Exclusive: Toys still top mom's holiday list

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Picture this: a youngster in tow with a shopper as she peruses your store aisles until finding the toy she was looking for. But she's nowhere near a purchase decision. Instead, she aims her camera phone at the barcode, clicks to scan it, then clicks again to send. Almost instantly, *Amazon.com*, *Shopping.com* or another service fills the phone (or pda) screen with detailed product information, reviews and—get this—a list of competing retailers.

It gets worse. The stores are all within two or three miles of where she stands. There are maps and driving directions, actual in-stock positions and real-time competitive pricing information in her phone. For good measure, a few online merchants and maybe even the manufacturer's buy-direct Web site are on the list. Just to sweeten the pot, some retailers throw in an instant electronic coupon or offer free shipping.

One more click and the deed is done. The purchase is made, from a competitor, all while standing in *your* store, looking at *your* inventory.

Customers In The Driver's Seat

By Brent Felgner

The scenario is real, and it's happening somewhere right now. Maybe it's time to differentiate—to actually do it this time—or face the prospect of putting the key in the door and walking away.

"Anything that's going to help the end consumer with information or help them make a purchase decision, they're going to use," says Ashish Muni, chief technology officer for New York-based Scanbuy, one of the early developers of scanning technology. "Brick-and-mortar stores today, if I bring in a coupon or an ad from one of their competitors, they will honor it. We can probably [also] use this technology in real time in much the same way."

With more than 80 million mobile phones in the U.S. market—many with cameras, Internet and e-mail-ready—Muni sees an almost unlimited market waiting to be tapped. And it's not just unlimited insofar as users. Imagine if those online retailers included some in Russia, or China or Japan.

Just pull the barcodes? Forget it. Updated versions of the software will include the ability to key the product number manually.

Offering consumers 24/7 access to the air around them, cell phones have been one of the most overlooked marketing and shopping devices, even though they've already eclipsed the market penetration of personal computers, says Retail Forward Vice President, Jim Crawford, the firm's expert in next-generation technology.

But they're now poised to become the next powerful wave in the retail marketplace. Forty percent of the phones are text messaging, 22 percent are taking pictures—and beginning to scan barcodes—and 18 percent are connected to the Internet.

Reach out and touch someone

"We're entering a new world where consumers expect to be able to touch you as a retailer or manufacturer anywhere they are," Crawford told attendees at the consultancy's 2005 Strategic Outlook Conference last spring.

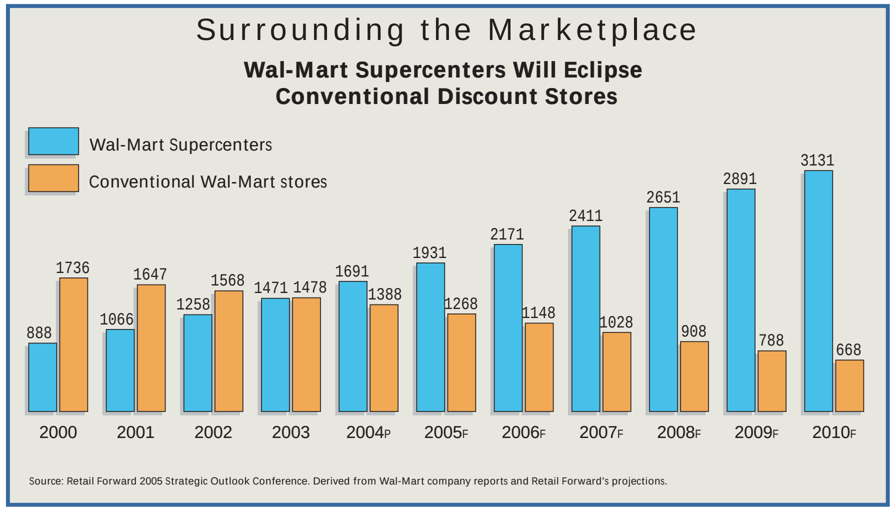
Blame Google. That is what's leading consumers to expect to find anything, anytime, anywhere, suggests Lois Huff, senior vice president, Retail Forward, the Columbus, Ohio.-based market research company.

"Because of the 'Google Effect'—some people call it empowerment—we have this idea that we can have access to anything we want at anytime in any situation wherever we are. Just going online and connecting up is raising our expectations that we will be able to get answers or be able to accomplish many things," she says.

