

# ZURU: Disruption in Toyland

Entrepreneurs are a breed apart. Presented with a challenge they ask “What is the problem to be solved?”<sup>1</sup> and chart a different path to secure results. Raised by parents who said “There is no such thing as failure,” 12 year old Mat Mowbray created a Hot Air Balloon that won the New Zealand Science Fair in 1993. His brother Nick would help out during school holidays and enlist friends as well to help out.” The kitsets were sold at festivals like the hot air balloon festival in Hamilton, New Zealand. An old barn on their parent’s dairy farm served as the factory – in return for spraying weeds on the farm. Sales eventually reached 10,000 kitsets a year with some production outsourced to China when Mat turned to Nick and just said out of the blue, “Maybe we should just go to China.” Nick, working during a break from university while starting a law degree replied, “Yeah. Why not? Maybe we should just go to China and do this.” Law school concurred with the decision by not offering Nick a place in second year.

So in 2005 the brothers just got on an airplane and went to Hong Kong (a story recounted to 60 Minutes as part of a 2015 profile). The plan involved sleeping at the airport for the first couple of nights because they did not want to pay for a hotel. But the airport lights were too bright so they slept in the bushes outside the airport which – it turned out--were mosquito infested. “It wasn’t much fun,” recalled Nick. From Hong Kong the brothers traveled up to the manufacturing hub of Guangzhou and got their first small apartment-changing the lounge into their first office. “We went to the Canton Show (China’s largest import and export trade fair), hired a translator, brought over our sister Anna and her boyfriend Tom, plus our cousin Simon and just go into it really.”

“There were no foreigners, no one spoke English, and we lived in this small apartment on the eighth floor, there was no elevator. We lived on about \$1 to \$2 a day for food just eating rice and vegetables every day.” In time, Nick moved to a small showroom in Hong Kong and slept under the table. The next upgrade was to a ramshackle hostel which cost \$20 a month in rent. Nick would sneak out the back fire escape of the hostel to have meetings with customers or clients who stayed across the road at an expensive hotel.<sup>2</sup>

Fast forward to 2018. Nick Mowbray is selected for the EY Entrepreneur of the Year 2018 award in New Zealand. Judges commented that it was clear throughout the judging that Nick wants to build one of the largest manufacturing businesses in the world. “Lots of people have big ideas but don’t execute well. Nick has ideas and executes perfectly from the macro level down to what makes the difference at the customer interface. We don’t see that very often. Every detail is managed.”<sup>3</sup>

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Professor Michael W. Coombs and Kimberly Esser prepared this case solely as a basis for class discussion and not as an endorsement, a source of primary data, or an illustration of effective or ineffective management. Copying or posting is a violation of copyright. USC Marshall School of Business, University of Southern California, February 2019. Special thanks to management at ZURU for their support and contributions.

Nick, with his brother Mat and sister Anna, co-founders of international toy manufacturer ZURU, reflected on the success of the company and recognized that new challenges confronted the team as they seek new avenues for success going forward.<sup>4</sup>

## **FINDING A NICHE**

ZURU became one of the most recognized names on toy shelves around the world, with toys such as Robo Fish, X-Shot, and Bunch O Balloons (Exhibit 1). Two of the company's toys; Bunch O Balloons and Fidget Cube were voted top selling toys by The Toy Association in 2017<sup>5</sup> (Exhibit 2). Acknowledging these accomplishments, one industry analyst said: "These awards recognize achievements and unique successes in a fast-paced and increasingly competitive environment. Amidst the quickly moving trends, the industry is winning with both innovative products marrying toys with technology, and evergreen toys standing the test of time."<sup>6</sup> Since then ZURU's outreach has magnified and sales increased significantly to \$500 million NZD in 2018.

From the day ZURU launched the Mowbrays approached the industry in a distinctive way. Instead of establishing headquarters in New Zealand and outsourcing to global manufacturers, they established their entire operation in Asia. Instead of seeking multi-year contracts with movie and media companies they looked for innovative ideas among inventors and other sources. Zuru challenges existing manufacturers with similar products at price points which benefit both the retailer and the consumer. The spirit of relentlessness and agility is expressed on their website:

ZURU is a disruptive and award-winning company that designs, manufactures, and markets innovative toys and consumer products. We are known for our agility, creativity and ability to deliver unbeatable value to our customers. ZURU is changing the industry through new-age manufacturing techniques and invests heavily in automation design and development.<sup>7</sup>

In early 2018 ZURU employed 400 people at their head office in Shenzhen. "We've got a lot of original innovations. We have a massive design development team, a massive engineering team, and a massive automation team."<sup>8</sup> In addition to developing toy ideas in-house, ZURU maintains vigilant contact with crowdfunding requests, inventors, retail data, competitors, speaking to kids, and YouTube. "We get ideas from speaking to a very broad spectrum. An idea doesn't just come from one place – it is very much a process and an evolution,"<sup>9</sup> said Mowbray.

