

# **Completed acquisition by VTech Holdings Limited of LeapFrog Enterprises Inc.**

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Glossary

## Terms of reference and conduct of the inquiry

### Terms of reference

1. On 30 August 2016, the CMA referred the completed acquisition by VTech Holdings Ltd (VTech) of LeapFrog Enterprises, Inc. (LeapFrog) for an in-depth phase 2 inquiry.
  1. In exercise of its duty under section 22(1) of the Enterprise Act 2002 (the **Act**) the Competition and Markets Authority (**CMA**) believes that it is or may be the case that:
    - (a) a relevant merger situation has been created, in that:
      - (i) enterprises carried on by VTech Holdings Ltd (**VTech**) have ceased to be distinct from enterprises carried on by LeapFrog Enterprises, Inc (**LeapFrog**); and
      - (ii) the conditions specified in section 23(2)(b) of the Act are satisfied; and
    - (b) the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition within a market or markets in the United Kingdom for goods or services, including in relation to the supply of toddler electronic learning toys, child laptops/tablets and child electronic reading systems in the UK.
  2. Therefore, in exercise of its duty under section 22(1) of the Act, the CMA hereby makes a reference to its chair for the constitution of a group under Schedule 4 to the Enterprise and Regulatory Reform Act 2013 in order that the group may investigate and report, within a period ending on 13 February 2017, on the following questions in accordance with section 35(1) of the Act:
    - (a) whether a relevant merger situation has been created; and
    - (b) if so, whether the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition within any market or markets in the United Kingdom for goods or services.

**Kate Collyer**  
**Deputy Chief Economic Advisor**  
**Competition and Markets Authority**  
**30 August 2016**

## Conduct of the inquiry

2. We published [biographies](#) of the members of the inquiry group conducting the phase 2 inquiry on 30 August 2016 and the [administrative timetable](#) for the inquiry was published on the inquiry case page on 16 September 2016.
3. We invited various third parties to comment on the Merger. These included competitors, customers, potential bidders and advisers to VTech and LeapFrog. Evidence was also obtained from third parties through hearings, telephone contact and written information requests. Non-confidential versions of the [summaries of hearings](#) with third parties are published on the inquiry case page.
4. We received written evidence from the Parties and non-confidential versions of their [main submissions](#) are on the inquiry case page. We also held hearings with the Parties, including separate sessions with VTech and former LeapFrog staff on 17 November 2016.
5. On 16 September 2016 we published an [issues statement](#) on the inquiry case page setting out the areas of concern on which the inquiry would focus.
6. On 5 October 2016 members of the inquiry group, accompanied by staff, attended a presentation by VTech and LeapFrog at the offices of LeapFrog.
7. In order to prevent actions that may impede any remedial action taken or required by the CMA following its phase 2 inquiry, on 8 September 2016, we imposed an interim order under section 81(2) of the Enterprise Act 2002 on VTech in relation to the acquisition of LeapFrog. This replaced the Initial Enforcement Order imposed by the CMA on 12 May 2016 during the initial stage (phase 1) of the CMA inquiry. The inquiry group considered and agreed a number of derogation requests from the parties. The [Interim Order](#) and the [Notices of Derogation](#) are published on the inquiry case page.
8. On 19 September 2016 we directed VTech to appoint a monitoring trustee.
9. Prior to the main party hearing, we sent to VTech and LeapFrog some working papers indicating emerging thinking.
10. Our provisional findings were announced on 9 December 2016 and a non-confidential version of the [provisional findings report](#) was placed on the inquiry case page on 9 December 2016. We invited interested parties to comment on this.
11. Our findings were announced and a non-confidential version of the final report was placed on the [inquiry case page](#) on 12 January 2017.
12. We would like to thank all those who have assisted in our inquiry.

## Merger background

1. In this appendix we outline the process that led to the sale of LeapFrog to VTech, discuss the Parties' stated rationale for the deal and look at the details of the Merger.

### Merger overview

2. On 4 April 2016, VTech acquired LeapFrog.
3. VTech informed the CMA that the merger was not notified to any competition authority but that the US Federal Trade Commission launched a voluntary investigation into the Merger, which it closed on 28 March 2016.
4. The acquisition by VTech was for 100% of the outstanding common stock of LeapFrog at \$1 per share through an all-cash tender. The aggregate consideration was approximately \$72 million.

### Appointment of Morgan Stanley 2015

5. In March 2015, as a result of concerns about the company's poor financial performance and an unsolicited offer of \$4.19 to \$4.90 from Bidder 1, the LeapFrog board established a Strategy Committee, comprising a smaller number of board members, to evaluate possible alternative strategic approaches to improving stockholder value, and to report to the board on the results of its deliberations.<sup>1</sup>
6. In April 2015, the Strategy Committee recommended to the board that LeapFrog move forward by retaining Morgan Stanley. Morgan Stanley was formally appointed in May 2015 as LeapFrog's financial adviser.
7. During June 2015, Morgan Stanley met senior management and members of the LeapFrog board to review its business and to consider its historical and potential operating performance and its plans.
8. The Parties told us that, on 29 June 2015, Morgan Stanley presented the preliminary results of its review to the LeapFrog board. It recommended that LeapFrog should:
  - (a) focus its exploration of strategic alternatives on a sale process; and

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<sup>1</sup> United States Securities and Exchange Commission, Schedule 14D-9 (Rule 14d-101) Solicitation/ recommendation statement, LeapFrog Enterprises, Inc. (Schedule 14D), p12.

- (b) continue to explore other alternatives in the event that a sale was not successful, including opportunities to reduce costs further, divest or license certain assets, and/or restructure the business.
9. Following Morgan Stanley's presentation, the LeapFrog board directed senior management to prepare additional, revised operating plans and forecasts for the company that would focus on controlling overheads, reduce operating costs by addressing staffing levels and other factors, preserve liquidity, and pursue product development efforts that could lead to increased revenues during the 2017 holiday season.
10. At the same time, the board requested Morgan Stanley to take steps to explore a potential sale of the company, a process which ultimately ended in an agreement with VTech Holdings Limited. Below we discuss the steps that led to the sale of the business to VTech.

### **The sale process**

11. The Parties provided us with a detailed timeline and description of the sales process, and a summary of the interactions between LeapFrog and its advisers with key interested parties. We corroborated this evidence with third parties.
12. LeapFrog was advised by Morgan Stanley that a sale of the entire company would likely yield more value than a break-up sale of assets. Representatives of Morgan Stanley prepared a preliminary analysis of potential outcomes if the Company were liquidated, based on assumptions provided by the Company. The analysis calculated that liquidation was not likely to return more than \$0.75 per share.<sup>2</sup>

### **Potential purchasers**

13. On 21 July 2015, Morgan Stanley contacted 53 parties (including Bidder 1 and Bidder 2) of which 25 were strategic parties and 28 private equity firms. Morgan Stanley subsequently distributed a confidential Information Memorandum to 25 parties including 9 strategic parties and 16 private equity firms.
14. Between July 2015 and November 2015, there were Indications of interest from various potential buyers who conducted various degrees of due diligence on LeapFrog.

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<sup>2</sup> [Schedule 14D-9](#), p16.

15. Between 10 and 14 September 2015, Morgan Stanley received firm indications of interest from two strategic parties (Bidder 1 and Bidder 2) and two private equity firms (Bidder 3 and Bidder 4).
16. The Parties submitted that, during the week of 16 November 2015, LeapFrog met 12 strategic parties and private equity firms in [REDACTED]. Several of these firms subsequently executed non-disclosure agreements with LeapFrog and received information from Morgan Stanley concerning the business as well as a process timeline. These firms included Bidder 5, Bidder 6 and Bidder 7.
17. An unsolicited offer was received from Bidder 8 on the 22 March 2016. Table 1 summarises the most relevant potential buyers of LeapFrog.

**Table 1: Identities of parties that submitted indications of interest**

<i>Reference*</i>	<i>Company</i>
Bidder 1	[REDACTED]
Bidder 2	[REDACTED]
Bidder 3	[REDACTED]
Bidder 4	[REDACTED]
Bidder 5	[REDACTED]
Bidder 6	[REDACTED]
Bidder 7	[REDACTED]
Bidder 8	[REDACTED]

\* References in this appendix will not be to the company names for commercial confidentiality reasons.

18. The details of bidders 1 to 8 are discussed in Appendix C: Counterfactual.

### ***VTech timeline***

19. In relation to VTech's interest in LeapFrog, we understand that the key events were as follows:
  - (a) On 15 December 2015, VTech submitted an Indication of Interest to acquire LeapFrog for \$1.00 per share.
  - (b) On 31 December 2015, a purchase agreement proposed by LeapFrog was submitted to VTech for comment.
  - (c) On 22 January 2016, VTech submitted a detailed mark-up of the purchase agreement and tender and support agreement.
  - (d) On 27 January 2016, representatives of the LeapFrog board and Morgan Stanley met representatives of LeapFrog's Class B shareholders and outlined the terms of a potential transaction with VTech.
  - (e) On 5 February 2016, VTech and LeapFrog issued a joint press release announcing the execution of the Merger Agreement. VTech agreed to acquire 100% of the outstanding common stock of LeapFrog for \$1.00 per

share for LeapFrog's Class A and Class B shares and the total purchase consideration was around \$72 million.

## **The acquisition of LeapFrog by VTech**

### ***Rationale for the Merger***

#### ***LeapFrog***

20. LeapFrog's rationale for the merger was due to the financial health of the company and forecast liquidity issues that arose due to poor performance largely attributable to poor sales following the launch of LeapTV and declining sales of tablets.
21. Morgan Stanley was engaged by the LeapFrog board to help advise on how to turn LeapFrog's performance around and explore a sale process.<sup>3</sup> [REDACTED]
22. Further detail on the financial difficulties at LeapFrog Inc. are detailed in the counterfactual Appendix C.

#### ***VTech***

23. VTech did not prepare extensive internal documentation prior to the decision to purchase LeapFrog. [REDACTED]:

(a) [REDACTED]

(b) [REDACTED]<sup>4</sup>

#### ***Commercial, strategic and operational considerations***

24. In the Parties' initial submission, VTech described the decision to acquire LeapFrog as being driven by the following considerations:<sup>5</sup>

(a) [REDACTED]

(b) the efficiencies to be derived from capitalising on VTech's [REDACTED] capabilities [REDACTED];

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<sup>3</sup> Schedule 14D-9.

<sup>4</sup> [REDACTED]

<sup>5</sup> Initial submission, paragraph 66.

- (c) the enhancement of VTech's educational learning portfolio [REDACTED] via the acquisition of LeapFrog's complementary toy line, R&D team, content development team, learning specialists [REDACTED]; and
  - (d) [REDACTED]
- 25. VTech told us that it had a good understanding of the LeapFrog businesses. In particular, [REDACTED].
- 26. In addition, as LeapFrog is listed on the New York Stock Exchange, its business and financial condition were easily understood by VTech.
- 27. The [REDACTED] papers presented to the board of directors, senior management and shareholders showed [REDACTED].
- 28. In spite of this [REDACTED].
- 29. It was agreed at the [REDACTED].
- 30. VTech's investor presentation for its 2016 results<sup>6</sup> highlights three strategic reasons for the strategic acquisition of LeapFrog:
  - (a) 'Broaden product portfolio.'
  - (b) 'Eliminate costs and investment for competing with LeapFrog.'
  - (c) 'Strengthen global leadership.'
- 31. In the initial submission it states that VTech's [REDACTED].

## **Details of the Merger and valuation of the companies**

### ***The completed Merger***

- 32. The acquisition was via a purchase of shares as opposed to alternatives such as an acquisition of assets. As such, once VTech had acquired greater than half of the voting rights it would have effectively had control of the global LeapFrog business.
- 33. A sale of shares meant that the deal was not structured on a country by country basis.

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<sup>6</sup> See [Conference Call – Acquisition of LeapFrog](#) (15 April 2016), slide 16.



34. The Parties informed us that the merger was not notified to any competition authority but that the US Federal Trade Commission launched a voluntary investigation into the Merger, which it closed on 28 March 2016.
35. The Merger was executed via a two-step acquisition allowing VTech to gain control of LeapFrog quickly.
36. The tender offer commenced on 3 March 2016 and expired on 1 April, 2016. Approximately 56.6% of all issued and outstanding shares of LeapFrog common stock were tendered into the offer and accepted for purchase by Bonita Merger Sub, L.L.C, an indirect wholly-owned subsidiary of VTech Holdings Limited. The tender offer and the merger were completed, effective 4 April 2016; LeapFrog became an indirect wholly-owned subsidiary of VTech.
37. The aggregate consideration for VTech was approximately \$72 million.

### **Valuation**

38. LeapFrog's share price fell below \$1 towards the last quarter of 2015 and stayed below \$1 on average between this date and the acquisition by VTech. LeapFrog's share price had been falling since mid 2013 when the shares were trading at over \$11, see Figure 1 below.

**Figure 1: LeapFrog Enterprises, Inc. historic share price**



Source: [Bloomberg](#).

39. Trading below \$1 per share is in breach of the New York Stock Exchange listing rules. On September 4, 2015, LeapFrog, Inc. announced that it had received a letter from The New York Stock Exchange providing notification that, for the previous 30 consecutive trading days, the average closing price for the company's common stock had closed below the minimum \$1.00 per share. This NYSE Delisting Notice stated that for continued listing on The

New York Stock Exchange under the NYSE Company Manual, the Company had six months in which to regain compliance.

40. In considering the assets within the LeapFrog business, we note that VTech assessed the assets and liabilities within LeapFrog in order to value the goodwill on purchase. [REDACTED]

**Table 2:** [REDACTED]

[REDACTED]

41. Excluding elements that make up working capital it is cash and cash equivalents (about \$[REDACTED] million) and the brand (about \$[REDACTED] million) which appear to be the greatest individual assets in LeapFrog. The low level of fixed assets is due to reliance on leasing and the use of third parties in the manufacturing of the toys.

## Counterfactual

1. This appendix sets out additional evidence provided in relation to the counterfactual to the merger. For ease of presentation, we have grouped the evidence by reference to limbs 1 and 2 of the 'exiting firm scenario'.