While that might open the door to some confusion and conflict, more effective communication empowers these consumers to be change drivers for themselves, their groups and society. To be sure, a large part of that —

"We need to look at how we're marketing and selling our products in ways that make them far more unique. We also need to focus on microniches—really get deep."

—Lois Huff, Retail Forward



is the Internet, which recorded sales of $141 billion last year—about a 7.24 percent increase—according to *Shop.org* and Forrester Research. Toys and video games accounted for $3.9 billion in sales, estimated at 10 percent of the total segment revenue. What's more, online retail sales are expected to grow by 7.7 percent this year.

But that also means the retail marketplace will become more commoditized with an oversupply of inexpensive, high-quality goods that essentially look and act the same. The right item at the right price at the right time—that old retail cliché—becomes meaningless. Traits like quality, consistency and selection will offer only a baseline, a starting point, with little or no visible differentiation. Retailers that seek to differentiate strictly on price will likely get beaten up, unless they are Wal-Mart.

"In an anything, anytime, anywhere environment, standing out is going to be one of the most difficult things to do," says Huff. "We need to look at how we're marketing and selling our products in ways that make them far more unique. We also need to focus on microniches—really get deep."

Thinking ahead

It sounds like a multi-channel strategy is the way to go. But that might not be enough if one considers forward-thinking Williams-Sonoma, which refers to itself as an omnichannel retailer—trying to be everywhere its consumers are, all the time. Indeed, this merchant is not only in stores, catalogs, online and in the air, it has also sliced itself into multiple businesses by its consumers' lifestyles and stages: Williams-Sonoma, Pottery Barn, PBTeen, Pottery Barn Kids, Hold Everything, Williams-Sonoma Home and its hot new urban take, West Elm. Count them: seven core businesses multiplied by three-plus channels. It's still hunting for the one or two consumers it's missed.

Some get it. Others simply don't understand, suggests Port Washington, N.Y.-based consultant NPD Group's Marshal Cohen, who refers to the latter scenario as a "quagmire."

"Yes, the consumer is in the driver's seat because, frankly, they can go anywhere and buy the product they want at the price they want, because everyone's got the same product," he notes. "Kids today have so much more say, not only what's being bought for themselves, but what's being bought for the rest of the family. If I'm using my factory capabilities to decide what I'm going to make and it disconnects with the consumer, I am driving them away. "The

After punishing experiences at the turn of the century, online retailers like eToys have been rebuilding and broadening their businesses slowly and carefully.

'You say you want a revolution...'

Consumers vote with their wallets. The new consumer and retail revolutions—less strident but more powerful than their '60s origins—are already well underway.

More sharply defined consumer groups are demanding special treatment and products. No longer will most retailers be able to adopt a one size fits all approach to serving those constituency groups, Retail Forward suggested at its 2005 Strategic Outlook conference.

On the flip side, those changes will create more opportunities for retail innovation than ever before as merchants fight for wallet share. Looking forward to 2010, Lois Huff, senior vice president of the Ohio-based consultancy, predicts "concurrent changes in the retail environment and consumer characteristics [will be] the driving forces behind the new consumer value orientation."

In assessing the consumer marketplace, she noted that fragmentation will result in an endless proliferation of groups based on ultra-narrow demographic, lifestage and lifestyle characteristics. Moreover, the "Google-effect" of being connected everywhere all the time, is altering consumer expectations, prompting them to expect to find what they want from the Internet, on demand—and therefore, everywhere else, too.

The way to create value for the consumer will be by attending to "elements that are very personal, that say, 'I matter and my interests matter'—the uniqueness aspect, more inspirational," she says. It's about participation, community and consumers' aspirations.

Huff says one of the ways to accomplish that is "by marketing 'me' and letting them brand themselves."

That said, the consultancy also cited broad retail opportunities that should be exploited between now and 2010, among them:

- **Catch a Wave.** Demographic, social, economic and techno changes rule. See Apple's iPod and the entire industry of accessories that has grown up around it. Not to be outdone by OEMs, Apple started extending the line. But wait, there's more: Don't forget the media with those quickly multiplying podcasts—some paid—and the iTunes Music Store, all paid.
- **Help Me Choose.** The creation of a learning environment eases the intimidation factor, as many of the crafts chains, like Michaels, JoAnn and A.C. Moore learned with their customer classes. The Apple Store and Apple online provide continuous learning.
- **Enhance the Experience.** As the Internet gains traction among shoppers, brick and mortar retailers are being challenged to create a more effective pull into their stores—to make them "superimmersive" experiences.