Upset by the bankruptcy of Toys R Us in the United States and Canada the traditional toy market experienced significant disruptive change in 2018. Traditional toy manufacturers lost their audience for new product launches. Large retailers responded rapidly to capture market share. Major toy manufacturers competed for licensing deals with TV and movie studios. Tariffs imposed by the Trump administration on goods manufactured in China significantly impacted the economics of the industry. In the midst of all this turmoil, how can ZURU continue to be competitive in toys and any other businesses in which they choose to compete?

## TRADITIONAL TOY INDUSTRY

Toy sales are tracked in two categories: 1) traditional and 2) electronic, which includes computers and videogames. ZURU's products were primarily in the traditional category which does not include video games, online games, or mobile games (Exhibit 3).

Traditional toy products have a very short life and are sold in brief, well-defined selling seasons. Few products last for two seasons and many toys experience significant price markdowns at the end of product life. Globally, there are many local toy manufacturers, but much of the global manufacturing is in Southeast Asia (Exhibit 4), which creates long oceanic transit shipping times and information lags between manufacturing and the target markets in Europe and North America.<sup>10</sup> China is the world's biggest toy producer and exporter. It has more than 10,000 toy manufacturers with about 6 million employees. China's domestic toy sales reached over 64.6 billion yuan (\$10 billion) in 2017, an increase of 16.2 percent year-on-year.<sup>11</sup>

The global toy business is characterized by rapid change and uncertainty. Demand for fad-driven products moves from tepid to boiling overnight and then suddenly evaporates as the next hot product sweeps the market. Constant product innovation, short life cycles, and high cannibalization rates are typical. ZURU's strategy to counter this threat is to focus on toys that get played with across generations, also known as "evergreen" toys in the industry.<sup>12</sup> An evergreen is a brand that has a dominant position in a category, and has managed to build longevity of that brand for an age, making it a more reliable earner for the company. Examples of evergreen brands are Hotwheels (die-cast cars), Barbie (dolls), NERF (dart blasters), and LEGO (construction bricks). With their core competencies in automation ZURU is recognized in the industry for building their own space in these evergreen categories with a comparable product at a lower price. ZURU's competitive brands are Metal Machines die-cast cars (launched in late 2017), Sparkle Girlz (acquired January 2019), X-Shot blasters (launched in 2012), and MAX Build More construction bricks (launched in October 2018). These products reduce the volatility and seasonality for ZURU and distinguish the firm in the toy industry.

Supply chains that span the globe and include many emerging countries add currency and political risks that can disrupt supply and change cost structures with little notice. As if these risks are not enough, sensitive product safety issues send many industry CEOs to bed with burning stomachs.<sup>13</sup>

The face of toy retailing continues to evolve as the consumer journey becomes more omni-channel. Consumers search online for product information and recommendations, review the product in brick and mortar stores and finalize the sale in whichever channel provides the best price, service, or delivery and return options. The toy industry is unique as a seasonal fast moving consumer good (FMCG) industry since 50 % of sales are achieved in the final weeks of the calendar year (Exhibit 5).

## INDUSTRY DISRUPTION

The global toy industry in 2017 was the largest it had ever been (Exhibit 6). The global toys and games market in 2017 generated total revenues of \$98bn, representing a compound growth rate (CAGR) of 5% between 2013 and 2017. The performance of the market is forecast to accelerate, with an anticipated CAGR of 6.2% for the five year period 2017-2022 and expected to drive the market to a value of \$132.2 billion by the end of 2022. Comparatively, the Asia-Pacific and US markets are expected to grow with CAGRs of 11.2% and 1.1% respectively, over the same period, to reach respective values of \$62.4 billion and \$24.7 billion in 2022.<sup>14 15</sup>

In 2017 the toy business was hurting. Not because parents had less reason to buy, not because the market was shrinking, and not because kids were ditching toys for tablets. It was hurting because the industry structure changed. In September 2017, major US retailer Toys R Us filed for bankruptcy. In February 2018 Toys R Us announced it would be closing down all its US and UK stores. There were a variety of factors that led Toys R Us to go out of business in 2018. One factor was a startling demographic shift. Millennials are marrying later, and having children later than previous generations, with many not even having children. Normally, the US could rely on immigration to make up for any decline in the birth rate, but with immigration policies hardening under the Trump administration, high immigration could no longer be taken as a given.<sup>16</sup> In addition, Toys R Us struggled under heavy debt load after the buyout by private equity firms, which limited funds available for merchandise and facility upgrades.<sup>17</sup>