### **Limb 1 – Would LeapFrog have exited (through failure or otherwise) in the absence of the merger?**

#### ***The Parties' views***

2. The Parties submitted that LeapFrog was failing financially for the following reasons:
  - (a) [REDACTED] In its most recent financial report prior to the merger, LeapFrog reported comprehensive losses of \$[REDACTED] for the nine-month period ending 31 December 2015. This followed losses of \$[REDACTED] for the same period in 2014.
  - (b) [REDACTED]
  - (c) LeapFrog's share price fell below \$1 in September 2015 which put in jeopardy its listing on the New York Stock Exchange.
  - (d) LeapFrog's own cash flow estimates predicted [REDACTED]. LeapFrog's December 2015 10Q report said that liquidity existed for the first two quarters of the year beyond which the ability to continue as a going concern was in 'substantial doubt'.<sup>1</sup>
  - (e) Bank of America Merrill Lynch (BofA), LeapFrog's primary source of credit, was highly unlikely to cover this period of negative cash flow as BofA imposed a [REDACTED] restriction on the facility and reserved the right to restrict all drawdowns on the facility.<sup>2</sup>
  - (f) One of LeapFrog's stockholders, Blue Pacific Partners, in an open letter to the LeapFrog board dated 15 July 2015, criticising the LeapFrog leadership, concluded that 'LeapFrog is not positioned to withstand

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<sup>1</sup> LeapFrog 10-Q, p7.

<sup>2</sup> [REDACTED]

multiple years of large financial losses' and demanded a change in the strategy and management of the company.<sup>3</sup>

3. The Parties told us that numerous steps had been taken to turn the business around without success:
  - (a) reducing its headcount by approximately 45% between January 2015 and March 2016;
  - (b) deferring the development of new products;<sup>4</sup>
  - (c) reducing other budgeted spend, such as advertising costs; and
  - (d) freezing recruitment, and not replacing employees who left.
4. The Parties told us that there was a contingency plan of voluntary liquidation in mid-2016 as indicated by LeapFrog's Securities and Exchange Commission (SEC) filing declarations and LeapFrog's belief that there would be insufficient liquidity available to fund its operations during the first two quarters of the 2017 financial year and hence there was substantial doubt about LeapFrog's ability to continue as a going concern.
5. The Parties submitted an analysis using the Altman Z Score, which is a credit-strength test that gauges a publicly traded company's likelihood of bankruptcy within a foreseeable time frame. [REDACTED]

**Table 1: LeapFrog Altman Z score**

[REDACTED]

6. The conclusion was [REDACTED].

### ***Third party views***

#### ***Bank of America Merrill Lynch<sup>5</sup>***

7. BofA provided LeapFrog with a seasonal, revolving credit facility of up to \$[REDACTED] during the peak Christmas holiday season and up to \$[REDACTED] during the remainder of the year.
8. The facility was not meant to be used to fund day-to-day working capital, but was intended to be a last resort facility. In 2015, LeapFrog drew down \$[REDACTED]. This was paid back after the 2015 Christmas period. Prior to that, the last time

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<sup>3</sup> See announcement of 15 July 2015: '[Blue Pacific Partners Delivers Letter to Leapfrog Board](#)'.

<sup>4</sup> LeapFrog 10-Q, p7.

<sup>5</sup> [REDACTED]

LeapFrog withdrew large sums in excess of \$[REDACTED] from the facility was in 2011.

9. BofA stated that LeapFrog, told it LeapFrog would probably have defaulted on its covenants by June 2016 if it had not obtained liquidity. LeapFrog's 10Q statement<sup>6</sup> noted the concerns around LeapFrog's ability to continue as a going concern. BofA told us that it agreed with LeapFrog's assessment that a liquidity crisis was likely absent further action by LeapFrog. [REDACTED]
10. BofA recognised that LeapFrog had cut costs where possible yet this had not restored profitability as its problems revolved around lower than anticipated sales of three big products in the 2014 and 2015 holiday season. LeapFrog was left with a large inventory which it had to sell off at reduced margins.
11. [REDACTED]
12. [REDACTED]

#### *Morgan Stanley*

13. Morgan Stanley's advice with respect to LeapFrog's strategic alternatives is described in detail in LeapFrog's Schedule 14D-9 filed with the SEC.<sup>7</sup>
14. The Schedule 14D-9 notes:
  - (a) the insufficient sources of liquidity or financing to fund its operations in the intermediate and long term; and
  - (b) the lack of strategic alternatives to entering into a transaction involving the sale of the Company.
15. Morgan Stanley told us [REDACTED].

#### *Shareholders*

16. As early as July 2015, some shareholders were publicly criticising the direction the company was taking (see paragraph 2(f)).<sup>8</sup>

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<sup>6</sup> A 10Q statement is a quarterly report mandated by the US federal SEC, to be filed by publicly traded corporations.

<sup>7</sup> [Schedule 14D-9](#).

<sup>8</sup> See announcement of 15 July 2015: '[Blue Pacific Partners Delivers Letter to Leapfrog Board](#)'.

### **Further evidence on LeapFrog's finances**

17. It is evident from the LeapFrog Group financial accounts that LeapFrog had been loss-making since the 2014/15 financial year, as shown in Table 2 below. Accordingly, net assets fell between March 2014 and December 2015 from \$[REDACTED] million to \$[REDACTED] million by 2016.

**Table 2: LeapFrog income statement by quarter March 2014 – December 2015 in \$million\***

[REDACTED]

Note: Based on 10-Q and 10-K submissions, with Q1 2015 calculated from 10-k for fiscal year ended March 31 2015.

18. [REDACTED]

**Table 3: LeapFrog worldwide performance by product type, financial year April 2015 - March 2016. (\$'000)<sup>9</sup>**

[REDACTED]

19. [REDACTED]<sup>10</sup>

20. Despite actions to cut costs as outlined, losses continued. [REDACTED]

**Figure 1: Projected range of LeapFrog's cash balance, [REDACTED]<sup>11</sup>**

[REDACTED]

21. [REDACTED]

### **Limb 2 – Would there have been an alternative purchaser for the firm or its assets to the acquirer under consideration?**

#### **Background**

22. Morgan Stanley told us that around 60 potential bidders were contacted during the initial sales process for LeapFrog. By October 2015, all but one potential bidder had withdrawn from the process and this potential bidder withdrew in early November 2015. Given these circumstances, the LeapFrog board and senior management met with Morgan Stanley on 1 November 2015 to discuss the status of the process. At this meeting, it was concluded that LeapFrog should (a) initiate contact with VTech; and (b) pursue other financing and strategic opportunities in [REDACTED], in order to generate additional options for LeapFrog.

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<sup>9</sup> [REDACTED]

<sup>10</sup> [REDACTED]

<sup>11</sup> [REDACTED]

23. During the week of 16 November 2015, LeapFrog met 12 strategic parties and private equity firms in [REDACTED]. Several of these firms subsequently executed non-disclosure agreements with LeapFrog and received information from Morgan Stanley concerning the business as well as a process timeline.
24. Table 4 below summarises the most relevant potential buyers of LeapFrog.

**Table 4: Identities of parties that submitted an Indication of interest**

<i>Reference</i>	<i>Company</i>
<b>Phase 1</b>	
Bidder 1	[REDACTED]
Bidder 2	[REDACTED]
Bidder 3	[REDACTED]
Bidder 4	[REDACTED]
<b>Phase 2</b>	
Bidder 5	[REDACTED]
Bidder 6	[REDACTED]
Bidder 7	[REDACTED]
Bidder 8	[REDACTED]

### ***Stage 1 of the bidding process – pre November 2015***

#### ***Bidder 1***

25. On 10 September 2015, Bidder 1 made an Indication of Interest at \$2.20 per share later revised to \$1.10 per share and accompanied by a detailed mark-up of a draft purchase agreement but withdrew its Indication of Interest and terminated discussions with LeapFrog on 6 November 2015 indicating that it believed that in addition to the purchase price, substantial funds would be required to stabilise LeapFrog, and that it was not willing to accept the business risks associated with an undertaking of this magnitude.
26. Bidder 1 indicated to us that it might have been interested in purchasing assets, including the brand, from LeapFrog in a bankruptcy proceeding if the opportunity were to arise in the future.

#### ***Bidder 2***

27. On 12 September 2015, Bidder 2 made an Indication of Interest at \$1.22 to \$1.26 per share. However, on 31 October 2015 it advised that it was unwilling to consider an acquisition of the entire company but could be interested in an acquisition of LeapFrog's brand, toy business and interactive reading business for a total consideration of \$25–\$30 million. This was not progressed.

### *Bidder 3*

28. Bidder 3's Indication of Interest was the 'lower of market price or \$0.92 per share'. Bidder 3, a private equity firm, was not invited to undertake further due diligence because its offer was substantially lower than other offers received for LeapFrog.

### *Bidder 4*

29. Bidder 4's Indication of Interest was \$1.13 to \$1.27 per share but it withdrew on 9 October 2015. Bidder 4, a private equity firm, cited concerns about LeapFrog's ability to deliver its product pipeline and the scale of LeapFrog's infrastructure relative to its existing and potential revenues.

## ***Stage 2 of the bidding process – post November 2015***

### *Bidder 5*

30. On 23 December 2015, Bidder 5 presented an Indication of Interest to acquire LeapFrog for \$0.85 per share. Bidder 5 was invited to engage in further due diligence and to schedule sessions with LeapFrog's senior management. Representatives of Bidder 5 met LeapFrog's senior management in January 2016 and commenced due diligence using legal and financial professional service firms.
31. On 29 January 2016, Bidder 5 withdrew its Indication of Interest and submitted a non-binding offer to purchase a majority stake in LeapFrog with an investment of \$65 million in exchange for a new series of preferred stock.
32. Bidder 5 told us that it was a financial investor whose strategy focused on looking for firms with the opportunity to expand in the [X]. It was surprised to learn on 5 February 2016 that LeapFrog had accepted VTech's offer as it had thought it was still in with a chance of having its bid accepted.
33. Bidder 5 indicated that it considered itself a serious bidder for LeapFrog, which was evidenced by:
- (a) submitting a detailed second round bid;
  - (b) making two trips to meet with senior management of LeapFrog; and
  - (c) engaging the services of both a law firm and an accounting firm in New York for legal and financial due diligence work.



34. In its business proposal presentation of 2 February 2016 to Morgan Stanley, Bidder 5 said that its focus would be on the core business (reading and learning toys) to bring the company back to profitability before investing in new opportunities such as subscription services and the [REDACTED].<sup>12</sup> The same presentation said that it planned to stabilise tablet revenues but there was no mention of its plans for its business in the UK or of how these might be developed in the future. There is a general statement by Bidder 5 saying that it would support LeapFrog growth ‘... both domestically and internationally (especially into the [REDACTED] market and new categories)’.
35. Bidder 5 cited its resources and experience to support the growth plan in [REDACTED] under four headings.<sup>13</sup>
- (a) Strong government and public relationships [REDACTED].
  - (b) Deal experience in the [REDACTED] education sector and understanding of local business environment [REDACTED].
  - (c) Bidder 5 [REDACTED] national media and publisher network [REDACTED].
  - (d) Bidder 5’s resources and networks [REDACTED]:
    - (i) [REDACTED]
    - (ii) [REDACTED]
    - (iii) [REDACTED]
    - (iv) [REDACTED]
36. Bidder 5 also told us that it had invested in 18 companies in the USA and, therefore, it believed that it had the necessary experience for such an acquisition<sup>14</sup> and had significant resources at its disposal.
37. Bidder 5 told us that it was fully aware that LeapFrog was loss-making,<sup>15</sup> and although it had not conducted full due-diligence work, it had completed the first phase of legal, accounting and tax due diligence (‘Red-flag’ checks). It remained interested and at no point did it withdraw its bid. It said that its revised offer (of \$65 million) was made in recognition of the fact that the LeapFrog business needed additional funds in order to remain solvent.<sup>16</sup>

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<sup>12</sup> [REDACTED]

<sup>13</sup> [REDACTED]

<sup>14</sup> [REDACTED]

<sup>15</sup> [REDACTED]

<sup>16</sup> [REDACTED]

38. Bidder 5 told us that it expected that the detailed financial, legal and intellectual property due diligence would have taken approximately three weeks and, in its view, because of the simple nature of the transaction, it considered the deal would conclude shortly after this.
39. Bidder 5 told Morgan Stanley<sup>17</sup> that its proposal represented a premium of 33% to the closing market price of LeapFrog's Class A common stock on 28 January 2016 and therefore would be highly attractive to LeapFrog's shareholders. It told Morgan Stanley that the offer had received the necessary approval from the Bidder 5 investment committee and there were no envisaged regulatory impediments.
40. Bidder 5 told Morgan Stanley that the deal was subject to:
- (a) satisfactory completion of business, legal, accounting and tax, insurance, IT and other confirmatory due diligence reviews and discussions with the LeapFrog's management;
  - (b) satisfactory negotiation of definitive transaction documentation containing customary terms and conditions, including standard representations and warranties, covenants, and closing conditions;
  - (c) LeapFrog obtaining of an amendment of or waiver to the change in control provisions contained in LeapFrog's credit facility to ensure continued access to the revolver until its current expiration;
  - (d) final approval from Bidder 5's relevant funds' Investment Committee;
  - (e) regulatory approvals, as required; and
  - (f) 30 days' exclusivity due to the substantial time and resources that Bidder 5 had invested and planned to invest in the deal.

### *Bidder 6*

41. On 13 January 2016, Bidder 6 submitted a proposal to issue equity in LeapFrog at \$1.00 per share, by which Bidder 6 would gain economic and voting control over LeapFrog.
42. As well as making an initial non-binding offer, Bidder 6 had engaged professional advisers and attended an electronic data room in January 2016 to conduct some due diligence.

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<sup>17</sup> [REDACTED]

43. Bidder 6 told Morgan Stanley that it did not at the time have the financing in place to fund the deal, and that its proposal was subject to the approval of several governmental and regulatory agencies and parties and that it would have taken at least five to six months to obtain these approvals and complete the transaction.