Individual retailers—even category killers—may not be able to own a merchandise category, but they can own the "buying experience," suggests Retail Forward.

Toy stores like Build-A-Bear Workshop, American Girl and FAO Schwarz have established themselves as experiential retailers. The new Abercrombie format Ruehl—dark, seductive, boutique and village-like in its appeal—adds a generationally exclusive feel to the community it seeks to build.

- **Make It Easy.** As it attempts to sharpen its focus, market position and execution during its first months out of bankruptcy, KB Toys is again emphasizing its convenience store appeal—attempting to leverage its small, easy-to-navigate mostly mall-sited stores into a 12-month buying proposition for its customers.
- **Speed It Up.** Wal-Mart's and Target's emphasis on ease and speed of shopping are critical components of their propositions.

"Consumers value what is most scarce," suggests the report, "and time is at the top of the list for many. They want it fast (speed up the shopping process). They want it now (immediate gratification). They want it first (latest and greatest)." Among the lessons to keep in mind, the firm suggests, are that innovation is market driven and different from invention."***—B.F.***

> ***"At the same time, intense competition and hunger for growth have pushed, and supply chain innovations have allowed, today's companies to target ever-more demanding customers within ever-smaller segments."***
>
> **—David Court, McKinsey & Co.**

electronics toy industry and video game industry have been more centric about consumer needs and desires and wants than the toy business has," Cohen tells PLAYTHINGS.

"[Companies] are giving 8-year-olds product that helps them have the virtual reality of a 21-year-old, and that's exactly what they want," he adds.

Super-charged choices

Still not convinced? Try going to *MSNShopping.com*, which relaunched in mid-November and claims 1,686,666 items in its toy category. Yes, there are undoubtedly a few repeating SKUs; the point is, Wal-Mart's not the only competitive threat—far from it. The threats are everywhere.

Consider eBay: it's just an auction house filled with collectibles and used stuff, right? Think again. Take a walk through its recently redesigned New Toy Finder—as in new toys—and the few thousand "stores" selling toys online. Not a retailer itself, eBay may have found the best of all online worlds as the great enabler in a worldwide bazaar.

Been eying Target or Kmart? Toys "R" Us or KB as competitors? It might be a good idea to get Scott5510 on the radar, too.

This store—maybe a guy in a garage with just 93 SKUs of mostly *Star Wars*- and *Lord of the Rings*-related merchandise—has been selling on eBay since 2000 and has a 99.1 percent favorable rating from its customers. How many retailers can claim that? And while it's true, not all of the new eBay toy merchandise is current, it isn't at TRU, KB or eToys, either.

Not a competitive threat? Perhaps. But think about Scott5510 the next time there's an empty j-hook or slot on a shelf.

Of course, on the opposite end of the spectrum is Wal-Mart. The world's largest merchant just keeps rolling along, despite feeling a bit more challenged domestically—partly by opposition groups—but mostly by its own year-over-year growth, which has started to slow. That's why the company identified its supercenter format as its primary domestic growth vehicle, with 3,100 units expected to come online by 2010, says Retail Forward. That alone defines Wal-Mart's market position as ubiquitous—of course with its low-price standing—but the monolithic retailer is still pushing the edges of those positions, even as it continues to make its case against the "We Hate Wal-Mart" forces.

Wal-Mart may be the 800-pound gorilla in the toy industry, but at least it can be seen. The invisible threat may come from the thousands of fire ants swarming at the edges of the retail landscape.The point is fickle consumers have rapidly proliferating choices about where and how to shop—and what to buy. They perceive that they have more power than ever before and, while that's only partially true, they are often wielding it with unrestrained glee.

"It's a bit of a dance between, do you want to be 100 percent driven by what your customers want, or do you want to move them as well," posits new FAO Schwarz president Ed Schmults. "I think that dance moves back and forth across a continuum between being totally customer driven and establishing new directions and opening new doors [for consumers] to look into. That's what's exciting about retail for me. Despite all the science and all the analysis, there's a lot to it—and [making those decisions] are what great merchants are all about," he tells PLAYTHINGS.