The Toys R Us closure significantly changed the retail toy market in the United States and delivered ZURU a \$27 million financial loss.<sup>18</sup> “It’s about getting knocked down seven times and getting up eight,” Mowbray said.<sup>19</sup>

Not only have we lost one of our biggest customers, but consumers have lost an outlet to have more variety and more choice, which goes directly back to the manufacturer. Whereas some of the bigger US retailers are a bit more risk averse in that they want to see that a toy is proven and working, Toys R Us was always the one, without question, to support new innovation. Now manufacturers will have less tendency to take a risk on certain innovations. Maybe we won’t have that outlet to test them as much. So it’s going to have a really important domino effect.<sup>20</sup>

In 2018, mass retailers Walmart and Target responded to the Toys R Us announcement by increasing toy orders and floor space for the 2018 holiday season. Amazon published a toy catalogue for customers.<sup>21</sup> Despite other retailers’ efforts to fill the void with added floor space and deeper inventories, Toys R Us was in some ways an irreplaceable force in the industry. No other store can completely replace it in offering such a broad selection of toys and reliable supply of hot products right up through Christmas, said toy makers and analysts.<sup>22</sup>

## LICENSING

Two of ZURU's most popular products were licensed from inventors outside the company—such as the two it picked up from funding platform Kickstarter: Bunch O Balloons and Fidget Cubes (Exhibit 2). ZURU is keen to emphasize the company's current innovation credentials.

“We got to where we are today through cutting edge innovation, and spotting fantastic ideas. A large portion of our success is credited to the global inventor community we work with, that continue to push the boundaries of imaginative play. A great idea coupled with our agility, industry-leading manufacturing solutions and distribution channels can turn a simple sketch into a large global brand.”<sup>23</sup>

ZURU signed an exclusive, worldwide licensing agreement with Chrome Cherry Design Studios to manufacture, distribute, and market Nimuno Loops. Designed to transform any surface into a base for construction toy bricks and figures, Nimuno Loops were brought to the market in collaboration with ZURU's Mayka Tape construction brand. This product first emerged on Indiegogo where it raised over \$1.6 million in crowdfunding in 30 days. “Nimuno Loops is an exceptionally clever and transformational product,” said Nick. “Since its launch in April 2017 the product took off on social media and was featured in over 200 news and media outlets. It's truly amazing in this day and age how the whole world can see a product within a matter of days. We were very excited to collaborate with the team at Chrome Cherry Design Studios to bring Nimuno Loops to the global mass market, and into the hands of builders young and old.”<sup>24</sup>

In October 2018 Walmart joined with ZURU to launch a new toy brick brand, MAX BUILD MORE, a premium quality, value-priced toy brick line. This product was available exclusively at Walmart stores nationwide. MAX BUILD MORE blocks were compatible with all major toy brick brands and offered unbeatable value for budget with hundreds of high-quality bricks in each set for a fraction of the current price. The MAX BUILD MORE brand rolled out in December 2018 in New Zealand and in other leading markets in Spring 2019.<sup>25</sup>

“It was an amazing time to go and disrupt categories.”<sup>26</sup> In 2012 you weren't able to advertise the way you could in 2018. The power of social and digital media transformed the way we consume brands. “Kids have really shifted from watching TV to more consumer content online and on mobile (Exhibit 7), so it's really important for us to be where the kids are, which is on YouTube”<sup>27</sup>

## PRODUCT RECOGNITION and SOCIAL MEDIA

In the era of Facebook and YouTube, brand building is a vexing challenge. Social media changes everything by binding together communities that once were geographically isolated, greatly increasing the pace and intensity of collaboration. Social media expands and democratizes a variety of subcultures. With a few clicks, you can jump into the center of any subculture and participants' intensive interactions seamlessly among the web, physical stages, and traditional media. Together members push forward new ideas, products, practices, and aesthetics –

bypassing mass-culture gatekeepers such as TV ads. With the rise of crowdculture, cultural innovators and their early adopter markets become one and the same.<sup>28</sup>

ZURU actively utilizes social media to launch products and gain traction in the marketplace. ZURU launched SMASHERS, a brand new collectable toy line that gives kids a wacky surprise with every smash. SMASHERS Series 1 is based on the world's most popular sports including basketball, football, hockey, soccer and many more. All SMASHERS varieties appear on the accompanying Collector's Guide and Game Sheet encouraging kids to make repeat purchases and complete their collection. Kids can also track their SMASHERS collectables and points using the SMASHERS mobile app. In advance of the June 2018 FIFA World Cup ZURU teamed with Disney XD for a SMASHERS TV and digital campaign.<sup>29</sup>