#### *Bidder 7*

44. On 14 January 2016, Bidder 7 presented an Indication of Interest to acquire LeapFrog for a purchase price of \$1.20 per share.
45. As well as making an initial offer, Bidder 7 had engaged professional advisers. LeapFrog provided Bidder 7 with a form of purchase agreement, but it took no further action in this regard.
46. Bidder 7 told Morgan Stanley that it did not have the capability of financing its offer but was exploring options. The form of purchase agreement was provided to Bidder 7, who had engaged professional advisers; however, Bidder 7 chose not to conduct on-site diligence meetings with LeapFrog's senior management.
47. Bidder 7 requested an extension to the end of February 2016 to submit a more definitive proposal.

#### *Bidder 8*

48. On 22 March 2016, six weeks after the VTech bid had been accepted and a definitive merger agreement signed, Bidder 8 submitted an unsolicited non-binding proposal to LeapFrog to purchase all of the outstanding Class A and Class B common stock for \$1.10 per share (the March 22 Proposal).
49. Bidder 8 also submitted a draft merger agreement with a suggested closing date of May 23, 2016. Bidder 8 did not conduct any due diligence.
50. We also note that Bidder 8 was related by common ownership to [REDACTED], which had been invited to bid for LeapFrog but did not.
51. The Parties told us that the LeapFrog board were sceptical that Bidder 8's offer was genuine. Bidder 8 did not itself have any assets,<sup>18</sup> and the late stage of the offer made it unlikely that LeapFrog would have been able to accept the offer given its liquidity issues.

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<sup>18</sup> [REDACTED]

52. The LeapFrog board concluded that Bidder 8's offer, in the form received, did not constitute a superior proposal, and would not reasonably be expected to lead to a superior proposal.

*The Parties' views on Bidder 5*

53. The Parties told us that Morgan Stanley undertook extensive marketing efforts to sell LeapFrog. The Parties told us that after initially approaching 53 parties '[w]hen these parties failed to yield any offers, a further twelve parties were approached. Of all these, no serious bidders other than VTech emerged with the capacity to close a transaction before LeapFrog's liquidity crisis was likely to have materialised.'<sup>19</sup>
54. The Parties said that Bidder 5 was not a credible alternative purchaser because:
- (a) Bidder 5's offer was not a firm bid capable of any acceptance and was unlikely to reach that stage. Bidder 5 revising its bid frequently and requesting extensions for the due diligence process illustrated that as the sales process continued, the value of the LeapFrog business was declining both as its financial situation worsened and as Bidder 5 (and other bidders) continued to learn more about the reality of that situation.
  - (b) Bidder 5 appeared not to have any investments or operations in the toy industry and it failed to provide LeapFrog with a proposed operating plan or details of a management team going forward, or provide a budget for costs Bidder 5 expected to incur in restructuring and stabilising LeapFrog. Morgan Stanley advised at this stage that the Bidder 5 deal was not viable. [✂]
  - (c) Bidder 5 had not conducted its full due diligence, nor had it proposed revisions to the transaction documents. Morgan Stanley considered that a longer time period than three weeks would have been required for Bidder 5 to reach a final decision on LeapFrog.<sup>20</sup>
  - (d) The Bidder 5 offer would have required a meeting of LeapFrog stockholders. The Parties believe it would likely have taken at least three months to complete the process, which included preparing and filing a proxy statement with the SEC relating to this meeting, responding to any comments from the SEC on the statement, completing and signing a definitive agreement with Bidder 5 and holding the stockholder meeting.

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<sup>19</sup> Annex 1: Detail on the Appropriate Counterfactual, paragraph 24.

<sup>20</sup> [✂]

LeapFrog's liquidity crisis would have materialised by this point and LeapFrog would not have been able to continue operations.

- (e) A condition of the Bidder 5 proposal was [REDACTED].
- (f) The Bidder 5 proposal offered zero liquidity to the Class B stockholders and LeapFrog considered it was highly unlikely that the Class B stockholders would have been supportive of this as LeapFrog's view was that [REDACTED].

#### *Morgan Stanley's views*

- 55. Morgan Stanley told us the VTech proposal was the most actionable among the proposals that had been received by LeapFrog, because there were concerns as to whether the other interested parties could complete the deal in the necessary time frame, including completing due diligence, arranging the necessary financing, and receiving the necessary governmental, regulatory and other approvals.
- 56. Morgan Stanley told us that [REDACTED].
- 57. Morgan Stanley told us that Bidder 5 submitted a revised proposal in January 2016 which changed the structure of the transaction it was proposing (from a sale of the company to a proposal to invest capital in a new class of stock that would have resulted in Bidder 5 becoming the majority owner). Morgan Stanley also explained that the revised proposal was submitted without a marked-up contract and only provided very high level supporting information for its proposal. Morgan Stanley stated that there were incremental risks to the revised Bidder 5 proposal. In particular, Morgan Stanley explained that the revised proposal was subject to further due diligence and Bidder 5 had not provided a detailed proposal in the form of a marked-up contract as to how the investment would actually work, as well as the risks of requiring a shareholder vote, which the VTech offer did not require. Notwithstanding that the VTech offer was considered superior, Morgan Stanley continued to pursue every available option as long as it could and to the extent available until a definite transaction was reached.<sup>21</sup>
- 58. Morgan Stanley explained that one of the reasons the Bidder 5 offer was more uncertain than that of VTech, was that the deal would have required shareholder approval, which would have raised the incremental risk with regard to the ability to close the transaction.

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<sup>21</sup> [REDACTED]

59. Morgan Stanley documents state that Bidder 5 ‘requested 3 weeks to complete diligence and negotiate definitive documentation’.<sup>22</sup>
60. Morgan Stanley’s documents further state that Bidder 5 requested a period of exclusivity.<sup>23</sup> [REDACTED]
61. VTech had already signed a non-disclosure agreement before Bidder 5 was contacted to gauge interest.<sup>24</sup>

### *Shareholders’ views*

62. The only offer put to shareholders was VTech’s. The largest shareholder was a passive shareholder which had acquired its holding approximately six months prior to the VTech deal completing.
63. The shareholder told us that because the share price had fallen significantly in 2015, that LeapFrog had announced that the company was going through a restructuring and that management was exploring all possible alternatives with regard to enhancing shareholder value, the potential risk versus reward at the then share price made the purchase an attractive financial investment.<sup>25</sup>
64. The shareholder told us that the VTech offer was the only viable offer and that absent this deal, LeapFrog might have had to declare bankruptcy and that shareholders could end up with nothing.<sup>26</sup>

### *Other options*

65. Between 6 and 8 November 2015, LeapFrog met Morgan Stanley to discuss:
- (a) the impact of the termination of Bidder 1’s offer and the prospects for an alternative transaction emerging, including with VTech; and
  - (b) LeapFrog’s financial performance and prospects. The board discussed the company’s financial outlook, including its liquidity over the next 12 months and thereafter, and possible revisions to LeapFrog’s near term operating plan, including a further reduction in workforce and other cost-saving measures.
66. On 12 November 2015, representatives of Morgan Stanley prepared a preliminary analysis of potential outcomes if LeapFrog were liquidated, based

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<sup>22</sup> [REDACTED]

<sup>23</sup> [REDACTED]

<sup>24</sup> See [Schedule 14D-9](#).

<sup>25</sup> [REDACTED]

<sup>26</sup> [REDACTED]

on assumptions provided by LeapFrog. The analysis calculated that liquidation was not likely to return more than \$0.75 per share to shareholders on the basis of these assumptions. The board concluded that a liquidation of LeapFrog would involve considerable time and uncertainty and that, given the importance of continuing to operate the business, it needed to focus on pursuing possible strategic alternatives. It decided that spending further time analysing the impact of a liquidation would be unproductive.

## Review of the Parties' margin-concentration analysis

### Overview of the Parties' analysis

1. The Parties submitted a margin-concentration analysis to consider whether the product markets defined in the issues statement take into account the full set of immediate competitive constraints that would warrant inclusion in a well-defined product market.<sup>1</sup>
2. The analysis sets out whether NPD subclasses are relevant frames of reference to capture the immediate constraints placed on the Parties' products. Furthermore, it considers whether child tablets constitute a relevant market.
3. NPD is a market research company offering consumer and point-of-sale market research for the toys industry. NPD divides its database into super-categories and within each super-category, into segments, and further into subclasses. The Parties overlap within two super-categories: Infant/Toddler/Preschool toys and Youth electronics. Within these super-categories there are segments and subclasses. TEL toys, as defined in the issues statement, and child tablets map into two subclasses, namely Early Electronic Learning and Preschool Electronic Learning.<sup>2</sup> The Parties submitted that the NPD subclass Early Electronic Learning was more narrowly defined than TEL toys as defined by the CMA, and the NPD subclass Preschool Electronic Learning includes more than child tablets.
4. The Parties argued that if the NPD subclasses constituted well-defined product markets, then a significant level of control over them should provide some degree of market power. They provided two hypotheses:
  - A high level of overall concentration in a relevant market should be associated with higher margins. The reason being that higher concentration should result in lower competition and consequently higher profitability.
  - The higher shares the Parties had within a market should be associated with higher margins. The reason being that if a high share was to bestow market power, that would allow the firm that enjoyed higher shares to increase prices.

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<sup>1</sup> Initial submission, Annex 10.

<sup>2</sup> [X]



5. The Parties tested these hypotheses and found no relationship between:
  - the Parties' market share of a given subclass and its gross and net margins within that subclass;
  - the Herfindahl-Hirschman Index (HHIs) within a given subclass and either of the Parties' gross and net margins within that subclass; and
  - the number of significant firms<sup>3</sup> within a subclass and either of the Parties' gross and net margins within that subclass.
6. Also, the Parties analysed margins on individual products supplied by the Parties, regardless of which NPD subclass the products mapped into. They found that [✂].
7. The Parties concluded that their findings were inconsistent with:
  - (a) the NPD subclass Early Electronic Learning being a relevant market; and
  - (b) child tablets (even if defined slightly differently from the Preschool Electronic Learning subclass) being a relevant market.
8. Further, the Parties submitted that the results were strongly suggestive of constraints outside of the narrow NPD subclasses. In regard to child tablets, the Parties submitted that their findings were consistent with a declining segment facing considerable constraints from outside the narrowly defined child tablet segment.

### **Our assessment of whether NPD subclasses constitute relevant markets**

9. The Parties' underlying assumption is that for well-defined markets one would expect to find a positive relationship between concentration and profitability.
10. Not finding such a relationship may indicate that the markets are not well defined. However, there might be measurement issues and/or endogeneity issues that could bias these results. In addition, finding similar margins across different subclasses may as well be an indication of too broadly defined markets as well as the markets being too narrowly defined. Partly due to these kinds of issues, product markets are typically defined by looking at demand-side substitution patterns and not margins.

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<sup>3</sup> Significant firms are firms with market shares of more than 5%.

11. Therefore, our view is that while the results are consistent with the Parties' arguments, they do not, in and of themselves, prove the arguments.
12. In the following sections we discuss measurement issues, endogeneity issues and interpretation in turn.

### ***Measurement issues***

13. As a proxy for profitability, the Parties calculated gross and net margins at product level in their analysis, as well as a version of profits that only included costs that can be strictly attributable to a given product.
14. [X], the Parties also considered an alternative version of the profit calculation that only includes strictly attributable costs excluding only a small number of additional costs which vary with sales. For VTech the product-specific cost included [X]. For LeapFrog, product-specific costs [X].<sup>4</sup>
15. Furthermore, there are a number of semi-variable and variable costs that are not included in either the gross or the net margin. For VTech these are costs such as [X].
16. To the extent that variable costs not included in the margin calculations vary across products, this may lead to measurement issues that could bias the results. For example, if some products have high advertising costs and these costs are not included in the margin calculations, this could lead to less variation in margins across products. If the costs not included also vary by level of concentration, for instance that products facing much competition are more heavily advertised, then this would bias the results. Overall, fundamental measurement issues that reduce variation in margins across products may explain the lack of a positive relationship between concentration and margins.
17. In addition, different products may have different cost structures. For instance more technologically sophisticated toys could have higher fixed development costs and lower variable product costs than less technologically sophisticated toys. An example of a product that is likely to have high margins because of its cost structure is software. Thus, margins on software products are not comparable to margins on other products. Not taking differences in cost structures into account when analysing differences in margins across products may bias the results.
18. For robustness, the Parties have calculated margins in a number of different ways. In addition to calculating gross margins, they have calculated margins

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<sup>4</sup> Initial submission.

based on costs that could be directly attributed to products, they have calculated net margins, and they have included [X]. None of these alterations changed the Parties' main results. We note, however, that when [X]. This indicates that there is good reason to be concerned about the way the margins are calculated and how comparable margins are across different products.

### ***Endogeneity issues***

19. In their analysis, the Parties do not control for factors that could affect margins other than concentration.<sup>5</sup>
20. There are likely to be factors that could affect both the measures of concentration and the margins. Such factors lead to biased results if they are not controlled for. Suppose, for example, that there is a factor that is positively correlated with both the number of competitors and margins. This factor could be either observable or unobservable to the researcher. When one tries to analyse the effect of the number of competitors on margins but does not control for this factor, the results will be biased upward. The true relationship between the number of competitors and the margins will therefore be understated.
21. The Parties conducted a robustness test using the number of firms, rather than a measure of market share, as it is sometimes considered more robust than looking at market shares, since there is less scope for endogeneity.<sup>6</sup> The Parties found a similar relationship between the number of firms and the margin to that between concentration and the margin.
22. This would seem to suggest that the Parties do not believe that there are significant endogeneity issues in this analysis. However, the Parties analysis is unable to rule out the presence of endogeneity, which is a common issue in this form of analysis.

### ***Interpretation***

23. The Parties found no correlation between different levels of concentration and the Parties' margins. They concluded that these findings were not consistent

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<sup>5</sup> In a robustness test, however, the Parties investigate whether the relationship between the margin and the concentration measures differs in accordance with the total sales of each party within the subclasses and the size of the subclass. The reasoning for this is that one might expect that a Party's margin may be higher in subclasses where that Party has a larger presence due to potential economies of scale. The results were robust to this extension.

