

Research Department Federal Reserve Bank of San Francisco

December 23, 1977

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 heavy 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

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Business & Financial Letter

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example, has sold the Manufacturing rights for dolls to Hasbro, for games to Milton-Bradley, for hair care and cosmetics kits to H-G Toys, for model vans to Revell, and for radios to Illfelder.

Living by advertising

Television advertising has altered the composition of the toy supply in another 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 expressed preferences of their children. Since children typically are not exposed to magazine and newspaper advertising, toy manufacturers had little opportunity to influence children's preferences in the ancient days before T.V. Children's desires, when expressed, were typically based upon what they saw other children playing with. But for the most part, the industry's sales depended upon parents' ideas about what their children should have.

Children gained the upper hand, however, with the advent of T.V. toy advertising. During the two months prior to Christmas, toy ads make up more than half of all advertising on children's T.V. programs. As toy manufacturers enter the nation's living rooms with their messages, children not only become aware of what is available, but frequently become loudly convinced 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 argue that national advertising has stimulated demand for particular items, creating the basis for volume production with its associated economies of scale — the net effect being more toys at lower prices for more children. Critics, on the other hand, argue that advertising 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 assume that it is easier to fool children than adults, and that Saturday-morning commercials create a desire for toys whose performance proves disappointing or whose life expectancy does not go much beyond Christmas morning. The Federal Trade Commission partly agrees with the criticism, recently ordering three large toy companies to "cease and desist" from misleading 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 between 1972 and 1976, when toy companies handed more than \$150 million over to networks and local stations. (Indeed, T.V. accounted for about 95 percent of all toy-advertising expenditures.) 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

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 12/7/77	Change from 11/30/77	Change from year ago	
			Dollar	Percent
Loans (gross, adjusted) and investments*	105,381	+ 526	+ 12,692	+ 13.69
Loans (gross, adjusted) — total	80,752	— 555	+ 10,649	+ 15.19
Security loans	1,910	— 828	+ 341	+ 21.73
Commercial and industrial	24,883	+ 224	+ 1,978	+ 8.64
Real estate	26,858	+ 72	+ 5,521	+ 25.88
Consumer instalment	14,126	+ 45	+ 2,134	+ 17.80
U.S. Treasury securities	9,441	+ 570	+ 57	+ 0.61
Other securities	15,188	+ 511	+ 1,986	+ 15.04
Deposits (less cash items) — total*	102,784	+ 1,180	+ 10,815	+ 11.76
Demand deposits (adjusted)	30,290	+ 944	+ 3,150	+ 11.61
U.S. Government deposits	300	— 261	+ 59	+ 24.48
Time deposits — total*	70,256	+ 466	+ 7,035	+ 11.13
States and political subdivisions	5,519	+ 79	+ 832	+ 17.75
Savings deposits	31,300	— 163	+ 1,361	+ 4.55
Other time deposits‡	30,696	+ 450	+ 4,323	+ 16.39
Large negotiable CD's	13,294	+ 487	+ 2,996	+ 29.09
Weekly Averages of Daily Figures	Week ended 12/7/77	Week ended 11/30/77	Comparable year-ago period	
Member Bank Reserve Position				
Excess Reserves(+)/Deficiency (—)	+ 49	+ 41	+ 41	
Borrowings	13	92	0	
Net free(+)/Net borrowed (—)	+ 36	— 51	+ 41	
Federal Funds—Seven Large Banks				
Interbank Federal fund transactions				
Net purchases (+)/Net sales (—)	+ 609	— 265	+ 1,349	
Transactions with U.S. security dealers				
Net loans (+)/Net borrowings (—)	+ 505	+ 681	+ 827	

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

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