## **INFLUENCERS**

Toy marketing efforts shifted from TV to online platforms. The message to prospective customers now includes online influencers who move through the process of unwrapping, unboxing the product, set up, and extended engagement with the toy – further increasing the excitement and experience of discovery. For example, seven year old Ryan, of YouTube's Ryan Toys Review demonstrates the SMASHERS collectibles.<sup>30</sup> In 2017 he made approximately \$11 million USD a year and boasted more than 12 million subscribers. He was the eighth highest-paid YouTuber in the world and he made a fortune from reviewing, unboxing, and playing with various toys.<sup>31</sup>

ZURU's launch of X-Shot League on YouTube<sup>32</sup> helped drive engagement with the firm's key audience for toy blasters (dart guns). Influencers not only review current blasters but also the new range of blasters ahead of their official launch date, creating further excitement for the new product version. ZURU makes every effort to reach their core audience and fans through influencers that are experts in each category.<sup>33</sup> An online "shoot out" comparing the Nerf blaster versus the ZURU X-Shot demonstrated ZURU product comparability at a lower price point.<sup>34</sup> X-Shot became the fastest growing non-licensed brand in the category, according to ZURU. The firm anticipated shipping over 40 million X-Shot blasters worldwide in 2018.<sup>35</sup>

## **TOY MANUFACTURERS**

Globally, toy manufacturers range from hundreds of smaller companies, specializing in specific toys and/or games, to large corporations such as Mattel and Hasbro that produce and market a wide variety of products. Large firms, such as Hasbro and Mattel, fuel demand for their toys through extensive marketing activities which often result in these large companies producing the "must have" toys. Furthermore, large manufacturers such as Mattel and Hasbro tend to have the licensing rights to popular brands made famous by television, film, or book, such as Marvel, DDC, Star Wars or Transformers. In 2016 Hasbro acquired the Disney Princess production and closed its market share gap compared to Mattel. In addition, toy manufacturers are able to forward integrate, particularly through online sales, and this helps

negate the impact of retailers backwardly integrating. A successful example of supplier forward integration includes the LEGO manufacturer opening their own retail stores.<sup>36</sup>

### **Toy Maker Remake**

In 2017 Mattel hired Margo Georgiadis, a former Google VP, to rejuvenate the company and reverse declining sales, in an effort to staunch the decline of the stock price. Before Georgiadis took over, most of the toy company's advertising spend went to traditional television ads.<sup>37</sup> Simultaneously, rival toy manufacturer, Spin Master, prevailed over Mattel in obtaining the licensing rights for some DC Comics toys.<sup>38</sup> Mattel's stock price continued to decline to a low of \$9.35 in late 2018.<sup>39</sup>

Seeking new markets in 2017 Mattel expanded its partnership with Alibaba, the Chinese e-commerce giant, to develop new toys for the growing market in China. In addition to gaining access to more than 440m active buyers across Alibaba's e-commerce platforms, Mattel planned to work with Alibaba's artificial intelligence research unit to develop innovative products to aid child development. This initiative recognized that the Chinese market differed from the West in that Chinese parents preferred to spend extra money they may have for their children on educational pursuits. In 2017 the Chinese toy market was only about a third (30%) of the size of the market in the US, and that is because many Chinese parents regard play as a distraction from academic work.<sup>40</sup> Globally, the educational toys market (academic toys, cognitive toys, and motor skills toys) is expected to grow at a CAGR of almost 11% during 2018-2022.<sup>41</sup> According to Shenzhen-based market research firm CIConsulting, China's early childhood education market will grow by 20 percent annually to reach \$51 billion USD in 2020.<sup>42</sup>

In April 2018 Ynon Kreiz became Mattel's chairman and chief executive, the fourth person in that position in five years. Mr. Kreiz had significant entertainment and media-distribution experience, some background in licensing and merchandising, but no history in the company's core business: making toys.<sup>43</sup> Drawing from his experience, his plans include turning many of Mattel's brands into movies, television series and video games. He planned to slash \$650 million in expenses, lay off workers and sell some manufacturing plants.<sup>44</sup>

### **Agile startups**

Regardless of what products they make, toy startups like ZURU have an advantage that Mattel, Hasbro, and LEGO lack: Startups can start supply chains and distribution models from scratch. That means they can "fail fast," test products with the rapidity of a tech company, and tap e-commerce and digital advertising instead of breaking into brick and mortar stores and shelling out millions for TV ads. In all these ways, toy startups are much farther down a road the Big Toy manufacturers are still scouting out.<sup>45</sup>

### **TOY RETAILERS**

The toys and games retail market was generally fragmented; with numerous companies, boosting competition within the retail market. However, there were some large incumbents

such as Toys R Us gone from the U.S. market, that benefitted from economies of scale allowing them to compete more intensely on price. Some market rivals, primarily specialized toy retailers, are highly dependent on revenues from toy and game sales. Players such as Toys R Us and KB Toys experienced increased rivalry from mass retailers since pure-play toy retailers must be profitable within that particular market at all times.

