Babes in Toyland

Contrary to popular opinion, Santa's helpers do not rest in the off season. In fact, there is no off season. Even before the brownish Christmas trees begin to appear on the front curbs of America on December 26, the nation's multi-billion-dollar toy industry will have begun planning for next Christmas. For in about a month's time, manufacturers will show their wares at the annual February Toy Fair. Displays will be set up, orders will be taken, and the industry elves will scamper back to their factories to gear up for the new lines for next Christmas.

Like most American industries, the toy industry has undergone a number of changes since World War II, including the adoption of increasingly sophisticated electronic products. Two of these developments, however, seem to stand out more clearly than the rest: the increasingly close relationship between television and toys, and the gradual shift of producing facilities to other countries.

The industry is strongly competitive, yet increasingly concentrated over time. Between 1958 and 1970, while sales volume grew from $0.5 billion to $1.5 billion, the number of manufacturers fell from 845 to around 600. Meanwhile, the share of sales captured by the top four firms grew from 13 percent to 35 percent—and the share has probably increased since then, because of the high T.V. advertising costs that only large firms can shoulder.

Living by the tube
Toys typically are considered a miniature imitation of life, yet television increasingly is life for many of America's children. Consequently, children's toys have, more and more, become plastic manifestations of T.V. heroes. At the same time, the advent of T.V. toy advertising has altered the way in which families make their toy purchase decisions. Both of these developments have worked to alter the composition of the great American toy supply.

Wonder Woman, the Six Million Dollar Man, the Bionic Woman, Fonzie, Mr. Kotter and Starsky and Hutch battle it out not only for T.V. ratings but also for consumer attention on toy-department shelves. A whole new market in the rights to sell T.V. characters' likenesses has grown up. Last Christmas, Mego International hit the jackpot with its top-selling Cher doll. This Christmas, the same firm has rights to at least ten other T.V. programs, thus boosting its chances of having at least several strong items if Cher loses popularity.

But as the sales of T.V. character dolls and accessories rise, so do the prices of the rights to produce them. Consequently, program packagers increasingly break down the broad-based rights into separate categories and then auction them off individually. Toy firms then tend to bid for product categories in which they have a comparative advantage. Charlie's Angels, for

(continued on page 2)
example, has sold the Manufacturing
rights for dolls to Hasbro, for games to
Milton-Bradley, for hair care and cos­
metics kits to H-G Toys, for model vans
to Revell, and for radios to Ilfelder.

Living by advertising

Television advertising has altered the
composition of the toy supply in an­
other way, by influencing the
dynamics of the family’s choice of toys.
Parents typically choose toys for their
children based upon a combination of
their own preferences and the ex­
pressed preferences of their children.
Since children typically are not ex­
posed to magazine and newspaper ad­
vertising, toy manufacturers had little
portunity to influence children’s
preferences in the ancient days be­
fore T.V. Children’s desires, when ex­
pressed, were typically based upon
what they saw other children playing
with. But for the most part, the indus­
try’s sales depended upon parents’
ideas about what their children should
have.

Children gained the upper hand, how­
ever, with the advent of T.V. toy ad­
tertising. During the two months prior
to Christmas, toy ads make up more
than half of all advertising on chil­
ren’s T.V. programs. As toy manufac­
turers enter the nation’s living rooms
with their messages, children not only
become aware of what is available,
but frequently become loudly con­
vinced that they must have these new
items. Johnny’s and Jill’s entreaties are
not totally forgotten when the parent
finds himself at the toy counter.

Does this development represent a
net social gain? Toy manufacturers ar­
gue that national advertising has stim­
ulated demand for particular items,
creating the basis for volume produc­
tion with its associated economies of
scale—the net effect being more toys
at lower prices for more children. Crit­
ics, on the other hand, argue that ad­
vertising not only raises the total cost
of getting toys into the market, but
also raises the “junk toy” component
of total toy purchases. The critics as­
sume that it is easier to fool children
than adults, and that Saturday-morn­
ing commercials create a desire for
toys whose performance proves dis­
appointing or whose life expectancy
does not go much beyond Christmas
morning. The Federal Trade Commis­
sion partly agrees with the criticism,
recently ordering three large toy com­
panies to “cease and desist” from mis­
leading advertising. Moreover, one of
these three is the object of a
multimillion-dollar class-action suit for
deceptive advertising practices.

Has advertising raised or lowered the
prices of toys? Expenditures for T.V.
toy advertising more than tripled be­
tween 1972 and 1976, when toy com­
panies handed more than $150 million
over to networks and local stations.
(Indeed, T.V. accounted for about 95
percent of all toy-advertising expendi­
tures.) During that same period, total
advertising spending rose from 3.0 to
4.9 percent of manufacturers' sales. Given no change in the wholesale-to-retail markup, advertising spending thus would represent a larger component of retail toy prices than heretofore.

The question then becomes whether rising advertising costs have been offset by the cost savings due to large-scale production. Theoretically, to the extent the industry is competitive, industry-wide cost savings must get passed on to consumers. But, as noted above, the toy industry has become more concentrated over time, with the top four firms accounting for 35 percent of total sales in 1970 and probably somewhat more today. Academic researchers and anti-trust investigators generally expect a decline in price competition and other signs of undesirable market behavior to manifest themselves when the top four firms gain 40 to 50 percent of a market. Yet by these standards, at least some segments of the toy market are still highly price competitive, making it possible for consumers to benefit from growing economies of scale.