Niche consumers

Senior marketing executives around the world worry out loud that their efforts are becoming more complex and too expensive, even as they become less effective, according to a McKinsey & Co. 2004 report capsulizing the trend.

"Evidence of the new proliferation lies all around us," wrote David C. Court, a director in McKinsey's Dallas office. "Consider the growing fragmenta-

KB positioning for convenience

KB Toys is aiming to get its groove back in essentially the same neighborhood it's always lived.

"We're a convenience store for mom," says Ernie Speranza, the recently appointed chief marketing officer for KB Toys. "I don't think consumers will do all their Christmas shopping at KB, but they will fill in. They'll see we have great prices. We have frontline merchandise plus we have closeouts—a nice combination of product that's still viable but can be purchased at a much reduced price."

After rationalizing its store base during a painful bankruptcy to just more than 600 stores, Speranza says the company is just now preparing to review a store opening program. He did not indicate how many stores might be opened or precisely how they'd be sited or assortment, but it seems clear there will likely be no radical departures from the merchant's current base.

In essence, KB will be betting on a set of core assumptions about its market strategies and customer base.

"This is not something you take lightly," he says. "You need to review what are the things that made KB successful? We're fast. Where's the marketplace going? There are now lifestyle strip centers—it may not be an enclosed mall but it can be a very viable shopping experience."

True, occupancy costs are much higher in mall locations, particularly the more prime locations. But the retailer views those rents almost as a marketing cost for drawing the customer traffic, Speranza says. The mall draws them in, then it's up to KB to get them to make the turn into the store—with displays and signage, demonstrations and it's own brand identity.

"The key is how do you make it more convenient for the customer?" Speranza asks and then answers. "I think the customer has always been in the driver's seat, more so in the last few years because of the [range of] choices, especially in the toy industry. Wal-Mart and Target have become very, very strong in the toy business and that's why they've hurt Toys "R" Us—because they all tend to be destination stores. We're not necessarily a destination store—we're a convenience store."

One-stop shop

Arguably, that's a similar position held by toys in a Wal-Mart or Target environment, where a toy may be a convenience add-on while shopping for groceries or home goods. Indeed, a major thrust of the mass merchants' market drive has been about increasing the frequency of customer visits, which is what drove Wal-Mart into the supermarket business. Those points notwithstanding, it's KB's convenience play that will likely guide its future.

Speranza offers the example of the average child attending 10 to 15 birthday parties a year and asks where the parents will likely shop for a $10-$30 gift. Will it be a destination store trip for a single item? Or will they opt for the convenience of picking up a toy while shopping for other things in a mall?

"It's not about running an ad in a newspaper with this item at this price," Speranza notes. "It's really focusing in on the customer at the point of purchase—at the depth of the decision making, which is, 'Do I walk into that store?' or 'Don't I walk into that store?'"***—B.F.***

"It's always easy to add an SKU, but it's courageous for a manufacturer or retailer to take it off."
—Jim Singer, ATKearny

Wal-Mart and other merchants are increasingly focused on unrelated services as a means of extending their reach to consumers.Those services are opertated direct, through franchises or as in-store leased departments.

tion of customer segments. Modern society is at once more multicultural, because of immigration, and more divided, because income groups have polarized into rich and poor. Both trends create additional and more distinct customer segments. At the same time, intense competition and hunger for growth have pushed, and supply chain innovations have allowed, today's companies to target ever-more demanding customers within ever smaller segments."

In the process, they are fragmenting their own businesses and going beyond the now obsolescing "mass customization" buzzword tossed around a few years back. Even in the big boxes, it's evolving into a marketplace of one—one consumer selecting that one item right now. When Marshall Field, in the late 19th century, uttered the words—"Give the lady what she wants"—he could have had no idea.

Market incursions

Whether consumers' power is real or perceived, retail merchants are still trying to direct their shoppers where they need and want them to go. It's pushed insurgent companies further into each other's spaces as they seek more room to grow and acquire greater market share. Low-price value player Wal-Mart is trying to push further into Target's space with higher price points and more trend-right merchandise. Target is digging in deeper and expanding its designer and fashion appeal, while hammering home its own we're-not-Wal-Mart-or-Kmart message with "Expect More. Pay Less."

The problem, notes retail veteran Maxine Clark, chairman and CEO of Build-A-Bear Workshop, St. Louis, is not that there's too much choice, but too much sameness. Complicating the process even more: Products formerly available only at independent specialty stores are leaching down to the mass market, lured by a lust for volume and market share.