Manufacturers also lost one of their preferred partners when rolling out new products before deciding if the toy warranted a wider launch. With Toys R Us gone from the US market, leading toy manufacturers such as Hasbro, Mattel and LEGO Group will have a harder time negotiating with their largest customers – Amazon, Walmart and Target on pricing. Big retailers are still cautious and unwilling to hold inventory, asking for smaller caseloads and just-in-time delivery and for vendors to take on more risk.<sup>46</sup> As a result, leading traditional toys and games manufacturers now face an increasingly uncertain future.<sup>47</sup>

Hypermarkets, supermarkets, and hard discounters form the leading distribution channels in the global traditional toys and games market, accounting for a 14% share of the total market value. Online retailers, such as Amazon, account for a further 13.1% of the market.<sup>48</sup> Retailers responded to the exit of Toys R Us in different ways: supermarket firm Kroger hosted a range of pop-up stores branded Geoffrey's Toy Box, named after the Toys R Us mascot. Amazon improved upon Toys R Us practice of issuing a Christmas catalogue: "The Amazon catalogue is a whole lot better than the Toys R Us catalogue. It's got much more production value, it's laid out in a much more appealing way, and the QR code is just brilliant."<sup>49</sup>

Some analysts believe 35% of toy retail could move online by 2022; up from the current 23%.<sup>50</sup> Amazon is predicted to be the "big winner" in the toy sector because it does not have to store huge quantities of seasonal inventory that could become unfashionable by the next holiday season. A greater shift to online sales within the toy industry may lessen the power of core Hasbro and Mattel Brands.<sup>51</sup>

Retailers, such as department stores and supermarkets, being less dependent on toy sales than specialized stores due to the wide variety of goods they stock, experienced decreased rivalry as variations in the performance of one market are easier to cope with. These players are also able to reduce their profit margins on toys, competing largely on price, creating a significant threat to specialized toy stores and further increasing rivalry. The tendency for customers to move between toys and game vendors coupled with low switching costs, also serves to increase competition. It is easy for customers to move from one retailer to another based on price and this boosts the intensity of rivalry among retailers. The popularity of toys and games is short-lived or seasonal, which means the retail market is subject to rapid change which further boosts rivalry. The global market grew strongly in recent years, which is likely to have reduced rivalry somewhat<sup>52</sup>

## **GLOBAL STRATEGY and NEW MARKETS**

In 2018 sales of toys around the world were on the move. The global toy industry experienced steady gains starting in 2012, along with increases in the global spend per child. In terms of regions, North America – driven by the United States – accounted for the largest amount of world toy sales. ZURU's toy sales in the United States prior to the closure of Toys R Us accounted for about 40% of their global sales. But, in terms of growth prospects, the toy market in Asia grew by 21 percent over a five-year period. The global market overall is predicted to top \$99 billion in 2022.<sup>53</sup>

Toy industry sales topped \$18.4 billion for the first half of 2018, marking an increase of 4 percent from 2017. In terms of regions, Mexico saw the largest toy industry growth at 15 percent for the first half of the year. Brazil and the United States closely followed, with 11 percent and 7 percent growth respectively (Exhibit 8). End of year reports for the United States indicate that toy sales fell 2% in 2018 as toy manufacturers endured their first Christmas without Toys R Us in more than 60 years.<sup>54</sup>

The demand for toys in China is changing from traditional and decorative toys to electronic or remote-controlled toys.<sup>55</sup> In terms of pricing, there is a huge gap between locally-made toys and international brand name toys. Locally-made toys still maintain a strong edge in the medium- to low-end segments of the market and practically monopolize sales channels like the wholesale market and individual-run retailers; e.g., grocery stores.<sup>56</sup>

ZURU launched its China sales team near the end of 2017 and now has a presence on major Chinese platforms such as TMall (Alibaba) and others. ZURU is forecasting \$10 million USD in sales by the end of 2019 and seek to scale this to \$100 million over the next three years.

