Learning Through Toys

Case Teaching Notes
Two Questions

1. Why the low response rate on his first catalog?
2. What should his next steps be?
Case Discussion

• Character of the industry
• Industry value chain
• Value analysis – what was LTT seeking to accomplish?
• Value chain of LTT
• Next steps for LTT?
Character of the industry

• Huge annual volume, dominated by big retailers.

• Increasing concentration at both mfg. and retail

• Seasonality

• Faddishness

• Pricing competition grows

$27 Billion – only $3.5 Billion among smaller retailers.

<table>
<thead>
<tr>
<th></th>
<th>Mfg</th>
<th>Retail</th>
</tr>
</thead>
<tbody>
<tr>
<td>C2</td>
<td>75%</td>
<td>53%</td>
</tr>
<tr>
<td>C4</td>
<td>84%</td>
<td></td>
</tr>
</tbody>
</table>

70% of sales Sept – Dec

Churning; new products important
What does this tell us?

• Mass merchandisers focus on biggest sellers: 80/20 rule

• Fairly efficient supply chain. Mfg. products usually available to all types of retailers – no exclusives by virtue of supply chain.

• Experimentation in specialty by mass merchandisers puts pressure on smaller retailers.

• Pricing and margins considerably disadvantage smaller retailers.
## Pricing Analysis

### $20 toy sold to Walmart
- **Mfg. sell price**: 20.00
- **Walmart margin**: 25%
- **Walmart sell price**: 26.67

### $20 toy sold to Walmart through Wholesaler
- **Mfg. sell price**: 20.00
- **Wholesale margin**: 33%
- **Wholesale sell price**: 29.85
- **Retailer margin**: 25%
- **Retailer sell price**: 39.80

### $20 toy sold to small retailer
- **Mfg. sell price**: 20.00
- **Wholesale margin**: 33%
- **Wholesale sell price**: 29.85
- **Retailer margin**: 50%
- **Retailer sell price**: 59.70
What does this tell us?

• Mass merchandisers focus on biggest sellers: 80/20 rule
• Fairly efficient supply chain. Mfg. products usually available to all types of retailers – no exclusives by virtue of supply chain.
• Experimentation in specialty by mass merchandisers puts pressure on smaller retailers.
• Pricing and margins considerably disadvantage smaller retailers.
• Small retailers must add value through product selection, customer service, and experience.
• Small retailers might carry some faddish hits – to stay relevant during seasonal buying time – but may have to offer them as "loss leaders"
Why the low response rate?

• Much lower than the average new catalog
• Even its best response list (FAO Schwartz, known specialty toy buyers) was much lower than average new catalog
<table>
<thead>
<tr>
<th>Why Low Response Rate ??</th>
<th>Possible Reasons</th>
<th>Countervailing Arguments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Catalog is the wrong medium</td>
<td>Retail much more prevalent</td>
<td>Catalog industry is huge</td>
</tr>
<tr>
<td></td>
<td>No experimentation possible</td>
<td>Target customer high propensity to use</td>
</tr>
<tr>
<td>Catalog done poorly</td>
<td>Not enough pages / products</td>
<td>Rating system provides assurance</td>
</tr>
<tr>
<td></td>
<td>Wrong product selection</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Wrong pricing</td>
<td></td>
</tr>
<tr>
<td>Wrong target customers</td>
<td>Already buy toys</td>
<td></td>
</tr>
<tr>
<td></td>
<td>good list from FAO</td>
<td></td>
</tr>
</tbody>
</table>
Value Analysis

Educational
Assurance of Interest
New
Competitively Priced
Convenience
Why does he fail to deliver on these values?

• Examine his value chain
Outsourced Activities
Not Unique

Internal Activities
Creating Value

Profits

Inputs  Operations  Distribution  Marketing & Sales  Service

Finance, MIS, Legal Services
Human Resource Management
Research & Development
Procurement

List Broker
Toy Wholesalers
Catalog Design Production
Fulfillment Telemarketing Warehousing

Teacher Panels
Children Panels

Buyers
Children Parents Grandparents
## Catalog Production Timing Reduced Flexibility

<table>
<thead>
<tr>
<th></th>
<th>Days</th>
<th>Date</th>
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<tbody>
<tr>
<td>Start</td>
<td>0</td>
<td>March 07</td>
</tr>
<tr>
<td>Product selection</td>
<td>60</td>
<td>May 07</td>
</tr>
<tr>
<td>Catalog design</td>
<td>60</td>
<td>July 07</td>
</tr>
<tr>
<td>Publishing</td>
<td>45</td>
<td>Aug 21</td>
</tr>
<tr>
<td>Printing</td>
<td>30</td>
<td>Sept 20</td>
</tr>
<tr>
<td>Postal deliver</td>
<td>10</td>
<td>Oct 01</td>
</tr>
</tbody>
</table>

- Must lock in to products & pricing early on
- Cannot respond to new fads emerging during the year
- Cannot respond to price specials & discounts offered by competitors
## Value Analysis

<table>
<thead>
<tr>
<th>Ways to Create Value</th>
<th>Same for Lower Price</th>
<th>More for Same Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Educational</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Assurance of Interest</td>
<td>X</td>
<td>Unconvincing</td>
</tr>
<tr>
<td>New</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Competitively Priced</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Convenience</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>
Customers

Firm

Suppliers

Same toys sold in toy retailers

Same supply channels as toy retailers

Outsourced almost all operations functions

Customers acquired through list customers

Customers who already shopped at toy retailers
End of story.....

• Must invest in activities in value chain that are unique, cannot be imitated, and which create value.

• Outsourcing key strategic activities is a recipe for disaster. Anyone can imitate – no possible source of advantage here.

• Hard-to-imitate relationships up and down the industry value chain can provide a source of advantage. Think Uber, AirBnB, or VRBO.
Next steps?

• A longer catalog would not address value chain deficiencies

Options?
1. Use unique customer panel research to work upstream with small manufacturers to develop novel toys and an exclusive.
2. Reconfigure the company as educational toy research, sell findings to toy manufacturers and/or specialty retailers.
3. Shut down