In toys, that means a merchant like Target saw the need and identified the opportunity to venture into heretofore specialty store-only SKUs, like Thomas the Tank Engine, or technology and learning-oriented toys."

"At Target you can find so many wonderful categories of toys that when you go to a specialty store it's not all that different except for some of the stuff at the top of the line," observes Clark. "It's getting harder for the specialty stores to differentiate themselves. Their cost structure is always higher, so they wouldn't be able to meet the prices at a Target.

"It's difficult for those big [retailers] to differentiate from each other," she explains. "The manufacturing base, like Mattel, Hasbro or Jakks Pacific, has fewer companies to sell to so everything has to be in those places or it's hard to make [this business] work. So, the point of differentiation becomes price."

So does newness. As consumers flex their muscles and exhibit shorter attention spans in marketplaces seething with products begging for their attention, retailers can only try to stay ahead of them. Treading on traditional specialty store turf may be viewed as mandatory for some mass merchants trying to get away from Wal-Mart or, for that matter, anyone trying to move away from any retailers higher up in the food chain.

With noteworthy exceptions, almost every retailer has reigned-in merchandise lifecycles, in some extreme instances making their opening order their only order.

It's even translating beyond retail as merchants look to align themselves with an increasing number of services that keep their customers closer and longer. Already Wal-Mart transfers more money to Mexico than the Federal Reserve, and it's currently trying to parlay those financial services into operating its own Utah-chartered bank.

Home Depot has added design and decorating services. Could it be much of a stretch to imagine a Toys "R" Us with its own remedial education classrooms, activity centers or kid gyms inside?

And those positions carry over into toys as Wal-Mart broadens its direct-sourced, private label offerings and Target works hard at staying fresh with the hottest items just out and most in-demand.

In the process, both of these mass merchants could lay claim to what could be the most productive—if not most profitable—5,600 square feet in toy retailing.

Not to be forgotten, mass market toy specialists Toys "R" Us and KB Toys, online merchant eToys, along with high-end retailer FAO Schwarz, jealously guard their flanks as they continue through a rebirthing process, all under new management and new investor-owners.

Sink or swim

We've entered the era of hedge fund and private equity owners, many committed to a belief that the art and science of retailing will, under their leadership, be demystified. Their sink-or-swim, substantially shorter-horizon business model will deliver their returns on investment through merchandising—or hard assets.

All the while, mom and pop independent stores desperately search for niches, rapidly disappearing, where they may still exist alongside the retail monsters. As these stores churn at shocking rates, a few standouts emerge—sophisticated and shining examples of how it still can be done well with scrupulous attention to detail, sharp merchandising and the customer experience.

It's a dangerous retail world, albeit fraught with exciting and seductive opportunities in every corner of the business.

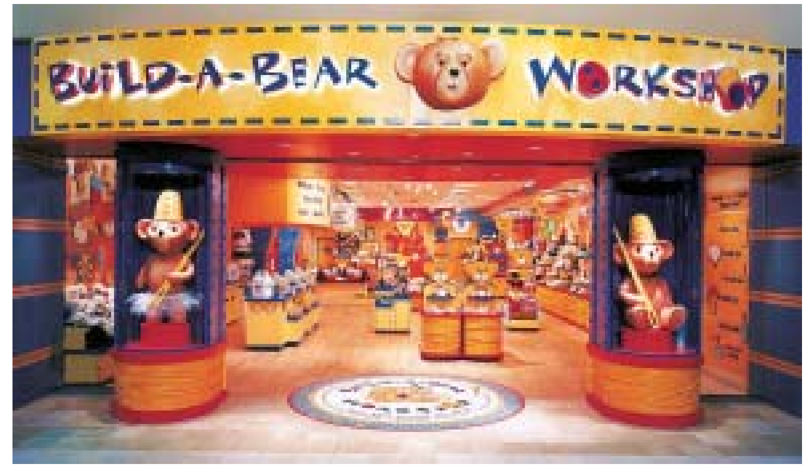
No wonder stores have proliferated and then closed—often with entire retail chains disappearing. No wonder brand managers and merchants have alternately tussled and conspired to extend product lines—even from the day of their introduction. It's no surprise that all the discussions about retail company valuations and real estate over the last few years have partially clouded the focus on the most valuable and important real estate in the equation: shelf space.

