merging two companies is quite different from a "hostile takeover," which is initiated by the acquiring company over the objections of the target's incumbent management.

Except for two replacements of the electric motor and a new power cord, this is the same machine that Franklin Berkshire acquired from Navy surplus in 1974. Bags of filling are loaded into the machine hopper and mechanically fluffed to the proper loft.⁷ An operator places the empty arm, leg, body, or head over a stationary nozzle and uses a foot pedal to control the flow of filling. The machine operator judges whether the part has been filled correctly. Too little filling affects the firmness of the bear; too much filling is unnecessary and expensive. Inferior grade fiber filling is less expensive but can cause clumping and clogging in the hopper. When this happens, production is interrupted and the operator must unclog the vacuum hose and reset the machine.

Next, the arms, legs, and head are attached to the torso using three-part snap-on, hard plastic disc joints. The disc joints allow the head and limbs to rotate and eliminate the need for sewn attachments. The plastic joints are designed to be foolproof in production and dependable for the life of the product. However, the joints cannot be removed without destroying them. Occasionally, after initial joint insertion, the parts do not fit together properly and they must be removed and replaced.

At the end of the construction process, a woven satin label that states "Made in America by the Berkshire Toy Company" is attached to the back of each bear. More polyester filling is stuffed into the torso and the back seam is hand-stitched, using essentially the same "shoelace" procedure practiced by surgeons. Each seam is brushed by hand to give the bear a seamless look.

The production process is a continuous source of airborne polyester and acrylic fibers that must be controlled, both to protect the health and safety of

the employees and to safeguard the production equipment. The company has taken several steps to control the fibers. First, an air filtration system works constantly to remove dust and fibers from the factory. Second, production employees wear dust masks while they are working with fabric or filling. Finally, regular cleaning and maintenance of the sewing, cutting, and stuffing machines is performed to prevent the fibers from building up.

Maintenance is especially important for the sewing machines. Machine oil and static electricity attract pile fabric lint. Lint buildup can cause lines of stitches that are uneven and seams that do not hold. The Berkshire Bear workmanship is guaranteed for life. Burst seams require repair during the production phase and during the lifetime of the product.

All production employees are paid a regular wage for a 40-hour work week. They receive their regular wage plus an overtime premium of one-half the regular wage rate for overtime. The cost of fringe benefits and employer taxes, such as social security, health insurance, and vacation time, adds 20.55 percent to the cost of labor. The employees' regular wages are charged to direct labor. The overtime premium and the fringe benefits are carried as variable overhead costs.

Marketing

Marketing of the product takes place at the retail level via catalogue sales and in the company's retail store

⁷ Fiber filling is a loose material. Two pounds of bagged filling occupy approximately one cubic foot of space. The filling is loaded manually into a metal bin or "hopper." Rotating sets of fork-like tines separate the strands of filling and increase the volume by incorporating air. The proper mixture of air and filling is the "loft."