<sup>6</sup> This is because entry and exits are typically considered as longer-term strategic variables than the pricing elements that make up the margin, and hence it is less likely to have issues of endogeneity in looking at relationship between the margin and the number of firms in a given year.

with the NPD subclasses being well-defined markets and when taken in conjunction with the other evidence submitted, were supportive of constraints outside of the narrow NPD subclasses.

24. We agree that finding equal margins across different subclasses of toys with different levels of concentrations may indicate that the subclasses are too narrowly defined to constitute relevant markets. For instance, it could be that where concentration is high, the subclass is too narrowly defined and as such constrained by other products, resulting in lower than expected margin. This is in line with the market being too narrowly defined.

### **Our assessment of whether child tablets constitute a relevant market**

25. The Parties compared margins on child tablets with other products in financial year (FY) 2016. They found that [REDACTED]. For VTech, [REDACTED], and for LeapFrog the [REDACTED]. The Parties concluded that this was consistent with child tablets being a declining segment facing considerable constraints from outside.
26. We agree that this finding is consistent with child tablets not being a relevant market. However, the measurement issues discussed above also apply to this analysis. To the extent that there are costs not included in the margin calculations that vary by products, this may bias the results.
27. Furthermore, the Parties supply both tablets and associated content/software. Margins on tablets may be a misleading proxy of profitability if tablets and content are sold as a bundle. The Parties may then choose a pricing strategy that optimises the profits of the two products combined. Such a pricing strategy might imply earning relatively low margins on tablets and relatively high margins on content.
28. To further investigate the Parties' argument and to analyse how margins on tablets and content have evolved over time, we undertook two extensions to the Parties' analysis of margins on child tablets.<sup>7</sup> We calculated average yearly weighted margins on child tablets and associated content combined and compared these with average yearly weighted margins on the Parties' other products.<sup>8</sup> This allowed us to test whether margins on the bundle of child tablets and content are systematically lower than margins on other products. Furthermore, we calculated average weighted margins on tablets and content and other products also for the financial years 2013 to 2015. This allowed us to investigate whether margins on tablets and content have

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<sup>7</sup> The data used was provided by the Parties in. In line with the Parties' analysis in the initial submission, we excluded outliers (products with gross sales of less than £10,000 and margins outside of a plus/minus 100% margin range).

<sup>8</sup> The 'Other products' category includes all other products except tablets and associated content.

declined over time, which would be consistent with a decline in the child tablets segment.<sup>9</sup>

29. Figures 1 and 2 show the results for VTech and LeapFrog, respectively.

**Figure 1: VTech's average margins on tables and software relative to other products**

[REDACTED]

Source: CMA analysis.

**Figure 2: LeapFrog's average margins on tables and software relative to other products**

[REDACTED]

Source: CMA analysis.

30. Figures 1 and 2 show that the Parties' average margins on child tablets and content combined [REDACTED], especially for the later years. This is consistent with child tablets and content not being a relevant market.
31. These results do not, however, in and of themselves, prove this argument. The measurement issues argument also applies to this analysis. We note that the Parties submitted a similar analysis to our analysis outlined above.<sup>10</sup> In their analysis, the Parties presented average gross margins on child tablets and content and other products for the financial years 2013 to 2016 for both VTech and LeapFrog. The Parties' analysis included [REDACTED] and outliers (products with gross sales of less than £10,000 and margins outside of a plus/minus 100% margin range). Compared with our analysis, the Parties' analysis showed [REDACTED]. [REDACTED]), although [REDACTED] is excluded.
32. Furthermore, Figures 1 and 2 show that there is a decreasing trend in margins on child tablets and content over time. This finding is consistent with child tablets and content being a declining segment. There may, however, be alternative explanations to this decline. Figure 1 shows that [REDACTED] both in FY 2015 and FY 2016. This may indicate that VTech was caught out by a fall in demand and ended up with excess stocks of tablets and content two years in succession. Thus, [REDACTED] may reflect VTech's procurement decisions in recent years, and the [REDACTED] may not persist into the future. In their hearing, the Parties told us that there was no indication of excess stocks of tablets in VTech's accounts.<sup>11</sup> We do not, however, have sufficient detailed management accounts data to confirm this. Overall, a longer time series is needed to determine whether the downward trend is persistent for both VTech and LeapFrog.

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<sup>9</sup> The Parties have provided a similar analysis in [REDACTED].

<sup>10</sup> [REDACTED]

<sup>11</sup> [REDACTED]

## The CMA's assessment of the consumer survey evidence

### CMA surveys

1. The CMA commissioned DJS Research Ltd to conduct research with customers of the Parties' toys to inform our inquiry. This comprised quantitative surveys with those who had registered a child tablet, DigiGo, reading system or a TEL toy (from a limited range of TEL toys) that had been bought within the last year and qualitative research in the form of depth interviews with customers for a wider range of TEL toys, also bought within the last year. Full details of the methodology, questionnaires used and results are available in DJS's report that we have published.<sup>1</sup>
2. We consider that the results from the surveys for tablets, DigiGo and reading systems may be used as evidence for our inquiry, subject to the following caveats:
  - (a) While those who had registered the product in the last year and were, therefore, invited to participate in the online surveys represented high proportions of the Parties' sales of these products, the response rates were around 5 to 7%. This is fairly typical for an online survey, but it does mean that it is possible that the high level of non-response could mean that the achieved samples are not representative of the wider populations of interest, namely customers for the Parties' tablets, DigiGo and reading systems, respectively, and we are not able to assess this.
  - (b) Questions about diversion behaviour are, of necessity, hypothetical and the results rely on stated preferences that may, or may not, accord with what the customer would have done if actually confronted with the situations described. Additionally, the answers for those customers who purchased the product less recently, or were only involved in the purchase decision, may be relatively less reliable, but we have no way of assessing this.
  - (c) Surveys conducted online do not benefit from interviewer/interviewee interaction that allows the interviewer to clarify or challenge responses and that would be expected to improve the quality for a face-to-face or telephone survey.

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<sup>1</sup> DJS (October 2016), [VTech/LeapFrog consumer research. Summary report prepared for the CMA.](#)

3. Our quantitative survey with customers of the Parties' TEL toys suffers from the following, additional limitations:
  - (a) The range of TEL toys registered on the Parties' websites was very limited, so the sample available only covers a narrow range of the Parties' products in this category.
  - (b) The registrations as a proportion of sales was lower for the TEL toys than for the other product categories registered.
  - (c) While the response rate was comparable to that for the other products, the actual numbers of responses for customers of each Party were below the threshold we consider necessary to treat the results as providing quantitative estimates.
4. For the reasons above, and given that the Parties have themselves conducted a quantitative survey of customers who have purchased TEL toys, we have decided not to use the results of the CMA's TEL toys online survey.
5. As explained in the DJS report, due to the specific limitations concerning the TEL toys survey, we supplemented it with in-depth interviews with 50 customers of a wider range of the Parties' TEL toys. The CMA was directly involved in the briefing of all the DJS interviewers and a number of the recorded interviews were listened to; we consider that they were conducted in accordance with the interviewer instructions and followed the topic guide.
6. We consider that the in-depth interviews for TEL toys provide useful insights and we have referred to the results as appropriate, noting that they are being treated as providing qualitative evidence.

#### **The Parties' survey (TEL toys)**

7. The Parties commissioned their own survey with purchasers of the Parties' TEL toys to provide additional evidence for the inquiry for this product group. The market research agency JRA conducted 455 face-to-face interviews (265 with VTech customers and 190 with LeapFrog customers) in 28 locations across Great Britain with customers who had bought one of a range of their TEL toys during the last year. The fieldwork took place over two weeks between 20 October and 2 November 2016. The questionnaire used was broadly based on that used by the CMA; a copy of the questionnaire for the Parties' survey, which includes the screener, is included in the [Annex](#) to this appendix.
8. We have the following comments about the quality of the Parties' survey for TEL toys:

- (a) The CMA, where possible, tries to monitor the quality of fieldwork for both its own surveys and those conducted on behalf of Parties. The sampling methodology here did not lend itself to fieldwork monitoring, as many areas selected for interviewing specified a very wide area, such as a town centre. However, it was possible to observe part of an interview shift in one location (comprising one interview that was just finishing and two other, complete interviews) and we have the following observations:
- (i) Although the interviewer had many years' experience, the interviewer was confused by the screener questions, having received instructions that were not very detailed and no verbal briefing.
  - (ii) For one of the observed interviews, the respondent could see the tablet screen and may, therefore, have been prompted to mention either or both of the Parties' brands. This could have conditioned responses to some of the survey and may have led to more mentions of the merger party than would otherwise have been the case. It may also have resulted in more stated diversion to the merger Party among responses to the diversion questions.
  - (iii) For the same interview, the customer mentioned a product out of scope for the survey (a child tablet), but the interviewer did not refer to the photographs of the relevant TEL toys and coded the tablet as being a TEL toy and continued the interview.
  - (iv) For the same interview, the customer thought the product had been bought more than a year ago (so the interview should have been closed) but it was recorded as 6 to 12 months and the interview was continued.
  - (v) The diversion question was paraphrased by the interviewer and this resulted in answers being given that were not valid, and in confusion over subsequent questions, the answers to which may have been different had the initial question been asked correctly.
  - (vi) The interview that was just concluding when the observation started is not recorded on the survey data set.
- (b) While we only observed part of one interview shift in one location, we note that the briefing appears to have been inadequate for a survey with complicated screening and where it was vital that the questions should be asked exactly as written. Our assessment, from observing many interviews across a range of CMA cases, is that it is likely that if the briefing was similar in type and detail for all or many of the interview locations, other interviewers will have also experienced confusion carrying



out the initial screening, taken similar shortcuts, for example in paraphrasing the long diversion questions and may have mis-coded responses.

- (c) The Parties sought to sample across a fairly wide range of specified TEL toys of both Parties and achieved interviews covering a variety of the toys in scope for the survey. The extent to which the sample was representative of the Parties' TEL toys according to the volume of sales varied, with some toys over-sampled and others under-sampled, as might be expected.
9. The Parties have shared the CMA's detailed comments concerning the fieldwork with the market research company and a response has been received from them. In their reply they stated that 28 of the 38 experienced interviewers employed for this survey were briefed either face to face or by telephone by one of the six area supervisors and that it was made very clear during this briefing that the toy lists did not include all VTech/LeapFrog toys. Interviewers are instructed to test the script before starting work and are provided with Test ID numbers on their quota sheets so that they can familiarise themselves with the survey; this data is removed from the data set. A contact number is given for them to call if they have any queries at any time and it is estimated that at least half the interviewers made use of this for this survey, although most of the queries related to synchronising the handheld tablets used for the interviews. The tablet screen clearly indicated to the interviewer whether the interviewee was to be shown the White, Yellow, or Green toy list. JRA further stated that interviewers were accompanied by supervisors at set intervals and standard practice points were re-enforced, which included reading questions exactly as written.
10. The Parties also asked JRA to provide an analysis of their survey comparing the results for the 28 verbally briefed interviewers against those for the ten interviewers who received only a limited, written briefing. They conducted an analysis comparing the overall results for all 455 respondents with the 348 where the interviewer had been verbally briefed (a subgroup of the total 455) and highlighted that there was little difference on certain measures between these two groups (one of which is a subset of the other). We consider that the analysis provided is not conclusive. We consider that the more appropriate analysis would have been comparison of the results for the 348 respondents where the interviewer was verbally briefed with those for the 107 where the interviewer received only a written briefing. This would have resulted in larger differences. We also note that only a limited number of measures were selected for analysis and did not include a conventional diversion ratio calculation as has been included in the CMA's analysis of the survey data set. We have considered these responses alongside our own observations and

still have some concerns about the quality of the fieldwork. Ten of the interviewers did not receive a verbal briefing and the written briefing was not detailed. The diversion question was long and we disagree with a comment made by JRA that there is no obvious reason why the question would not be read out exactly as written. In our experience, having commissioned and observed many face-to-face surveys, complicated, long questions are paraphrased by many interviewers and careful and repeated briefing is often required to change this behaviour.

11. Notwithstanding these comments, we recognise the benefits of face-to-face interviewing arising from the interaction with the interviewer. We also regard the sample sizes achieved, 265 VTech customers and 190 LeapFrog customers, to be sufficient to provide estimates of reasonable precision. While some ineligible customers may have been included in this sample, they are not likely to have been a high proportion of the total, particularly if most interviewers used the photograph sheets provided to check for eligibility. Some respondents may have seen the merger Party mentioned before reaching the diversion questions<sup>2</sup> which may have conditioned respondents with the consequence that they would have had a higher propensity to cite the merger Party in responses to the diversion questions than would otherwise be the case.

#### **Diversion ratios for the Parties' survey with purchasers of their TEL toys**

12. We calculated our own diversion ratios to the merger party and to alternative brands from the survey dataset provided by the Parties to the CMA. We have calculated diversion ratios not allowing for own party diversion and presented these in our final report; this is consistent with the diversion ratios presented for child tablets that we derived from the CMA survey. Also consistent with the diversion ratios calculated from our own survey, we re-allocated the 'don't know' responses to questions asking about the brand to which the respondent would divert in the same proportions as those who did identify a brand; for some questions, the numbers of 'don't know' responses were a high proportion of the total responses.
13. For a few respondents there are some inconsistencies in the Parties' dataset between their responses to different questions, which make it difficult to establish definitively which brand the customers are saying they would divert to. The value of 13% reported for diversion from LeapFrog to VTech is our

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<sup>2</sup> The screener was designed so that respondents who did not mention one of the Parties unprompted, may, under some circumstances, be shown toy lists of both the merger Parties. Some respondents may also have seen the merger Party mentioned on the interviewer's tablets, as happened in one of the interviews observed by the CMA.

best estimate, but depending on how the responses are interpreted; where there are such inconsistencies, it could be as low as 12% or as high as 24%. Likewise, the value of 8% reported for diversion from VTech to LeapFrog is our best estimate, but it could be as high as 16% (the lower bound remains at 8%). Where we to have used the upper or lower values instead of our best estimates, there would also have been consequential changes to diversion to a minority of the alternative brands.

