

VTECH/LEAPFROG MERGER INQUIRY

Summary of hearing with TOMY on 10 October 2016

Background

1. Tomy said it held a broad portfolio of products but that it focused on the preschool market. It said its major selling brands were Lamaze, a nursey plush range for ages up to 18 months, and Tomy brand floor and bath toys for ages 18 months to three years. Tomy said its other product ranges included Aquadoodle and Megasketcher, which were arts and crafts toys for ages three to four. It said these four brands made up the most significant segment of its business.
2. Tomy said that its other product lines included Pokemon toys (a boys' action line) for ages up to eight or nine, Britain's brand of die-cast collectible tractors and farm implementation, and preschool games such as Pop-Up Pirate and Screwball Scramble.

Product overlaps

3. Tomy said age was one way to segment the toy market. It said that the physical and cognitive development of different age groups determined whether reading, complicated rules, turn-taking or physical dexterity were incorporated into play patterns, and resulted in obvious breaks in toy categories
4. Tomy said other market segmentations included gender, licenses and play locations, as well as standalone categories such as construction and arts and crafts. It said that retailers widely followed the categories set by market research company NPD.
5. Tomy said that electronics could be used either to augment the reward experience of play patterns with sound and lights, or to drive the play pattern in a way that could not be done without electronics. Tomy said that consumers looked for a toy for a particular play pattern, and the electronics provided some added value (but would also have a higher retail price). At one time electronics was an amazingly effective way to add value to a play pattern, but now it is commonplace.

6. Tomy said some of its products included motors, lights and sounds, would be classified as electronic, but that a product's design was determined by the desired play pattern. It said that language-specific programming, sound chips and screens, were costly investments when producing electronic toys, and would need to be considered with the commercial reality of that toy
7. Tomy believed that a consumer of the Tomy infant and preschool toys was not looking for electronic toys, but for classic play. Tomy said some consumers preferred physical toys as they stimulated the imagination and provided a greater degree of physical response. It said the classic play patterns featured in its Tomy preschool range were not based on electronics but on clockwork, and pull back or wind up mechanisms or other non-electronic quirks to give a reward.

Development and product pipeline

8. Tomy said it monitored the market leaders in the preschool toy category (Fisher Price is very much the leader) to understand how they are behaving, and trends to plan its product development, and category management from a retailer perspective to obtain a balanced offer.
9. Tomy said it did not consider VTech or LeapFrog to be direct competitors to its Tomy infant and preschool toys. Both had an element of 'cause-and-effect play', but VTech take play patterns and add electronics to them, positioning themselves as having some kind of technological added value, and using electronics as a differentiator.
10. In contrast, Tomy said that the Tomy brand emphasised physical rewards because it believed physical cause-and-effect design was more rewarding than its electronic equivalent.
11. Tomy said that the use of licenses was becoming more prevalent in the preschool toy market. It said over one third of the toy industry was licensed. It said licenses such as Bob the Builder, Peppa Pig, My Little Pony, and even Transformers, were coming down in age in the way they are presented to be appealing to the preschool market.
12. Tomy said that licenses were widely available but that selecting the right one was a difficult commercial decision. It said most license properties were derived from television series or movies. It said manufacturers were at risk as they often had to secure license agreements when it was still unknown whether the licenced property itself would be successful. It said larger manufacturers could better manage this risk as they were likely to have a diversified portfolio of licences.

13. Tomy said it intended to maintain its current brand strategy, but that there was always the option for further thematic innovation to keep play patterns fresh. It said, however, there was a limit to play pattern innovation owing to the relatively tight age span in which it operates.

Contract/supply agreement negotiation

14. Tomy said there was a well-established seasonality to the toy industry. It said it conducted its negotiations with retailers every summer and autumn. It said negotiations typically began in July with a preview of the offerings that would be available for the following January. It said discussions centred on a business plan detailing the objectives, terms of scale, the opportunities of products, and why retailers should maintain certain products. Tomy said it repeated the process in October for the following autumn's product line. It said the two processes together formed a full-year business plan with a specific retailer.
15. Tomy said that retailers repeated the process with various toy manufacturers and conducted an internal selection process led by a merchandising director. It said retailers settled on a particular portfolio of products and informed manufacturers whether or not their products were to be included. It said that products could be selected for full distribution across a retailer's entire estate, or a limited run in a specific distribution channel – such as online.
16. Tomy said the negotiation process was dynamic and that failing to secure a product's selection did not preclude its further negotiation and inclusion in the next season.
17. Tomy said that retailers were bound to varying degrees to the seasonality of the toy market. It said retailers that specialised in toys, such as Toys R Us or Smyths, were often more flexible as they could refresh their product lines any time of the year. It said specialty toy retailers did not have to undergo as dramatic a seasonal change as retailers with a toy department, such as supermarkets.
18. Tomy said that there was considerable competitive pressure to get a product listed and onto the shelf of a retailer. It said Toys R Us and Argos were among the largest retailers with the broadest portfolio of products, but that no brick-and-mortar retailer was able to accept every product produced by toy manufacturers. Tomy said that retail distribution was crucial to provide the necessary volumes to make production commercially viable.
19. Tomy said that online retailers, such as Amazon, were often not limited in the portfolio of products they could list. It said online retailers accepted a broader

range of products and the barrier to listing a product was lower. It said the challenge with online retailers was differentiating a product in a market environment of nearly limitless options. It said in this scenario promotion and marketing were particularly important.

20. Tomy said that it was aware of who its historical competitors were and could use historic trends to predict how they might act. It said, however, that it was not aware of the new products its competitors were designing, licencing, and launching. It said it also did not know beforehand if there were new entrants in the market.
21. Tomy said manufacturers with a desirable and unique product were in a strong position with retailers to negotiate higher prices. It said manufacturers who produced generic products were in a weaker position and retailers may leverage the wide availability of the product to offer low prices.
22. Tomy said aside from price considerations, retailers and manufactures could also negotiate over promotional and marketing requirements – such as television campaigns, instore or catalogue promotions – and other factors including rebates and growth incentives.

End consumer behaviour and branding

23. Tomy said that manufacturers whose brands were established in particular categories of products were typically responsible for most of the advertising, and also pursuing innovative new product designs in their respective areas.
24. Tomy said it was not easy for a new or lesser known brand to grow in the toy market. It said for a product to be successful it had to differentiate itself, hold wide appeal and be able to afford to market the product to tell people about it.

Final remarks

25. LeapPad tablets are in a currently struggling category, given the availability of cheap fairly good quality tablets and 'hand-me-downs' as parents upgrade. Tomy believed LeapPad hit on a particular trend and did well to keep going as long as they did in that particular category.
26. Tomy said that it typically had concerns when any market consolidation occurred affecting negotiating power. A fragmented, fluid market was better for Tomy.