Moving abroad
Much of the continued price competition comes from foreign producers, who now account for roughly 25 percent of what American kids stash in their toy boxes. The foreign share has risen from about 18 percent in 1970 and an estimated 5 percent just before World War II. This shift reflects the ability of other countries to gain a comparative advantage in labor-intensive toy production over time.

Hong Kong, for example, has been the world's leading toy exporter since 1971, when it took the lead from Japan. The attractiveness for manufacturing of this crowded, little city-state becomes apparent when we realize that the average U.S. manufacturing worker now earns almost seven times as much as his Hong Kong counterpart. Also, given the seasonal nature of the industry — October peak employment is typically half again as high as the January trough — Hong Kong is better able to manage seasonal hirings and layoffs because of its weaker government regulations and weaker unions.

Rather than sit back and watch the market cut out from under them, U.S. toy manufacturers have responded to this import growth by joining the overseas migration. Some build production facilities in Mexico, Hong Kong and other foreign locations, but most simply contract with foreign firms to produce the toys with their low-cost labor and then ship them to this country to be sold under the U.S. firm's name. So when the toy men and women of the nation gather at their February toy fair, they'll notice that a growing share of their products have come from overseas — and that an even larger share have come from the make-believe land of television.

Michael Gorham
### BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

<table>
<thead>
<tr>
<th>Selected Assets and Liabilities</th>
<th>Amount Outstanding 12/7/77</th>
<th>Change from 11/30/77</th>
<th>Change from year ago</th>
<th>Dollar</th>
<th>Percent</th>
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<tbody>
<tr>
<td><strong>Loans (gross, adjusted) and investments</strong></td>
<td></td>
<td></td>
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<tr>
<td>Loans (gross, adjusted) — total</td>
<td>105,381</td>
<td>+ 526</td>
<td>+ 12,692</td>
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<td>Security loans</td>
<td>80,752</td>
<td>− 555</td>
<td>+ 10,649</td>
<td>+ 15.19</td>
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<td>Commercial and industrial</td>
<td>1,910</td>
<td>− 828</td>
<td>+ 341</td>
<td>+ 21.73</td>
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<td>Real estate</td>
<td>24,883</td>
<td>+ 224</td>
<td>+ 1,976</td>
<td>+ 8.64</td>
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<td>Consumer installment</td>
<td>26,858</td>
<td>+ 72</td>
<td>+ 5,521</td>
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<td>U.S. Treasury securities</td>
<td>14,126</td>
<td>+ 45</td>
<td>+ 2,134</td>
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<td>Other securities</td>
<td>9,441</td>
<td>+ 570</td>
<td>+ 57</td>
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<td><strong>Deposits (less cash items) — total</strong></td>
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<td>Demand deposits (adjusted)</td>
<td>102,784</td>
<td>+ 1,180</td>
<td>+ 10,815</td>
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<td>U.S. Government deposits</td>
<td>30,290</td>
<td>+ 944</td>
<td>+ 3,190</td>
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<td>Time deposits — total**</td>
<td>300</td>
<td>− 261</td>
<td>+ 59</td>
<td>+ 24.48</td>
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<td>States and political subdivisions</td>
<td>70,256</td>
<td>+ 466</td>
<td>+ 7,035</td>
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<tr>
<td>Savings deposits</td>
<td>5,519</td>
<td>+ 79</td>
<td>+ 832</td>
<td>+ 17.75</td>
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<td>Other time deposits**</td>
<td>31,300</td>
<td>− 163</td>
<td>+ 1,361</td>
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<td>Large negotiable CD’s</td>
<td>30,696</td>
<td>+ 450</td>
<td>+ 4,323</td>
<td>+ 16.39</td>
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<td><strong>Weekly Averages of Daily Figures</strong></td>
<td>13,294</td>
<td>+ 487</td>
<td>+ 2,996</td>
<td>+ 29.09</td>
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<tr>
<th><strong>Member Bank Reserve Position</strong></th>
<th>Week ended 12/7/77</th>
<th>Week ended 11/30/77</th>
<th>Comparable year ago period</th>
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<tr>
<td>Excess Reserve(+) / Deficiency (−)</td>
<td>+ 49</td>
<td>+ 41</td>
<td>+ 41</td>
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<tr>
<td>Borrowings</td>
<td>13</td>
<td>92</td>
<td>0</td>
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<td>Net free(+) / Net borrowed (−)</td>
<td>+ 36</td>
<td>− 51</td>
<td>+ 41</td>
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<tr>
<td><strong>Federal Funds—Seven Large Banks</strong></td>
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<td>Interbank Federal fund transactions</td>
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<tr>
<td>Net purchases (+) / Net sales(−)</td>
<td>+ 609</td>
<td>− 265</td>
<td>+ 1,349</td>
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<tr>
<td>Transactions with U.S. security dealers</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Net loans (+) / Net borrowings (−)</td>
<td>+ 505</td>
<td>+ 681</td>
<td>+ 827</td>
</tr>
</tbody>
</table>

*Includes items not shown separately. Financial statements include individuals, partnerships and corporations.*

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**Editorial comments may be addressed to the editor (William Burke) or to the author.* Information on this and other publications can be obtained by calling or writing the Public Information Section, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco 94120. Phone (415) 544-2184.**