14. The reason that our best estimate is close, or identical, to the lower value in both these ranges is that there are few, if any, cases where we identified the merger party as the diversion destination but we consider that this could have been incorrect. By comparison, our best estimate is further removed from the upper value in both ranges because we identified a number of cases where we considered that, while having recorded diversion to somewhere other than the merger party, another interpretation of the combination of responses would have allocated the diversion to the merger party. While the numbers of such cases are few, when combined with the reallocation of the 'don't know' responses, the overall effect of this is to increase the overall diversion ratio to the merger party.
15. The main questions where the inconsistencies were identified were for the forced diversion questions where the respondent had previously identified the own party as the diversion destination where only the specific toy they had bought was not available. Examples of inconsistencies between responses to different questions include: a respondent being asked a question that they shouldn't have been asked at all (had the script been followed correctly) but then identifying the merger party at that later question; a respondent providing more than one destination brand in the free text responses, one of which is the merger party; and a respondent identifying a brand other than the merger party at the closed response question, but having written in the merger party brand at an earlier free text question.

#### **Our conclusion on the Parties' survey with purchasers of their TEL toys**

16. We conclude that the results of the Parties' survey may be given evidential weight for our inquiry, subject to the quality concerns we identify above, and refer to the results within the main body of our final report.

## Questionnaire for the Parties' face-to-face TEL toys survey<sup>3</sup>

### Notes on this document

- Instructions in **CAPS** are for computer programming
- **Bold** or underlined words are for emphasis within a question
- Different question types have different numbers:
  - Screener questions are labelled SA, S01, S02, S03 etc.
  - Main survey questions are labelled Q01, Q02, Q03 etc.
  - Further demographic / classification questions are labelled D01, D02, D03 etc.
  - Number codes are included on each question for data processing purposes

### Introduction

Hello, I'm from JRA research, an independent market research company, and we're carrying out a survey in this area about toy buying. It will only take 5-10 minutes of your time to complete. Could you spare a few minutes to help us? **IF YES CONTINUE**

### Screening questions

#### SAa. ASK ALL

Can I first check if you are over 18 years old?

Answer list	Code	Routing
Yes	1	CONTINUE
No	2	CLOSE

#### SA. ASK ALL

Have you bought a 'toy' for a child under the age of 10 in the past twelve months?

Answer list	Code	Routing
Yes	1	CONTINUE
No	2	CLOSE

#### SB. ASK ALL

And can you remember any brands of toys you have bought in the past twelve months for children under 10 years? **OPEN QUESTION**

**IF VTECH OR LEAPFROG MENTIONED MOVE TO SD**

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<sup>3</sup> Version submitted to the CMA by the Parties on 29 November 2016 (identified as final)

IF DIFFERENT TOY BRAND MENTIONED OR DON'T KNOW ASK SC

### SC. ASK ALL

Have you bought any of the following toy brands in the past twelve months? **MULTI CODE / ORDERED**

Answer list	Code	Routing
Early Learning Centre	1	
Fisher Price	2	
Hasbro	3	
K'nex	4	
Leapfrog	5 *	CONTINUE
Lego	6	
Little Tikes	7	
Play-Doh	8	
Playmobil	9	
Vtech	10 *	CONTINUE
Bruin / Toys R Us	11	
Chad Valley / Argos	12	
Don't remember	13 *	CONTINUE
None	99	

ALL MUST HAVE BOUGHT EITHER LEAPFROG OR VTECH AT SB OR SC OR DON'T REMEMBER AT SC

IF VTECH ONLY AT SB OR SC SHOW **WHITE** VTECH LIST

IF LEAPFROG ONLY AT SB OR SC SHOW **YELLOW** LEAPFROG LIST

IF BOTH VTECH & LEAPFROG SHOW **GREEN** LIST [THIS INCLUDES VTECH LEAPFROG AND OTHER TOYS]

IF DON'T REMEMBER AT SC SHOW **GREEN** LIST

<INTERVIEWER INSTRUCTION TO SHOW WHICH COLOURED LIST>

### SD. ASK ALL

Here is a list of toys **GIVE RESPONDENT <WHITE OR YELLOW OR GREEN LIST>**. Have you bought any of these in the past 12 months?

SHOW RESPONDENT COLOUR PICTURES OF TOYS (LEAPFROG ON YELLOW/VTECH ON WHITE/LONG LIST ON GREEN) RECORD WHICH TOYS BOUGHT IN PAST 12 MONTHS ON TABLET

White List (VTech toys)			
2Bounce And Discover Frog	1	Pop And Play Elephant	60
Baby's 1st Smartphone	3	Pop-Up Friends Train	61
Cody The Smart Cub	5	Push and Ride Alphabet Train	64

Cora The Smart Cub	6	Put and Take Dumper Truck	65
Crawl and Learn Bright Lights Ball	9	Shake and Move Puppy	72
Crazy Colours Torch	10	Sing Along Microphone	75
Crazy Legs Learning Bug	11	Sing N Learn Music Mic	77
Discovery Activity Tree	12	Sit To Stand Music Centre	78
Feed Me Dino	13	Sort and Discover Drum	79
Fly And Learn Aeroplane	15	Sort And Learn Car	80
Grow N Go Ride On	20	Spin And Discover Ocean Fun	81
Little Friendlies Moosical Beads	35	Spin and Learn Colours Torch	82
Little Friendlies Musical Penguin	36	Stack and Discover Rings	83
Little Friendlies Sing Along Spinning Wheel	37	Tiny Tot Driver	87
Little Singing Alfie	40	Tiny Touch Phone	88
Little Singing Cody/Cora	41	Tiny Touch Remote	89
Musical Rhymes Book	46	Tiny Touch Tablet	90
Nursery Rhyme Book	53	Turn and Learn Cube	91
Play And Learn Activity Table	56		
Playtime Bus	59	None of these	98

## Yellow list (LeapFrog toys)

Alpha Pup Assortment	2	My Own Leap Top	48
Count Along Till	7	My Pal Scout	49
Count and Crawl Kitty	8	My Pal Violet	50
Fridge Numbers	16	My Talking Lappup Scout/Violet	51
Fridge Phonics Letter Set	17	Number Loving Oven	52
Goodnight Light	19	Peek A Shoe Octopus	55
Leapfrog Music Player	24	Read With Me Scout	66
Leapstart Pre-School System	25	Scout Band	68
Learn and Groove Musical Table	26	Scout/Violet Chat and Count Phone	69
Learning Friend Hippo and Panda Figures/Book	27	Shapes and Sharing Picnic Basket	74
Learning Friend Owl and Parrot Figures/Book	28	Sing and Play Farm	76
Learning Friends Adventure Bus	29	Tag Junior Reading Scheme	84
Learning Friends Play and Discover Set	30	Tag Junior Scout Book	85
Learning Lights Remote	31	Turtle (Melody The Musical Turtle)	92
Lettersaurus	33		
Lil' Phone Pal	34		
Mobile Medical Kit	43		
Musical Mat	44		
Musical Rainbow Tea Party	45		
My Discovery House	47	None of these	98

## Green List (VTech, LeapFrog and other toys)

Alpha Pup Assortment	2	Number Loving Oven	52
Cbeebies Bugbies Arty Flippity Fun Sounds	4	Nursery Rhyme Book	53
Cody The Smart Cub	5	Paw Patrol Pup Squirters	54
Cora The Smart Cub	6	Play And Learn Activity Table	56
Crawl and Learn Bright Lights Ball	9	Play Doh	57
Crazy Legs Learning Bug	11	Playmobil Truck	58
Discovery Activity Tree	12	Playtime Bus	59
Feed Me Dino	13	Pop And Play Elephant	60
Fire Rescue Helicopter	14	Potato Heads	62
Fly And Learn Aeroplane	15	Pull N Chatter Lobster	63
Fridge Phonics Set	18	Read With Me Scout	66
Grow N Go Ride On	20	Scout and Violet Chat and Count Phone	67

Hide and Squeak Eggs	21	Sesame Street – Furchester Hotel/Talking Elmo	70
Laugh and Learn Cookie Shape Surprise	22	Sesame Street Building Blocks	71
Laugh and Learn Smart Stages Puppy	23	Shapes and Sharing Basket	73
Leapfrog Music Player	24	Sing and Play Farm	76
Leapstart Pre-School System	25	Sit To Stand Music Centre	78
Learn and Groove Musical Table	26	Stack and Discover Rings	83
Learning Lights Remote	31	Tag Junior Reading Scheme	84
Lego Duplo Creative Suitcase	32	Tag Junior Scout Book	85
Lettersaurus	33	Teddy Bear Laptop	86
Little Friendlies Moosical Beads	35	Tiny Tot Driver	87
Little Friendlies Spinning Wheel	38	Tiny Touch Phone	88
Little Learning Phone	39	Turtle Bath Drums	93
Little Singing Alfie	40	Very Hungry Caterpillar Book	94
Little Singing Cody/Cora	41		
Mirror Laptop	42		
Mobile Medical Kit	43		
Musical Rainbow Tea Party	45		
Musical Rhymes Book	46		
My Discovery House	47		
My Own Leap Top	48		
My Pal Scout	49		
My Pal Violet	50		
My Talking Lappup Scout/Violet	51	None of these	98

IF NOT BOUGHT ANY OF VTECH OR LEAPFROG PRODUCTS LISTED IN PAST 12 MONTHS AT SD THEN CLOSE

IF BOUGHT MORE THAN ONE PRODUCT FROM ANY LIST ASK SE

### SE. ASK IF MORE THAN ONE PRODUCT FROM SD LISTS ARE SELECTED

You have bought more than one of these toys in the past 12 months from those you have just seen. Could you select which of the toys you bought most recently? **SINGLE CODED**

LIST OF VTECH AND LEAPFROG PRODUCTS FROM SD – MOST RECENT ONE SELECTED

IF MORE THAN ONE VTECH OR LEAPFROG TOY AT SD I.E. SE ASKED

READ OUT: Could you now think back to the <INSERT TEXT AS PER SAMPLE: VTech OR LeapFrog> ><INSERT TOY FROM QUESTION SE/SF> that you bought most recently. All the questions from now on will relate to this specific toy.

IF ONE LEAPFROG/VTECH TOY ONLY AT SD READ OUT: Could you now think back to the <INSERT TEXT AS PER SAMPLE: VTech OR LeapFrog><INSERT TOY FROM QUESTION SD> you bought in the past 12 months. All the questions from now on will relate to this specific toy?

### S02. ASK ALL

Approximately, how long ago was the <INSERT TEXT AS PER SAMPLE: VTech OR LeapFrog> toy purchased? **SINGLE CODE / ORDERED**

Code	Answer list	Scripting notes	Routing
1	Less than 3 months ago		

2	Between 3 and 6 months		
3	Between 6 months and 1 year		
4	More than 1 year ago		CLOSE
85	Don't know		CLOSE

### S03. ASK ALL

Thinking back to when the <INSERT TEXT AS PER SAMPLE: VTech OR LeapFrog> toy was purchased, was it new or second hand? SINGLE CODE / ORDERED

Code	Answer list	Scripting notes	Routing
1	New		
2	Second hand		CLOSE
85	Don't know		CLOSE

### SO4. ASK ALL

When the <INSERT TEXT AS PER SAMPLE: VTech OR LeapFrog> toy was first purchased, which of the following statements best describes your involvement in the process? SINGLE CODE / ORDERED

Code	Answer list	Scripting notes	Routing
1	I purchased the product myself		
2	I didn't purchase the product myself but I was involved in making the decision to buy it (for example, asked somebody else to buy it)		
3	I didn't purchase the product and was not involved in making the decision to buy it		CLOSE
85	Don't know		CLOSE

## Main Survey

### Q01a. ASK ALL

How old was the child who the <INSERT TEXT AS PER SAMPLE: VTech OR LeapFrog> toy was purchased for, at the time it was purchased? If you're not sure, please provide an estimate or select 'don't know'. OPEN

Code	Answer list	Scripting notes	Routing
1	____ years	ALLOW 0 TO 10	
85	Don't know		
86	Prefer not to say		

### Q02a. ASK ALL

And was the <INSERT TEXT AS PER SAMPLE: VTech OR LeapFrog> toy purchased for a boy or a girl? SINGLE CODE / ORDERED

Code	Answer list	Scripting notes	Routing
------	-------------	-----------------	---------



1	Boy		
2	Girl		
86	Prefer not to say		

### Q02b. ASK ALL

And was the <INSERT TEXT AS PER SAMPLE: VTech OR LeapFrog> toy purchased for your own child or someone else's child? **SINGLE CODE / ORDERED**

Code	Answer list	Scripting notes	Routing
1	Own Child		
2	Grand child		
3	Nephew/Niece/Cousin		
4	God child		
5	My Friends' child / child at my child's school or nursery		
86	Other – please specify _____		

### Q02c. ASK IF Q02b=1 (OWN CHILD) AND AT SD/SE=<LEAPFROG PAL SCOUT> OR <VTECH CODY/CORA THE SMART CUB>

And have you registered the <INSERT TEXT AS PER SAMPLE: VTech Cody/Cora the Smart Cub OR LeapFrog Pal Scout> with the company?