### **Tariffs May Impact Toy Manufacturers**

Trade disputes dented the confidence of retailers in 2018. An increased trade war between the United States and China will hurt the toy market going forward, given that 86% of the toys sold in the United States are produced in China (Exhibit 4). Toy makers fear another round of tariffs is likely to push up the price of toys.<sup>57</sup> According to research by China's AmCham, two-thirds of the 430 US firms in China were impacted by the trade war and 30 percent of the firms considered moving out of China.<sup>58</sup>

For years, Hong Kong was the world's largest toy exporter. However, as the costs of rent and labor increased drastically Hong Kong toy manufacturers moved their labor-intensive operations to other lower-wage areas. The Pearl River Delta (PRD) region of the People's Republic of China (PRC) is one of the favorite choices for outsourcing because of cheap and available labor.<sup>59</sup> In 2018 to remain competitive on price, many manufacturers explored other geographic locations for their manufacturing operations.

The push towards manufacturing more toys outside of China accelerated somewhat during 2018 due to ongoing cost pressures, the need to drive cost savings following the implosion of

Toys R Us, and fears that President Donald Trump would apply tariffs to Chinese manufactured toys. “The 2018-2019 trade war encouraged some manufacturers to look at other countries for setting up their operations, but this process will not happen overnight as it requires extensive planning for manufacturers to relocate.” China continues to possess the “most resourceful and skillful labor force in the toy industry. Other Asian countries, where manufacturing might shift, are three to five years behind the mainland in their ability to manufacture more complex toys.”<sup>60</sup> In mid-2018 Hasbro was increasing its manufacturing outside of China from 30% to 40% over a few years.<sup>61</sup> Perhaps rising wages in Asia would eventually push manufacturers to look to Africa for cheap labor.<sup>62</sup>

Among the options outside of China, there are some obvious long-term winners. Over the course of the last 12 months, India’s toy manufacturing industry grew further as Hasbro and others increased the number of vendors in India. Vietnam as another credible and growing manufacturing hub was ranked No. 1 among seven emerging Asian countries as a manufacturing destination when demographics, wages and electricity costs, rankings in doing business and logistics, and manufacturing as a share of total foreign direct investment are considered.<sup>63</sup> McKinsey evaluated growth potential in emerging economies <sup>64</sup> (Exhibits 9 and 10) and reported that Vietnam was seen by many to be at capacity.<sup>65</sup>

Other Asia locations will also be growing opportunities. Most capacity in Thailand comes via Thai subsidiaries of Chinese manufacturing groups, and expansion into other countries is expected as pressure grows on the businesses in China. Malaysia, Thailand, Indonesia, and the Philippines each have some good factories. The easy option remains China, but manufacturing and shipping cost savings combined with quicker re-supply times desired by large mixed retailers are rapidly changing things.<sup>66</sup> For instance, some retailers only order small lots, expecting the manufacturer to hold inventory in storage for rapid supply on demand.

Anticipating increased manufacturing away from China, adjacent businesses which support the toy manufacturing industry anticipated disruption by establishing operations in other regions. SGS - the toy testing, verification and inspection company launched new testing capabilities in Vietnam and India. SGS toy safety testing services spans the EU toy directive and the requirements of the US Consumer Product Safety Act.<sup>67</sup>

## **THE ROAD AHEAD**

What will the traditional toy industry be like in 2022? One analyst presented his expected outcomes<sup>68</sup> (Exhibit 11). If you found these predictions credible, what actions would you take?

Several questions remain: Should ZURU manufacture where they sell to shorten the time from order to delivery for large retailers? Should ZURU re-organize into regional centers in order to adapt to cultural differences in customer demand for different products? Will social media have the same reach in emerging economies as it has in developed markets? If not, how should ZURU build demand in new markets? Which toy markets should ZURU target for sales? How should they enter new markets?

The Mowbrays are very interested in receiving your recommendations tomorrow.

## EXHIBITS

<b>Exhibit 1: Representative ZURU Brands</b>	
Bunch O Balloons	Fidget Cube by Antsy Labs
Metal Machines	Micro Boats
Oosh	Rainbowcorns
Robo Alive	Shnooks
Smashers	Tangle
Tube Superstar	X-Shot
Zuru Capsules	Zuru Games
5 Surprise	

Accessed at: <https://zuru.com/brands>

### Exhibit 2: The Toy Association Toy Awards 2018.

#### Top Property of the Year

Property	Corporate Manufacturer
Nerf	Hasbro

#### Top Selling Toy of the Year

Item Description	Corporate Manufacturer
L.O.L. Surprise! Doll Assortment	MGA Entertainment

