

VTECH/LEAPFROG MERGER INQUIRY

Summary of hearing with Toys R Us on 28 September 2016

Product Choice

1. Toys R Us stated that it had the largest footprint of stores in the UK and, within its stores, it offered a greater range of depth than any other bricks-and-mortar retailer.
2. Toys R Us told us that the Toys R Us website was an important source of information in identifying customer demand and data from the website would feed into range development and product purchases. Toys R Us told us that its vendors produced a large amount of trend analysis and the US-based segment of Toys R Us carried out a lot of work analysing global trends of brands such as Mattel, Hasbro and Lego. Others, such as VTech, would be analysed on a regional basis.
3. Toys R Us said that the toy industry was seasonally driven and forecasts were made on the basis of incomplete and small amounts of information. It highlighted that, in some cases, purchasing decisions were made while a product was in development.

End consumer behaviour and branding

4. Toys R Us told us that it had data that showed around 40% of consumers had researched the toy they wished to purchase online, a similar percentage knew which area they were looking at, and 20 to 25% of people just wanted to buy something with a target end consumer in mind. Toys R Us said that, in the pre-school and infant market, the product was selected by the parent or gift-giver whereas in the older age categories, the product was typically selected by the recipient, who sought a particular brand, licence or type of product.
5. Toys R Us told us that products for infants were typically driven by the desire of the purchaser to acquire either a branded product or a type of product with a learning dimension. Toys R Us told us that they had not seen any evidence to show that customers first decide they want an electronic infants' toy.
6. Toys R Us said that the grouping of products in Toys R Us stores was determined by age range and that, within age ranges, there were sub-groupings by licence, brand or vendor or usage eg bath toys, music.

7. Toys R Us told us that the target age grade or range of individual items was fundamental within infant and pre-school toys. The choice of toy for toddlers or pre-school children was largely driven by what the gift-giver believed a child should be learning at a certain point in their development. For older children, this aspect was relatively unimportant.
8. Toys R Us told us that children were exposed to tablets and phones at a very young age and parents looked for products that were more age-appropriate, safer and robust. Other items, such as cameras and watches, had evolved to become functional but simplified versions of adult products. Toys R Us believed that although people had tried to make these applicable to older age groups, they were only attractive up to about age five.
9. Toys R Us told us that child tablets were targeted at the parents of younger children and were purchased for their durability and appearance (ie they are intended to look less like an infant's toy).
10. Toys R Us told us that the market for child tablets had decreased, primarily due to price reductions on conventional tablets. Other factors that had contributed to the decline were the advent of devices passed from adults to children ('hand-me-down' devices) especially as adult devices had developed, and the availability of a wider range of cheaper/free software via retailers such as Apple.
11. Toys R Us said that a further reason for the failure of child tablets was the desire to extend the age range for which they were appropriate. Tablets moved from being very 'kiddie' orientated to targeting eight to ten year olds and this transition led to competition against cheaper, adult products that offered a comparable level of functionality. Toys R Us told us that it stocked cheap adult tablets in its stores, but a more limited range than it used to.
12. Toys R Us told us that LeapFrog did not foresee the contraction in demand and the arrival of cheap products in the tablet market. When it launched the next evolution of its product about two years ago which retailed at around £100, it was competing against products retailing at nearly a third cheaper. With the exception of the Amazon Kindle Fire, which offered excellent functionality, the decrease in sales was not unusual in the tablet market.

Contract/supply agreement negotiation

13. Toys R Us told us that VTech and LeapFrog negotiated in a similar manner. Negotiations and previews of products to be sold in the autumn/winter season were started in autumn of the previous year. Final negotiations would be

concluded by the end of January, early February, as where decisions on promotional activities such as price promotions and media activity.