Code	Answer list	Scripting notes	Routing
1	Yes		
2	No		
85	Don't remember		

## Part 2 – Purchasing questions

### Q03. ASK ALL

When was the <INSERT TEXT AS PER SAMPLE: VTech OR LeapFrog> toy purchased? **SINGLE CODE / ORDERED**

Code	Answer list	Scripting notes	Routing
1	Birthday present		
2	Christmas present		
80	Other reason		
85	Don't know		

### Q04. ASK ALL

Where was the toy purchased from? **SINGLE CODE / ORDERED**

Code	Answer list	Scripting notes	Routing
1	<INSERT TEXT AS PER SAMPLE: VTech OR LeapFrog>'s own website		
2	An online retailer (e.g. Amazon)		

3	An online auction site (e.g. eBay)		
4	In a supermarket		
5	In a toy shop		
6	In another type of shop		
85	Don't know		

#### Q05. ASK ALL SHOW LIST

Which of the following best describes the purchase of the toy? **SINGLE CODE / ORDERED**

Code	Answer list	Scripting notes	Routing
1	Made on impulse		GO TO Q07
2	Planned in advance		GO TO Q06
85	Don't know		GO TO Q06

#### Q06. ASK IF Q5 = 2 OR 85

Roughly how long did you spend thinking about or researching which toy to buy? **SINGLE CODE / ORDERED**

Code	Answer list	Scripting notes	Routing
1	Very little time		
2	Up to 30 minutes		
3	30 minutes to 1 hour		
4	1 to 3 hours		
5	More than 3 hours		
85	Don't know		

#### Q07. ASK ALL - SHOWLIST

When looking to purchase the toy, what other types of products did you consider buying instead? **MULTICODE / RANDOMISE**

Code	Answer list	Scripting notes	Routing
1	Imitation/role play toys like a costume set or play set		
2	Arts or Craft Toy		
3	Action Figure		
4	Toy Car or Train		
5	Doll		
7	Soft Toy		
8	Educational Toy		
9	Building Set		
10	Game		
12	Bike / ride on/ sports toy		
13	Book		
80	Other – please specify_____	FIXED	
81	Other – please specify_____	FIXED	
82	Other – please specify_____	FIXED	
85	No other types of products	FIXED/EXCLUSIVE	

**Q07b. ASK ALL**

Was the toy purchased as a: **MULTICODE / RANDOMISE**

Code	Answer list	Scripting notes	Routing
1	Toy		
2	Educational product		
3	Toy with an educational element		
4	Toy with an electronic element		
80	Other – please specify _____	<b>FIXED</b>	
85	Don't know	<b>FIXED/EXCLUSIVE</b>	

**Q08. ASK ALL**

Why did you choose the **<INSERT TEXT AS PER SAMPLE: VTech OR LeapFrog>** toy? Please select all reasons that apply. If there is a reason not listed, please type it in. **MULTICODE / RANDOMISE**

Code	Answer list	Scripting notes	Routing
1	Brand		
2	Recommendation from somebody		
3	Reliability/quality/guarantee		
4	Price/special offer		
5	Additional features/support etc.		
6	The child asked for it		
7	Latest model		
8	Was the toy all the kids wanted		
80	Other – please specify _____	<b>FIXED</b>	
81	Other – please specify _____	<b>FIXED</b>	

**Q09. ASK ALL**

And, what was the main reason that you chose this toy? **SINGLE CODE / SAME ORDER AS Q08**

Code	Answer list	Scripting notes	Routing
1	Brand	<b>&lt;INCLUDE IF SELECTED AT Q08&gt;</b>	
2	Recommendation from somebody		
3	Reliability/quality/ guarantee		
4	Price/special offer		
5	Additional features/support etc.		
6	The child asked for it		
7	Latest model		
8	Was the toy all the kids wanted		
80	<b>&lt;INSERT TEXT TYPED IN AS OTHER AT Q08&gt;</b>		
81	<b>&lt;INSERT TEXT TYPED IN AS OTHER AT Q08&gt;</b>		
85	Don't know	<b>FIXED</b>	

**Part 3 - Diversion questions**

**Q10. ASK ALL**

If the <INSERT TEXT AS PER SAMPLE: VTech OR LeapFrog> toy was not available to buy anywhere when you were deciding to make your purchase, what would you have done instead? *Please type in your answer.* **OPEN**

81	<b>OPEN</b>		
85	Don't know	<b>EXCLUSIVE</b>	

**Q11 ASK ALL**

Still thinking about if the <INSERT TEXT AS PER SAMPLE: VTech OR LeapFrog> toy was not available to buy anywhere, which of the following best describes what you would have done instead? **SINGLE CODE / RANDOMISE**

Code	Answer list	Scripting notes	Routing
1	Bought a different electronic toy		<b>GO TO Q12</b>
2	Bought a different toy or something else		<b>GO TO Q13</b>
3	Not bought anything		<b>GO TO D01</b>
80	Other – please specify _____	<b>FIXED</b>	<b>GO TO D01</b>
85	Don't know	<b>FIXED</b>	<b>GO TO D01</b>

**Q12. ASK IF Q11 = 1**

Which brand of electronic toy would you have purchased instead? **SINGLE CODE / ORDERED A-Z BY BRAND**

Code	Answer list	Scripting notes	Routing
1	Chicco (e.g. Musical Tales Singing Bear)		
2	Clementoni (e.g. Small Talking Mickey/Minnie Soft Plush Toy)		
3	Fisher-Price (e.g. Laugh and Learn Puppy)		
4	Golden Bear (e.g. In the Night Garden Explore And Learn Musical Activity Table)		
5	Hasbro (e.g. Cbeebies The Furchester Hotel Talking Elmo/Phoebie/Furreal friends)		
6	IMC Toys (e.g. Mickey Mouse Story Teller)		
7	KD Group (e.g. Peppa Pig Zap And Learn Remote)		
8	Kids II (e.g. Bright Starts Light & Sounds)		
9	LeapFrog (e.g. LeapReader/Tag Junior)	<b>IF SELECTED AT SD/SE CHANGE TO &lt;Read With Me Scout&gt;</b>	
10	Little Tikes (e.g. Activity Garden Plant N Play)		
11	TOMY (e.g. Colour Discovery Hot Air Balloon)		
12	VTech (e.g. Little Singing Cora/Cody)	<b>IF SELECTED AT SD/SE CHANGE TO &lt;Little Singing Alfie&gt;</b>	

14	Bruin / Toys R Us (e.g. Activity Cube)		
13	Chad Valley / Argos (e.g. Baby Tablet)		
15	Early Learning Centre (e.g. Mirror Laptop)		
80	Other – please specify_____	FIXED	
85	Don't know	FIXED	

IF Q12 SELECTION NOT OWN PARTY IE IF NOT LEAPFROG FOR LEAPFROG SAMPLE AND VTECH FOR VTECH SAMPLE GO TO D01

IF Q12 SELECT SAME BRAND AS SAMPLE I.E. VTECH SAMPLE CHOOSES VTECH OR LEAPFROG SAMPLE CHOOSES LEAPFROG GO TO Q15

### Q13. ASK IF Q11 = 2

What would you have bought instead? SINGLE CODE / RANDOMISE

Code	Answer list	Scripting notes	Routing
1	Imitation/role play toys like a costume set or play set		
2	Arts or Craft Toy		
3	Action Figure		
4	Book		
5	Toy Car or Train		
6	Doll		
8	Soft Toy		
9	Educational Toy		
10	Building Set		
11	Game		
13	Bike / ride on/ sports toy		
80	Other – please specify_____	FIXED	
81	Other – please specify_____	FIXED	
82	Other – please specify_____	FIXED	
85	No other types of products	FIXED/EXCLUSIVE	

### Q14a. ASK IF Q11 = 2 AND Q13 NOT 85/DON'T KNOW

What brand would you have purchased? *Please type in your answer.* OPEN

81	OPEN		
85	Don't know	EXCLUSIVE	

### Q14b. ASK IF Q14a = 81

Which of the following best describes the answer you've just given? SINGLE CODE

Code	Answer list	Scripting notes	Routing
------	-------------	-----------------	---------

1	<INSERT TEXT AS PER SAMPLE: VTech OR LeapFrog>		
2	Other brand		GO TO D01
85	Don't know	FIXED	

**Q15a. ASK IF Q12 OR Q14b = SAME BRAND AS THEY HAVE ALREADY PURCHASED (VTech for VTech sample and LeapFrog for LeapFrog sample)**

Now imagine that the <VTech OR LeapFrog> brand no longer exists, so that you were not able to buy any children's toy of that brand/make. What would you have done instead? *Please type in your answer.* OPEN

81	OPEN		
85	Don't know	EXCLUSIVE	

**Q15b. ASK IF Q12 OR Q14b = SAME BRAND AS THEY HAVE ALREADY PURCHASED (VTech for VTech sample and LeapFrog for LeapFrog sample)**

Still imagining that the <INSERT TEXT AS PER SAMPLE: VTech OR LeapFrog> brand no longer exists, which of the following best describes what would you have done instead? SINGLE CODE / RANDOMISE

Code	Answer list	Scripting notes	Routing
1	Bought a different electronic toy	GO TO Q16	
2	Bought a different toy or something else	GO TO Q17	
3	Not bought anything	GO TO D01	
80	Other – please specify _____	FIXED	
85	Don't know	FIXED	

**Q16. ASK IF Q15b = 1**

Which brand of electronic toy would you have purchased instead? SINGLE CODE / ORDERED A-Z BY BRAND IN BRACKETS / EXCLUDE VTECH FOR VTECH SAMPLE AND EXCLUDE LEAPFROG FOR LEAPFROG SAMPLE

Code	Answer list	Scripting notes	Routing
1	Chicco (e.g. Musical Tales Singing Bear)		
2	Clementoni (e.g. Small Talking Mickey/Minnie Soft Plush Toy)		
3	Fisher-Price (e.g. Laugh and Learn Puppy)		
4	Golden Bear (e.g. In the Night Garden Explore And Learn Musical Activity Table)		
5	Hasbro (e.g. Cbeebies The Furchester Hotel Talking Elmo/Phoebie/Furreal friends)		
6	IMC Toys (e.g. Mickey Mouse Story Teller)		
7	KD Group (e.g. Peppa Pig Zap And Learn Remote)		

8	Kids II (e.g. Bright Starts Light & Sounds)		
9	LeapFrog (e.g. LeapReader/Tag Junior)	EXCLUDE FOR LEAPFROG SAMPLE	
10	Little Tikes (e.g. Activity Garden Plant N Play)		
11	TOMY (e.g. Colour Discovery Hot Air Balloon)		
12	VTech (e.g. Little Singing Cora/Cody)	EXCLUDE FOR VTECH SAMPLE	
14	Bruin / Toys R Us (e.g. Activity Cube)		
13	Chad Valley / Argos (e.g. Baby Tablet)		
15	Early Learning Centre (e.g. Mirror Laptop)		
80	Other – please specify _____	FIXED	
85	Don't know	FIXED	

IF Q16 ANSWERED GO TO D01

### Q17. ASK IF Q15b = 2

What would you have bought instead? SINGLE CODE / RANDOMISE

Code	Answer list	Scripting notes	Routing
1	Imitation/role play toys like a costume set or play set		
2	Arts or Craft Toy		
3	Action Figure		
4	Book		
5	Toy Car or Train		
6	Doll		
8	Soft Toy		
9	Educational Toy		
10	Building Set		
11	Game		
13	Bike / ride on/ sports toy		
80	Other – please specify _____	FIXED	
81	Other – please specify _____	FIXED	
82	Other – please specify _____	FIXED	
85	Don't know	FIXED	

### Q18. ASK IF Q15b = 2 AND Q17 NOT 85/DON'T KNOW

What brand would you have purchased? *Please type in your answer.* OPEN

81	OPEN		
85	Don't know	EXCLUSIVE	

### Q19. ASK IF Q18 = 81

Which of the following best describes the answer you've just given? SINGLE CODE

Code	Answer list	Scripting notes	Routing
------	-------------	-----------------	---------

1	<INSERT OPPOSITE TEXT TO SAMPLE: VTech FOR LEAPFROG SAMPLE AND LeapFrog FOR VTECH SAMPLE>		
2	Other		
85	Don't know	FIXED	

#### Part 4 – Demographic / Closing questions

Finally, we would just I would just like to ask a couple of questions about you. This information will help us to analyse the responses to this survey.

##### D01. ASK ALL

Please select the gender that you most identify yourself with. SINGLE CODE / ORDERED

Code	Answer list	Scripting notes	Routing
1	Male		
2	Female		
82	Prefer not to say		

##### D01b. ASK ALL

Please could you tell me how old you are? SINGLE CODE / ORDERED

Code	Answer list	Scripting notes	Routing
2	18-24		
3	25-34		
4	35-44		
5	45-54		
6	55-64		
7	65+		
86	Prefer not to say		

##### D02. ASK ALL

What is your employment status? SINGLE CODE / ORDERED

Code	Answer list	Scripting notes	Routing
1	Working full-time or part-time		
2	Not working		
3	Student		
4	Retired / Unpaid voluntary work		
5	Looking after family/home		
80	Other – please specify_____		
85	Don't know		

##### D03. ASK ALL

What is the highest level of education you have achieved so far? SINGLE CODE / ORDERED



Code	Answer list	Scripting notes	Routing
1	No formal qualifications		
2	High school (e.g. GCSEs or equivalent)		
3	Further education (e.g. AS/A Level or equivalent)		
4	Higher education (e.g. degree or equivalent)		
5	Post graduate education (e.g. MBA)		
6	Other – please specify _____		
86	Prefer not to say		

#### D04. ASK ALL

Would you be willing to be re-contacted by jra Research if we have a need to further clarify any of the responses you have given in this survey today? **SINGLE CODE**

Code	Answer list	Scripting notes	Routing
1	Yes	ADD BOXES FOR CONTACT DETAILS IF THIS IS SELECTED	
2	No		

INTERVIEWER: PLEASE COMPLETE DECLARATION BELOW

**Respondent's name:** \_\_\_\_\_ **Home Postcode:** \_\_\_\_\_

**Respondent's Phone Number:**

\_\_\_\_\_ \* MUST GIVE WORKING TEL.  
NUMBER – EXPLAIN THIS IS SOLELY FOR QUALITY CONTROL PURPOSES

Interviewer declaration

I have interviewed this person in accordance with the instructions for this project and the Market Research Society's Code of Conduct. S/he is not a friend or relative.

Interviewer's name: \_\_\_\_\_ Interviewer number: \_\_\_\_\_

Date of Interview: \_\_\_\_\_ Time of Interview: \_\_\_\_\_

Signed: \_\_\_\_\_

## Supplementary evidence from the Parties and third parties

1. This appendix contains supplementary evidence provided to us, which supports our assessment set out in the main text (see Chapters 6 to 9).