#### Top Selling Toy by Supercategory

Supercategory	Item Description	Corporate Manufacturer
Action Figures & Accessories	Beyblade Starter Pack Assortment	Hasbro
All Other Toys	Antsy Labs Fidget Cube Assortment	Zuru
Arts & Crafts	Easy Bake Ultimate Oven Baking Star Play Set	Hasbro
Building Sets	Mega Bloks First Builders Big Building Bag, 80 Pieces	Mattel
Dolls	L.O.L. Surprise! Doll Assortment	MGA Entertainment
Games & Puzzles	UNO Card Game Assortment	Mattel
Infant/Toddler/Preschool Toys	Paw Patrol Basic Vehicle & Pup Assortment	Spin Master
Outdoor & Sports Toys	Bunch O Balloons 3 Pack	Zuru
Plush	Hatchimals Pengualas Pink Egg Assortment	Spin Master
Vehicles	Hot Wheels Singles 1:64 Assortment	Mattel
Youth Electronics	Cozmo	Anki

Accessed on December 28, 2018 at <https://www.toyassociation.org/PressRoom2/News/2018-news/npd-announces-winners-of-us-toy-industry-awards-at-toy-fair.aspx>

### Exhibit 3: Traditional Toys and Games include the following segments.

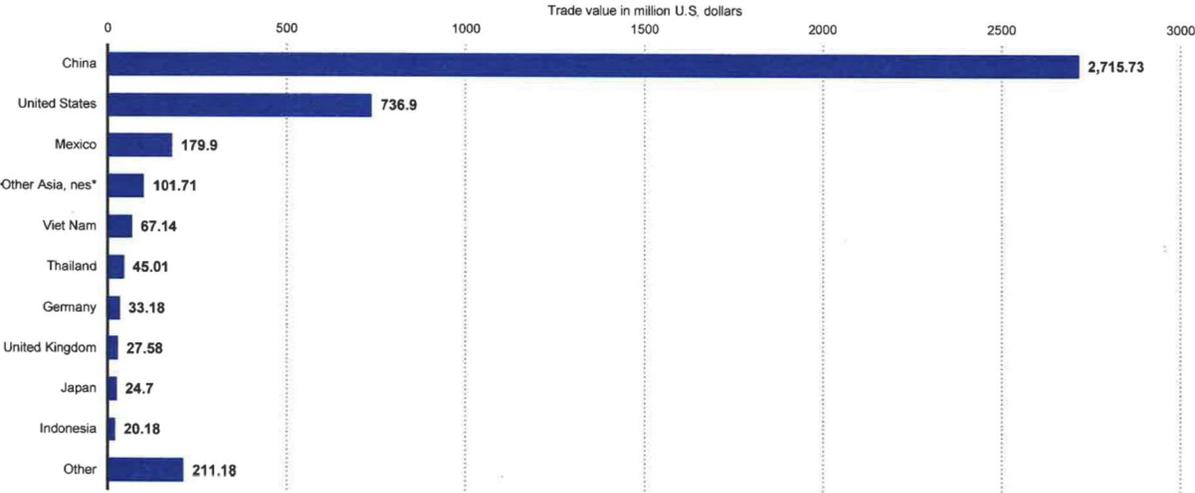
- Action figures
- Toy vehicles (e.g. trucks, boats, planes)
- Outdoor-related toys excluding bikes (e.g. scooters, swing sets)
- Sports-related toys (e.g. basketball, baseball bats)
- Dolls and related toys (e.g. doll clothes and accessories, dollhouses)
- Arts and crafts (e.g. clay, crayons)
- Stuffed animals
- Building sets (e.g. LEGOs, wood blocks)
- Puzzles
- Card or board games
- Electronic developmental and learning toys (i.e., kids-specific learning systems).

Source: MINTEL, Traditional Toys and Games-US-October 2018.

### Exhibit 4: Major toy exporters.

Import value of toys, games and sport requisites to the United States in 2017, by country of origin (in million U.S dollars)

