

The Transformational Toy Manufacturing Industry

The Toy Manufacturing Industry

The U.S. toy manufacturing industry is a highly concentrated industry including approximately 700 companies that generate annual revenue of about \$20 billion. Top leading toy companies include Mattel and Hasbro, while top leading gaming consoles are manufactured by Microsoft, Nintendo, and Sony. The top 50 toy companies generate about **75%** of the industry's revenue.

Major Product Segments (toys produced in U.S. and imports):

- Non-electronic toys
- Electronic toys and games
- Children's vehicles
- Model and collector sets
- Non-electronic games and puzzles
- Dolls, including clothes, accessories, and playsets
- Stuffed animals
- Action figures
- Infant/preschool toys
- Outdoor and sports toys
- Arts and crafts sets

Economic Turnaround?

- Compared to May, 2009, in May, 2010 U.S. personal income increased by **1.6%**
- Compared to January-June, 2009, in January-June, 2010 U.S. retail sales for sporting goods, hobbies, books, and music stores (potential measure of toy demand) increased **3.8%**
- Mattel – first quarter, 2010 (compared to first quarter, 2009)
 - Earned almost \$25 million (\$51 million loss in 2009)
 - Sales improved due to several new product offerings and core brands, such as Barbie
- Hasbro – first quarter, 2010 (compared to first quarter, 2009)
 - Profits neared \$59 million (up from \$19.7 million in 2009)
- The toy market compared to the overall retail sector is generally more resilient during times of recession and is also more quick to recover from such times.

Target Consumers of Toy Industry

The demand of toys is driven by the growth in the population of children **age 12 and younger**. Of this population, children age 5 and under are responsible for about **half of retail toy sales** (Toy Industry Association (TIA)). According to the Entertainment Software Association, video games once targeted consumers age 18 and younger; however, the reported average age of a **video game buyer is 35**. Personal income and product innovation drives the demand for gaming products. Regardless of company size (large or small), profitability depends on identifying appropriate market trends and marketing toys within those trends effectively.

Toy Industry Competition

The toy market is not only concentrated with the noise of toys, but toy manufacturers are also facing increasing competition from other sources of entertainment, including the Internet and television, thirsting for children's attention.

Importing Toys from Overseas

Many toy manufacturers mass produce toys overseas in such countries as China and other Asian countries since labor is **extremely inexpensive**. Not only are labor costs inexpensive, but toy production is inexpensive and there are no tariffs. Toy companies may also solicit toy components from third party manufacturers and assemble the toy at a separate facility or geographical location in order to cut down on manufacturing costs. Because many toys are produced in **Far East countries**, most toy companies need to manufacture and produce toys well in advance of when customers request deliveries in order to accommodate extended transportation and delivery times. Toy companies are increasingly using emerging technologies, such as radio frequency identification (RFID), to improve supply management and track and control inventory. Toy companies use customer estimates, historical market trends, and current and past market conditions to forecast the scheduling of toy productions. However like any forecast, the inventory of toys actually shipped can greatly vary resulting in an excess or shortage of toys.

Because of the unfair wages and employee treatment in countries such as China, the **International Council of Toy Industries (ICTI)** offers toy manufacturing facilities a certificate for providing acceptable wages and safe working conditions. Toy companies may choose to use a certified overseas manufacturing facility in order to protect the company's image and reputation.

- Imports makeup over **90%** of the U.S. market
- China produces close to **80%** of the world's toys

- Less an 10% of U.S. dolls, toys, and game production are exports
- Major export markets:
 - Canada
 - Mexico
 - Hong Kong
 - Paraguay
 - China

Growing Trend of Toy Industry

Recently, many children are beginning to mature faster and at a younger age with the growing advances in technology. Many of these children are moving away from traditional toys and gravitating towards what was once considered “**adult toys**” including video games and other electronic items. In order for toy manufactures to retain and maintain their competitive edge, many companies have integrated the use of computers into traditional toys.

- Between 2005 and 2009 the use of MP3 players among children younger than 14 increased six times than the previous average user! (NPD Group)

Importance of Sales and Marketing

Avenues of Marketing and Promotion:

- Television
- Magazines
- Radio
- Newspaper
- In-store displays
- Sweepstakes
- Combined events with companies offering complementary products
- Use of brand name toys
- Trade shows
 - Utilized in forecasting sales
 - Manufactures can get feedback from retailers

Not only are these avenues of marketing and promotion important and useful for toy companies, they can also be applied to video game console manufactures to help create product demand. Additionally, video game manufactures may pay retailers for specific shelf positions, special promotions, and merchandising programs.