### Influence of retailers on consumer demand

2. Retailers' views on their ability to influence consumer demand are shown in Table 1.

**Table 1: Retailers' views on how toys are segmented**

Retailer	To what extent does choice of product and the way they are displayed influence what consumers buy?
Amazon	[REDACTED]
Argos	Customers tend to shop for the brands they want across all retailers, however as a retailer it is our job to try and drive demand to us.
Asda	Asda customers are only able to purchase products from Asda that Asda has chosen to sell. Products that benefit from advertising/marketing support will be subject to a greater demand, particularly for lines over £25.
Boots	Biggest influence is value, not the way they're displayed. Choice is also a factor which is why Boots takes a brand blocking approach.  Promotions in-store are advertised through additional show material, such as barker cards. For our online offer, customers may be influenced by online promotional banners.
Debenhams	This must have an effect on the products which customers buy.
Ocado	This is important because if a customer can't see a product, then the customer can't buy the product. Therefore, the more prominent the product is on the website, the more likely it is to sell. We could, for example, place products on our home page to drive sales. We can also manipulate our search engines such that results display certain products at the top of the list, and others further down.  That said, if the customer is looking for a specific product, and conducts a search for it which returns a positive result, it's less relevant where the product is displayed.
Shop Direct	We believe that the Vtech and LeapFrog brands have a high degree of customer awareness and customers have a very good idea of the products they want to buy when visiting our websites.

<b>Retailer</b>	<b>To what extent does choice of product and the way they are displayed influence what consumers buy?</b>
	All our products are displayed in a standard format on the websites and we do not do anything special with the Vtech and LeapFrog products (eg as regards the product sort order) to particularly encourage customers to purchase these brands.
Tesco	To some extent. The way we display electronic toys (by brand) is in line with what our customers expect. Promotions can drive sales as well, we run these on an ad hoc basis, in line with planned events or as a reaction to market prices / slow sales.
Toys'R'Us	Ultimately it is our anticipation/experience of demand that drives our choices –the extent that this is generated (or may be) by advertising and marketing will clearly play a role.
Hamleys	We know the products which are in demand and therefore we make it easier for the customer to find it. So best-selling products will occupy the best positions.

Source: Third parties.

## Segmentation of toys and allocation of shelf space

### *Retailers' views*

- Retailers' views on the segmentation of toys and allocation of shelf space are shown in Table 2.

**Table 2: Retailers' views on how toys are segmented**

<b>Retailer</b>	<b>Segmentation of toys</b>
Amazon	Amazon defines the Toys category as products that sit within Toys, Games, Dress Up, Hobby and Educational Toys. On its website, it has multiple ways in which customers can navigate the Toys store, including age, price point and category. Top categories are Arts & Crafts, Building & Construction, Dolls, Figures & Playsets, Outdoor Toys, Games, Electronic Toys, Fancy Dress and Educational Toys.
Argos	Internally Argos segments Toys into four buying categories; Infant & Preschool (all children under 5), [✂] and Outdoor (all toys designed predominately for outdoor use). However, customers would see toys mainly segmented by brand (ie Star War or Fisher-Price) or type.
Asda	In respect of electronic learning toys, child tablets/laptops, child TV platforms and child software, Asda primarily segments by brand. For instance, all Leapfrog products are generally merchandised together, regardless of type of toy, age or gender.

Retailer	Segmentation of toys
Boots	Age
Costco	No segmentation. Limited SKU Count. 65 Toys to cover all categories and only on sale from 1st September until 24th December
Debenhams Retail plc	By category (ie type of toy) and broad age (eg baby, toddler, pre-school etc)
Ocado	By type and age
Shop Direct	The toy offer is segmented and managed largely by toy type and function. Our main toy categories include Action Figures, Arts & Creative, Educational Toys, Dolls & Accessories, Games & Puzzles, Lego & Construction, and Play Costumes. Alternative product categorisations are provided on our websites to help the customer product search process, including the age and gender of the children at which the product is targeted. Shop Direct operates a product category called “Children's Educational Toys”, which includes electronic learning products, children's tablets/laptops and TV platforms.
Tesco	Toys are segmented by play pattern, nurturing dolls, vehicles, and also by age pre-school to older girls/boys
The Entertainer	Type of toy
Toys'R'Us	By age (eg Infant, Preschool etc) and by Type (Learning, Role Play, Action Figure, Vehicle etc)  Toys'R'Us told us that 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. <sup>1</sup>

Source: Third parties.

4. Retailers' views on allocation of shelf space are shown in Table 3.

**Table 3: Retailers' views on allocation of shelf space**

Retailer	Main factors taken into account by retailers
<b><i>Retailers who do allocate to specific toy categories</i></b>	
Amazon	Amazon's Toys, Children & Baby department is divided into a number of sub-categories or 'stores', namely Toys & Games, Baby, Kids' Clothing, Baby Wish List and Amazon Family. Navigating to the Toys & Games Store, customers have a range of options for further narrowing their search or browsing options, including filtering by age (e.g. 1 to 2 years), price, brand (e.g. VTech) and category (e.g. Educational Toys, Education & Science or Toys for Indoors). In addition, 'Top Toys

<sup>1</sup> Toys'R'Us hearing summary, paragraph 6.

<b>Retailer</b>	<b>Main factors taken into account by retailers</b>
	Categories' are shown further down the page. These are further divided into subcategories. For example, Kids' Tablets & Games are listed as a further browsing option beneath the Electronic Toys category. [✂]
Argos	There are various categorisations that can be used, internally I look at Infant, Preschool, Character, Technology and Tablets
Asda	Shelf space would likely be determined by sales, profitability and customer demand
Debenhams	Baby, Toddler, VTech, Thomas, Peppa, Paw Patrol, Pre-school Licenses, Playmobil, Super Heroes, LEGO, Construction, Vehicles, Boys Licenses, Starwars, Transformers, Dolls, Disney Princess, Girls Licenses, Shopkins, Arts, Crafts & Science, Games & Puzzles, Interactive toys, Pocket Money, Role Play, Plush, Books, Outdoor toys and Salebuys.
Hamleys	Pre-school, boys, girls, construction, science, Sport & leisure, Books, Plush, Arts & Crafts, Luvley concept, Scrumpalicious concept
Shop Direct	Segmented by toy type and function, with our main toy categories being; Action Figures, Arts & Creative, Educational Toys, Dolls & Accessories, Games & Puzzles, Lego & Construction, and Play Costumes. We also present customers with a product category called "Educational Toys", which encompasses electronic learning products, children's tablets/laptops and Child Reading systems.
Toys'R'Us	Infant, Preschool, Electronic Learning, Action Figures, Dolls, Collectibles, Construction, Games, Puzzles, Craft, Robotics and Radio Control, Roleplay, Books, Science, Plush
<b><i>Retailers who do NOT allocate to specific toy categories</i></b>	
Boots	Allocated by brand
Costco	Order full pallet quantities and warehouses determine where stock is merchandised. Every SKU is generally allocated the same space and we display in full pallets, not shelves
Ocado	We are relatively flexible, so don't allocate space for a fixed number of products in the toy category. This allows us to stock new products during the year if the opportunity arises. We have some flex with regard to increasing one category and reducing another. If we want to increase or reduce the range of toys we offer, we are able to do this.
Tesco	We allocate shelf space by brand. This is driven by our customers who expect to see all toys manufactured by one brand in one area on the shelf space, e.g. all VTech toys will be displayed together.

Source: Third parties.

## Competitors' views

5. Competitors' views on toy segmentation are shown in Table 4.

**Table 4: Competitors' views on toy segmentation**

Competitor	Toy segmentation
Amazon	<p>Amazon defines the Toys category as products that sit within Toys, Games, Dress Up, Hobby and <b>Educational</b> Toys. On its website, it has multiple ways in which customers can navigate the Toys store, including age, price point and category. Top categories are Arts &amp; Crafts, Building &amp; Construction, Dolls, Figures &amp; Playsets, Outdoor Toys, Games, Electronic Toys, Fancy Dress and Educational Toys.</p> <p>Amazon also told us that the Amazon Fire Kids Edition was featured in the toys category but was also part of its consumer electronics portfolio.<sup>2</sup></p>
Artsana/Chicco	Infant / Pre-School; Age profiled; Movement development; Dexterity development
[✂]	[✂]
Hasbro	Boys, Girls, Preschool & Games
IntelliJoy	By educational topic (maths vs learning to read vs learning colours, etc.)
KD Group	<p>KD Group told us that it has two divisions: KD Interactive (in which tablets and smartwatches were located) and KD Toys (which included electronic learning toys made as generic items in its original designs and under licence working with companies such as Disney, Nickelodeon and Mattel) KD Group did not see its interactive products as toys, but as consumer electronics developed with children in mind. KD Group told us that it (and the industry) considered electronic learning toys to be a distinct segment within the pre-school and infant market. KD Group said that the key markets were for infant toys (0-18 months) and pre-school toys, and electronic learning was the second largest category within the pre-school market.</p> <p>KD Group said that all pre-school toys and, to some extent, infant toys were designed to address one or a combination of three objectives: cognitive development, physical development and social development. KD Group told us that it drew a distinction between an interactive electronic product and an electronic learning toy (i.e. a toy that was designed to teach children about colours, letters, shapes, etc.). KD</p>

<sup>2</sup> [Amazon competitor hearing summary](#), paragraph 7.

Competitor	Toy segmentation
	Group's interactive products are made under the Kurio brand, featuring apps and gaming that have learning benefits but are developed as proper electronics.
Mattel	Mattel told us that they managed its products by brand. Its major brands were Fisher Price, Barbie, Thomas the Tank Engine (Thomas), Hot Wheels and American Girl.
Mothercare (Early Learning Centre)	ELC categorises its range of products into the following broad categories: (i) baby & toddler toys; (ii) outdoor toys & games; (iii) dolls' house & toy dolls; (iv) dressing up & pretend play; (v) action figures & playsets; (vi) vehicles & construction; (vii) learning & books; (viii) art, music & creative play; and (ix) puzzles, games & gifts. ELC also has a 'toy searcher' tool on its website which enables customers to search for a toy by age, gender and price. This category split is based on how ELC categorises toys on its website. ELC would not necessarily consider these categories could be accurately used to help determine "a relevant market or markets."
TOMY	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. 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.

Source: Third parties.

## Parameters of competition

### *Retailers' views*

- Retailers generally supported the Parties' views and agreed that the main parameters of competition were wholesale price, fixed payments and marketing support. Retailers' specific responses are shown in Table 5.

**Table 5: Retailers' views on the main parameters of competition**

Retailer	Main factors taken into account by retailers
Amazon	[REDACTED]
Asda	[REDACTED]
Boots	[REDACTED]

CostCo	Price, and due days.
Debenhams	Contributions to marketing materials and promotional support
Kiddicare	[REDACTED]
Ocado	Cost prices, funding for promotions, and funding for onsite media advertising.
Shop Direct	[REDACTED]
Tesco	[REDACTED]
Toys'R'Us	Cost, marketing and promotion contribution, and payment terms.

Source: Third parties.

## Negotiations

7. The views of third parties on how negotiation occurs are summarised below.

**Table 6: Views of third parties on negotiation**

Retailer	How negotiation occurs
Argos	Argos indicated that there were other tablet suppliers it could bring in. <sup>3</sup>
Shop Direct	Shop Direct told us that it would not threaten to delist products during negotiations as VTech and LeapFrog were unique and [REDACTED] had a huge range of toys whereas other manufacturers did not have most of the products which VTech and LeapFrog offered in their range. <sup>4</sup>
Tesco	Tesco told us that child tablets were sold online only and were not grouped with adult products. According to NPD data, Tesco's market share of child tablets was zero. <sup>5</sup> [REDACTED]
Toys'R'Us	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. <sup>6</sup>  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. <sup>7</sup>

Source: Hearings with third parties.

<sup>3</sup> [Argos hearing summary](#), paragraph 18.

<sup>4</sup> [Shop Direct hearing summary](#), paragraph 6.

<sup>5</sup> [Tesco hearing summary](#), paragraph 7.

<sup>6</sup> [Toys'R'Us hearing summary](#), paragraph 22.

<sup>7</sup> [Toys'R'Us hearing summary](#), paragraph 27.



## **Influence of retailers on consumer demand**

### ***Extent of impulse purchasing***

8. The CMA's and the Parties' consumer research asked consumers why they chose to buy the product, to determine the extent to which the Parties' products are impulse purchases.

(a) The CMA survey<sup>8</sup> found that:

- (i) For tablets, 88% of customers planned their purchase in advance, with 10% making an impulse buy. Around 80% of customers spent at least 30 minutes researching their purchase.
- (ii) For reading systems, 84% of customers planned their purchase in advance, with 15% making an impulse buy. Around 75% of customers spent at least 30 minutes researching their purchase.
- (iii) For DigiGo,<sup>9</sup> 91% of customers planned their purchase in advance, with 7% making an impulse buy. Around 70% of customers spent at least 30 minutes researching their purchase.
- (iv) The in-depth interviews with consumers who had purchased a TEL toy found that around half of participants had made an impulse buy, with several stating that the purchase was semi-planned. By this they meant that they were planning to buy some kind of interactive/ educational toy but had not necessarily chosen that particular toy beforehand.

(b) The Parties' TEL survey<sup>10</sup> found that 43% of customers planned their purchase in advance, with 57% making an impulse buy. Around 24% of customers spent at least 30 minutes researching their purchase.

### **Product overlaps in learning toys**

9. This section provides a comparison of the products submitted by the Parties. Nine groups of TEL toys<sup>11</sup> were compared on various attributes.<sup>12</sup> The groups

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<sup>8</sup> See Appendix E: The CMA's assessment of the consumer survey evidence.

<sup>9</sup> DigiGo is a handheld smart device for children produced by VTech. It includes a messaging facility, learning games, a camera for photos and videos and a multimedia player.

<sup>10</sup> See Appendix E: The CMA's assessment of the consumer survey evidence.

<sup>11</sup> We note that within the market for learning toys for under-fives, the Parties are likely to overlap in more products and we note that this may be true for child smartwatches. We consider that the TEL toy overlaps give an indication of the types of overlap which may be present elsewhere.