14. Toys R Us told us that the final stage in the negotiating process would be the finalisation of launch volumes and post-launch activities. Vendors had access to sales data and would approach Toys R Us with promotional proposals, such as price promotions or requesting space in Toys R Us catalogues.
15. Toys R Us said that marketing and promotional spend were the main terms negotiated over. [X], usually products that had television exposure.
16. Toys R Us told us that, as part of its negotiating proposal, it could offer manufacturers a number of benefits from working with a large retailer, such as range, distribution, exclusivity and retail space.
17. Toys R Us said that it had a distribution list for its catalogues of around five million customers, who received new iterations two or three times a year ([X]). It highlighted that many of these customers would actively shop for products in-store and, with a proportion of these customers unsure of the product they wanted, Toys R Us could offer products greater visibility or a greater range distribution, particularly in smaller stores.
18. Toys R Us told us that it would favour a manufacturer not necessarily because the manufacturer offered a better price for a product, but because it would actively promote and stimulate demand for its product. The fact that a manufacturer offered a stronger promotional package could be used by Toys R Us in its negotiations with manufacturers. As well as price, vendors would offer advertising, backup in terms of defects, and any additional differentiation for the store (such as a new colourway or additional value bundle pack).
19. Toys R Us said that it would consider removing a vendor in instances where the level of support offered was low or if the range was not considered viable. It also told us that there was a fundamental difference between Toys R Us actively selling something and stocking something.

Entry and expansion by toy manufacturers

20. Toys R Us believed a number of infant and pre-school vendors would see the merger of VTech and LeapFrog as an opportunity in what was a growing and reliable category. For electronic learning toys (by which it meant tablets, laptops cameras, watches, reading systems etc), there was probably less scope as it was a declining sector and the barriers to entry were greater.
21. The infant and pre-school market can be split into non-licensed and licensed. The growth in the non-licensed part is driven by innovation and development

of exciting interactive (ie interacting with the child) products, resulting in products satisfying and exceeding customers' expectations, rather than necessarily that customers buy more toys. The growth in the licenced market is due to phenomenal success of certain licences within the pre-school arena (such as PAW Patrol).

22. Toys R Us told us that it did not see any reason why it could not switch from VTech and LeapFrog products to other manufacturers' toys.
23. Toys R Us told us that electronic learning toys was a challenging area for manufacturers. VTech, and to a lesser extent LeapFrog, had performed well. Vendors such as KD Group and Kurio did offer an alternative, but others, such as Samsung, were not very successful.
24. Toys R Us said that VTech and LeapFrog had historically been good at pitching the functionality and price of its products and it was the inability of other manufacturers to match this that had limited the success of these other manufacturers.
25. Toys R Us told us that LeapFrog had a strong presence in electronic reading systems, via its LeapReader and LeapStart products. Within the UK, no one had developed a true reading system (as opposed to some level of interactivity on a traditional page-turning book). In Europe, Ravensburger, in collaboration with TipToi, had launched a successful true reading system, but had chosen not to bring it to English speaking markets. Ravensburger was not minded to bring the product to the UK, despite being encouraged by Toys R Us.
26. Toys R Us said that traditional books and tablets such as iPads offered alternatives to electronic reading systems. There were a number of apps that existed to help children read and which offered more sophisticated help with grammar and spelling.
27. Toys R Us told us that if the proposition offered by VTech and LeapFrog worsened, if for example there was no investment in their products, it could decide not to support the brand and look at alternative products. It said that electronic learning was not a large part of its product base and did not generate much sales or profitability.
28. Toys R Us told us that toddler and pre-school toys were a growing sector and could be separated into two areas, the licensed and non-licensed parts. Toys R Us said that the non-licensed sector was driven by innovation and development (via brands such as Chicco and Fisher-Price) while the licenced sector was driven by the success in the pre-school arena of licenses such as PAW Patrol.

Innovation

29. Toys R Us told us that it would like to see companies with the correct proposition try to develop the tablet market. The initial success of child tablets came from the ability to emulate adult products, price and functionality. As time has moved on, the prices of adult tablets decreased, while the new versions of child tablets remained stable, which was not an attractive offer. Children were exposed to 'hand-me-down' electronics from their parents and apps for popular tablets such as iPads were cheaper than software for LeapFrog and VTech products.

Effects of the merger

30. Toys R Us said that it did not have any concerns regarding the merger. The infant and pre-school markets were buoyant and a lot of competition existed and, in any case, the long-term viability of LeapFrog with regards to tablets was questionable.