And while it's difficult to imagine that would ever become less valuable, even that paradigm is being influenced by an e-world. For example, Target.com is producing triple-digit sales growth even as it helps to extend product assortments beyond store capacity. It's also become something of a merchandise laboratory—a testing ground for new products and merchandising concepts, as well as an adjunct to category management, according to president Greg Steinhafel.

The online assortment has grown from about 70,000 SKUs last year to nearly 200,000 items this holiday season, he recently told financial analysts. What that means is a faster response to markets with decidedly less risk.

"If an item sells well on *Target.com*, our store merchants are able to capitalize on that trend and quickly place an order for merchandise to get in Target stores," Steinhafel explains.

"It's difficult for those big [retailers] to differentiate from each other The manufacturing base like Mattel, Hasbro or Jakks Pacific, has fewer companies to sell to so everything has to be in those places or it's hard to make [this business] work. So the point of differentiation becomes price."
—Maxine Clark, Build-A-Bear



Commonly mall-based, Build-A-Bear Workshop is one of an increasing number of experience retailers.

Too many choices?

It's possible, however, that consumers have too much choice and that SKU proliferation has surpassed the point of diminishing returns—at least in some areas, suggests Jim Singer, vice president for Retail Practice at ATKearny in New York. That, in turn, can actually introduce consumers to the concept of regret—that is, feeling sorry they made their choice and purchase because there may have been something else in the selection they should have bought.

The theory, which Singer has been testing and validating, was born from a relatively obscure business book, *The Paradox of Choice*, by Barry Schwartz, a business professor.

"The conventional wisdom is that if you have more shelf space you will have more market share," Singer explains. "In fact, what we're finding is that, as a retailer, you can actually take your assortment down significantly—20 percent to 30 percent—and still maintain your top line. Of course, you can't generalize across all categories.

"But it's a pretty courageous thing," he adds. "It's always easy to add a SKU, but it's courageous for a manufacturer or retailer to take it off. But the bigger scheme of getting better and smarter on the shelf is de-proliferation where it makes sense."

And that will offer more opportunities to innovate with different merchandise, according to Singer.

Said NPD's Cohen, "Ten years ago the manufacturer was the driving factor. Then it was the retailer. Now the consumer is saying, 'Hey, I don't care what you put on the shelf, I'm going to buy what I want to buy, and I'm going to go find it where I need to find it at the best possible price.' That's a change the toy industry still hasn't caught up with."

"Now the customer is saying, 'Hey, I don't care what you put on the shelf, I'm going to buy, and I'm going to find it where I need to find it at the best possible price.'"
—Marshal Cohen, NPD Group

A sharper focus for FAO

Nearly a year into its new life, FAO Schwarz is continuing to sharpen its merchandising and marketing focus. And while there are no current plans for its two-store base to grow again anytime soon, its new CEO Ed Schmults sees a virtually unlimited global presence—in the mail and in the Ether.

To be sure, the two stores—its legacy location in New York and its other experience location in Las Vegas—carry large potential on a standalone basis. But Schmults acknowledges that they also have a much larger role as branding mechanisms for the merchant's catalog and online efforts, which are perfectly situated to enlarge the retailer's base.

"I need to have kids get really excited about what they can learn on the FAO Web site."
—Ed Schmults, CEO

It's about the "wow" factor and translating the FAO experience beyond the stores.

"We're working on it as we speak," Schmults says. "Our current Web site leaves a lot to be desired. We're working on content issues, presentation, games; we're talking to vendors about [joint projects]. I need to have kids get really excited about what they can learn on the FAO Web site; what they can share with their peers and, frankly, what they can purchase from us. It's the physical manifestation that is our store. I need to translate that into the Internet space and get synthesis in the catalog so that the emotional connection people have in our stores can be continued at home. The space on the Internet can make it a deeper experience because it can be more personalized and more targeted."

Moreover, the Internet space provides lower costs—both in dollars and risk—marketing and merchandising options. Schmults points out the potential for an outlet site attracting a different consumer base without being a threat to the core FAO market position is something that might not be as viable in a 3-D world.

FAO will also seek to churn its merchandise assortments more frequently, not only to maximize turns but as a broader positioning statement that the merchant is always fashionable and fresh while remaining true to its core brands.