Additional Avenues of Marketing and Promotion for Video Game Consoles:

- Advertisements in genre-specific gaming magazines
- Special in-store promotions
- Company websites
- Pre-launch online
- Print Previews
- Post-launch reviews

Licensing is extremely important in the marketing of toys and is used by many companies to leverage them among competing toy manufactures. Licensing allows companies to use popular children's characters from television, movies, and books for a toy line's concepts and designs. Companies may also license in-house developed toys or characters to other companies for promotions, such as Hot Wheels or Barbie for McDonald's Happy Meal Toys. Many companies choose to use licensed characters as a way to reduce high failure rates for new toys and keep increasing marketing costs to a minimum. In addition, toy companies rely on extending an already established brand in order to reduce failure and increase the likelihood of consumer recognition.

In addition to the various means of marketing and promotion listed above, some companies have established **Internet-based retail services** that allow consumers to buy products directly from the manufacturer. Through this Internet-based service, companies can offer specialty or limited edition products, accessories or replacement parts, communicate recall or safety issue information, warranty information, and brand promotions.

The Toy Industry is Seasonal

The majority of sales for toy manufacturers occur during the late third and fourth quarters as a result of meeting the toy demand during the **winter holidays**. In order to reduce product over demand, companies may offer early-buy programs. During the quarters that have limited revenue, some companies may promote non-holiday toys such as educational and sports-related toys.

Working in the Toy Industry

- Production jobs require few skills and wages are moderately lower than the national average.
- Injury rate is about half the U.S. average
- Gaming hardware development jobs are highly technical and wages are moderately higher than the national average

Issues of Toy Manufacturing Industry

Toy Demand and Demographics

- Population changes of young children affect toy demand
 - Baby boom produces surplus of children followed by significant drop in births creating uneven demand
- Population shifts affect demand for products designed for specific age groups
- Total population of children expected to increase through 2050, families are having fewer children that may limit future toy growth

Large Retail Dependency

- Many companies depend on large retail stores, such as Toys'R'Us, for half of their sales.
- Just-in-time delivery has forced manufacturers to carry the burden of inventory costs.
- Cancelled orders and retailer bankruptcies can significantly impact toy manufacturer sales

Target Market

- Difficult for companies to predict toy trends and fads
- Short product life cycles and high failure rates of new products

Market Trends

Low Wholesale Prices (between 2004 and 2008)

- Wholesale prices of toys, games, and children's vehicles averaged 1.4%
- Retail prices for toys declined **20%**

Video Game Consoles

- Continued upgrades will enhance gamers experience
- With upgrades comes increasing costs of development for game consoles
 - Some console game development budgets reach over \$60 million

Acquiring Smaller Toy Companies

- Large toy companies buy smaller toy companies in order to avoid the expense of developing and marketing new toys or to diversify into new target segments
- Not all acquisitions are successful
- Lower than expected returns

Educational Toys

- Tend to have a longer life cycle and consumers can justify the higher-pricing

- In 2009, sales of learning and exploration toys **outsold** the overall sales of traditional toys. (NPD Group; TIA)

Online Gaming

- One of the fastest growing segments of the electronic gaming industry
- Greater social interaction
- Enable chat and voice conversations
- Downloadable games from the Internet
 - Consumers find it convenient
 - Game developers save on packaging costs
 - Projected revenue is estimated to **increase ten times** from 2008 to 2013

Gaming Consoles

- Current consoles allow access to the Internet, play movies and music, and enable chat aside from the game itself
- Have become media centers and will determine next generation console advances

Targeting Grandparents and Upper-Middle Class

- Purchase about **25%** of all U.S. toys sold annually (TIA)
- Baby boomer generation has more disposable income to indulge grandchildren
- Upper-middle class is more indulgent since many are dual income households

Targeting Tweens (ages 9-12)

- Toy manufacturers last chance of marketing to this target group before reach teenage years
- Look for toys that are integrate technology, fashion, sports, and music

Source: First Research: Toy Manufacture – June 7, 2010