<sup>12</sup> Recommended age, recommended retail price (RRP), number of activities, number of songs/melodies, whether it is personalisable and the skills it helps develop.

were formed based on LeapFrog toys, where VTech had a similar product. Each group of toys included one LeapFrog toy, one or more VTech toy and at least one similar toy from other manufacturers. The Parties' ranges of products are more extensive than the products included in this analysis and there may be other products which overlap,<sup>13</sup> but this comparison gives an indication of the closeness of the Parties' products (see Table 7 for an extract, giving a comparison of three specific LeapFrog products and the equivalent VTech products).<sup>14</sup>



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<sup>13</sup> Particularly as this list was compiled based on the previous TEL toys definition.

<sup>14</sup> The three the CMA has compared in detail were chosen from the spreadsheet because they were the three best-selling LeapFrog products among the nine compared.

**Table 7: Comparison of selected LeapFrog and VTech products**

<i>Image</i>	<i>Name</i>	<i>Manufacturer</i>	<i>Age</i>	<i>RRP</i>	<i>Number of activities</i>	<i>Number of songs/ melodies</i>	<i>Personalisable</i>	<i>Skills</i>
<b>Infant feature plush</b>								
	My Pals Scout & Violet	LeapFrog	6+ months	£19.99	15	40	Yes	First words, feelings, emotions, colours, counting, motor skills, music.
	Cody & Cora Smart Cubs	VTech	6+ months	£19.99	5 buttons	75	Yes	Daily routines, vocabulary, music, motor skills.
<b>Pull-alongs</b>								
	AlphaPup	LeapFrog	1–3 years	£16.99	26 buttons	3 songs & melodies	N/A	Alphabet, phonics, animal facts and gross motor skills
	Alpha-Gator	VTech	2–5years	£24.99	5 activities	26 songs & melodies	N/A	Alphabet, phonics, animal facts and gross motor skills

<i>Image</i>	<i>Name</i>	<i>Manufacturer</i>	<i>Age</i>	<i>RRP</i>	<i>Number of activities</i>	<i>Number of songs/ melodies</i>	<i>Personalisable</i>	<i>Skills</i>
<b>Infant laptops</b>								
	My Talking LapPup	LeapFrog	6–24 months	£ 9.99	40+ activities, songs and melodies	See above	N/A	Fine motor, numbers & counting, colours, shapes, Alphabet song, opposites
	Baby Bear Laptops	VTech	6–36 months	£14.99	Moveable mouse, light up nose, 5 buttons, rollerball	11	N/A	Shapes, numbers, animals, sensory development

Source: Parties.

10. The closeness of the Parties' product offering differs depending on the specific toy in question, as different toys have different features to satisfy the same learning need.

### **Tablet market changes**

11. Two competitors indicated that there was a move away from integrated child hardware and software, which would lead to more products competing with the child specific hardware and software over time:
- (a) Mattel said that there was a general view that the numbers of children using tablets and mobile phones, at a younger and younger age, was increasing. Mattel believed the software and apps for these was important and it did not see itself competing in the hardware segment of these markets.
  - (b) KD Group said that it believed that child tablets were moving towards content and hardware was becoming less important. It highlighted that a subscription-based model had already been launched by Disney.
12. Another competitor [REDACTED].

### **Retailer views on competitive constraints imposed by existing competitors**

13. Of respondents to our questionnaire, three indicated that they stock products from at least four other suppliers,<sup>15</sup> and a further three indicated that they stock products from at least two other suppliers.<sup>16</sup> These figures do not include responses from the Parties' top five customers, who told us:
- (a) Amazon<sup>17</sup> told us its search functionality facilitated the use of generic search terms that returned the products most similar to the key words inputted by the customer. Amazon said, in addition to generic search words, customers often searched by brand name.<sup>18</sup> It also said that it provided customers with as wide a selection of listed products as possible.<sup>19</sup>
  - (b) Argos told us that it stocked 17 suppliers (excluding the Parties) in its TEL toys category. Of these, four had more than ten products in this category

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<sup>15</sup> [REDACTED] who make up slightly over 3% of each Parties' sales.

<sup>16</sup> [REDACTED] who make up slightly over 5% of each Parties sales.

<sup>17</sup> We note that Amazon responded in its role as a direct purchaser from the Parties and except where explicitly stated, comments do not include products available and sales via the Amazon marketplace.

<sup>18</sup> [Amazon retailer hearing summary](#), paragraph 2.

<sup>19</sup> [Amazon retailer hearing summary](#), paragraph 6.

in stores: The Sales Partnership Distributors Ltd,<sup>20</sup> Mattel, Chad Valley and TOMY.<sup>21</sup>

- (c) Smyths told us that the preschool sector could be further broken down into toys and early learning.<sup>22</sup> It also said that it stocked many brands such as Fisher Price, VTech, LeapFrog and TOMY. It also stocked licensed products including Thomas the Tank Engine, Paw Patrol, Fireman Sam and Peppa Pig and imported wooden toys.<sup>23</sup>
- (d) Tesco told us that toy categories were broken down into subcategories, such as preschool, fashion dolls, collectibles and construction.<sup>24</sup> Tesco did not list which products it stocked in these categories, but did say it had its own-label toys under the 'Carousel' brand.<sup>25</sup>
- (e) Toys'R'Us said that the grouping of products in stores was determined by age range and that, within age ranges, there were subgroupings by licence, brand or vendor or usage, for example bath toys, music. It did not state which suppliers it stocked in these categories.<sup>26</sup> [✂]

### **Competitor views on competitive constraints imposed by existing competitors**

- 14. Mattel said that it viewed VTech and LeapFrog as competitors of its Fisher Price brand in preschool toys. It also said that it did not believe that Thomas the Tank Engine competed with VTech or LeapFrog. While it was a preschool product, Thomas was a content-driven product and operated in a fairly unique segment.<sup>27</sup>
- 15. Mattel said that it did not see TEL toys currently as a core focus of its business.<sup>28</sup> Mattel believed that Fisher Price was closer to VTech with regard to the products it offered. Over the past couple of years, VTech had sold electronic toys that were very similar to, and targeted, Fisher Price products.<sup>29</sup> [✂]<sup>30</sup>
- 16. Mattel believed that while consumers might have a particular brand in mind when making a purchase, their perceptions changed when they entered a

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<sup>20</sup> The Sales Partnership Distributors Ltd distributes products produced by other toy manufacturers including B Kids and WinFun.

<sup>21</sup> [✂]

<sup>22</sup> [Smyths hearing summary](#), paragraph 1.

<sup>23</sup> [Smyths hearing summary](#), paragraphs 20 & 21.

<sup>24</sup> [Tesco hearing summary](#), paragraph 3.

<sup>25</sup> [Tesco hearing summary](#), paragraph 5.

<sup>26</sup> [Toys'R'Us hearing summary](#), paragraph 6.

<sup>27</sup> [Mattel hearing summary](#), paragraphs 3 & 4.

<sup>28</sup> [Mattel hearing summary](#), paragraph 7.

<sup>29</sup> [Mattel hearing summary](#), paragraph 11.

<sup>30</sup> [Mattel hearing summary](#), paragraph 12.

store and had access to the full retail offering.<sup>31</sup> In our view this may mean that, at the point of purchase, other competitors act as a constraint on the Parties as consumers can switch to other products if they consider them to be more attractive than the Parties' products.

17. TOMY listed four products which used the same play pattern/development need as VTech products, but said that the TOMY products did not have electronics.<sup>32</sup> TOMY also said that it did not monitor the Parties, but it did monitor Fisher Price (Mattel), Bright Starts (Kids II), Little Tikes (MGA) and Sophie the Giraffe (Vulli).<sup>33</sup>
18. Early Learning Centre identified a small number of products which directly competed with VTech and LeapFrog products. Early Learning Centre tended to view its products as having simpler functionality than VTech's and LeapFrog's, particularly in terms of electronics, but said they had similar functionality and were targeted at the same customers, age group and/or price range.<sup>34</sup> Early Learning Centre also said that it carried out competitor shops of the market to ensure it was competitive on price in respect of the products supplied by the Parties and other competitors. [REDACTED]<sup>35</sup>
19. Hasbro identified products which fell into the TEL definition, however it said that the overall play experience associated with these products was different from that of VTech's or LeapFrog's products and it would not consider them particularly close competitors. It also said that it would expect consumers to switch between toys and games within the same age limit, depending on individual consumer preferences and fashion trends, regardless of whether or not there was an electronic component.<sup>36</sup> Hasbro also said that it procured general market data, [REDACTED]. It said that VTech and LeapFrog were likely to have featured in several of these NPD reports [REDACTED].<sup>37</sup>
20. Chicco UK said that though it operated in a similar age bracket to LeapFrog, it offered more conventional toys compared with LeapFrog's products, which had a strong connection with technology via its watches and tablets. Chicco UK's products did have some electrical components such as lights and sound, but they were very educational and tailored to the development needs of an

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<sup>31</sup> [Mattel hearing summary](#), paragraph 5.

<sup>32</sup> [REDACTED]

<sup>33</sup> [REDACTED]

<sup>34</sup> [REDACTED]

<sup>35</sup> [REDACTED]

<sup>36</sup> [REDACTED]

<sup>37</sup> [REDACTED]

infant. Chicco was more traditional whereas LeapFrog was moving forward and leveraging technology.<sup>38</sup>

## Entry and expansion

### *Competitors' views*

21. There are examples of [REDACTED] in learning toys from some competitors:
- (a) Trends said that it was launching a small range of five to six pre-school electronic learning aids under the Peppa Pig licence from EOne Entertainment. It said that its toys were different from the VTech/LeapFrog range in that its toys were more 3D toy-like representations of things like 'my first laptop' a flip-up style pretend phone.
  - (b) TOMY said that it was currently in the process of expanding its offering in TEL toys.
  - (c) Chicco UK told us that it offered electronic products, but its new strategy was very focussed on products that targeted the developmental needs of babies and pre-school children. It told us that it had adopted a new strategy to achieve its own unique selling point, as it believed there were a lot of similar products in the market and it wanted to establish Chicco as a toy specialist. [REDACTED] Chicco UK believed this approach, combined with a strong TV presence, had been successful, with a 26% increase in sales expected by the end of 2016.
  - (d) However, there is some evidence that entry and expansion may be difficult. TOMY said it was not easy for a new or lesser known brand to grow in the toy market. It said that 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.
22. Competitors told us that the costs associated with entry and expansion in learning toys were primarily around design, development and tooling. One competitor said that the costs would range from \$20,000—\$80,000 depending on the toy.<sup>39</sup> Competitors said that the time taken to enter ranged from 3 to - 24 months.

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<sup>38</sup> [Artsana hearing summary](#), paragraph 6.

<sup>39</sup> [REDACTED]



## Outside options to Parties' child tablets for retailers

23. Examples of reductions in space dedicated to child tablets over the last five years:

(a) Argos has cut the amount of page space in its winter catalogue from four pages in 2013 to 0.5 pages in 2016.<sup>40</sup>

(b) Shop Direct has reduced the number of tablets offered from 24 in 2015 to 14 in 2016.<sup>41</sup>

(c) [redacted]<sup>42</sup>

(d) Tesco stocked nine stock-keeping units of child tablets in store in 2013 and 0 from 2015 onwards.<sup>43</sup>

(e) [redacted]<sup>44</sup>

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<sup>40</sup> [redacted]

<sup>41</sup> [redacted]

<sup>42</sup> [redacted]

<sup>43</sup> [redacted]

<sup>44</sup> [redacted]

## Glossary

<b>10Q report</b>	Form 10-Q is a quarterly report of a company's performance and financial position that must be submitted to the US <b>SEC</b> by all publicly traded corporations.
<b>Apps</b>	An app is a self-contained program or piece of software designed to fulfil a particular purpose. Apps can be downloaded to a range of electronic devices such as a tablet or mobile device. Apps can confer a wide range of functionalities to users, for example games, entertainment, learning material, news or social media.
<b>Argos</b>	Argos is a toy retailer that also sells own-label toys under the Chad Valley brand.
<b>Artsana</b>	Artsana is a manufacturing company that manufactures toys under the Chicco brand.
<b>BofA</b>	Bank of America Merrill Lynch.
<b>CMA</b>	Competition and Markets Authority.
<b>Content</b>	Content refers to digitised content (for example, mobile applications ('apps'), ebooks, videos, etc) which is designed for use by children on tablets and often has some educational element to it.
<b>FY</b>	Financial year.
<b>Infants</b>	Children who are between the ages of 0 and 12 months.
<b>iOS</b>	iPhone Operating System is the mobile operating system that runs on Apple's mobile devices (ie iPhones and iPads).
<b>KD Group</b>	KD Group manufactures tablets under the Kurio brand.
<b>LeapFrog</b>	LeapFrog Enterprises, Inc.
<b>Mothercare</b>	Mothercare plc is a British retailer which specialises in products for mothers and children and is the parent company of the Early Learning Centre, which is a chain of shops selling toys for very young children.

<b>NPD</b>	NPD is a market research company offering consumer and point-of-sale market research and business solutions for the beauty, foodservice, sport and toy industry.
<b>NYSE</b>	New York Stock Exchange.
<b>Parties</b>	<b>VTech</b> and <b>LeapFrog</b> are together referred to as the 'Parties'.
<b>Preschool(ers)</b>	Children who are between the ages of three and five.
<b>R&amp;D</b>	Research and Development.
<b>SEC</b>	US Securities and Exchange Commission.
<b>SLC</b>	Substantial lessening of competition.
<b>TEL</b>	Toddler Electronic Learning.
<b>Tesco</b>	Tesco PLC is a grocery and general merchandise retailer which manufactures toys under the Carousel brand and also owns the Tesco Hudl tablet.
<b>Toddlers</b>	Children who are between the ages of one and three.
<b>TOMY</b>	TOMY is a toy manufacturing company that manufactures toys under various brands including the Lamaze and Aquadoodle brands.
<b>Toys'R'Us</b>	Toys R Us is a toy retailer that also sells own-label toys under the Bruin brand.
<b>US/USA</b>	United States of America.
<b>VTech</b>	VTech Holdings Ltd.