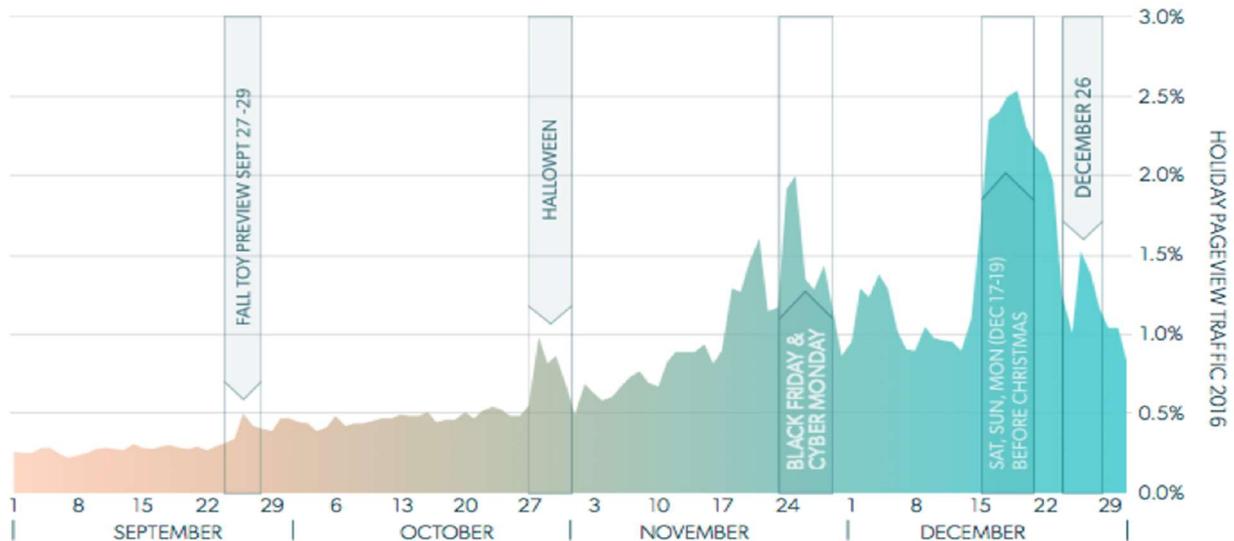
Value of toy and game imports to the U.S. 2017, by country of origin



Note: Canada; 2017; Data accessed April 20, 2018  
 Further information regarding this statistic can be found on [page 48](#).  
 Source(s): UN Comtrade; [ID 616678](#)

## Exhibit 5: Seasonal Demand for Toys

TOY SHOPPING TRAFFIC INCREASES THROUGHOUT THE FALL WITH KEY HOLIDAY PEAKS

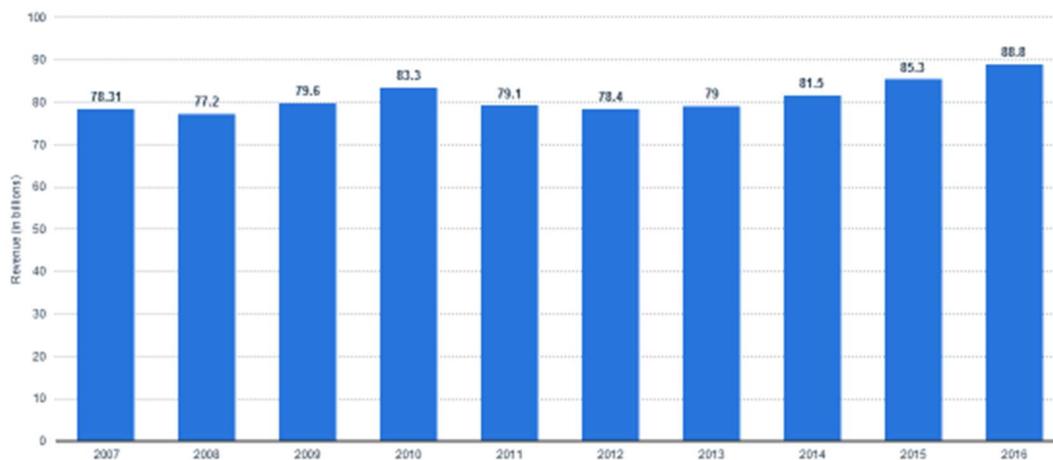


Source: Aiken Reeves@bazaarvoice, Toys and Games: Biggest Holiday Sales Spike Set for Late December, Accessed on December 7, 2017.

## Exhibit 6: Toy Market Revenue

Total revenue of the global toy market from 2007 to 2016 (in billion U.S. dollars)

Global toy market: total revenue 2016



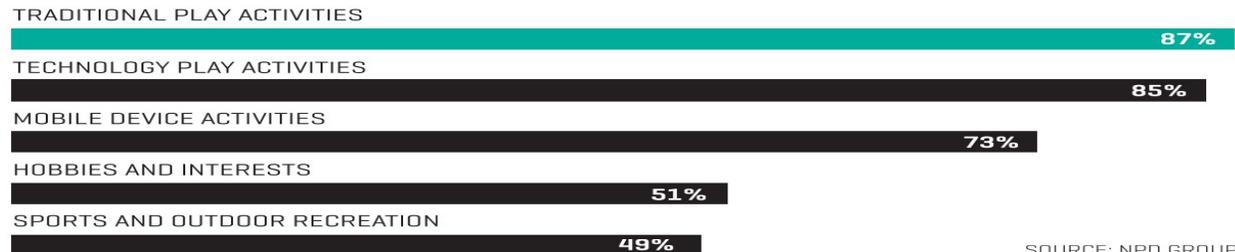
Note: Worldwide; 2007 to 2016  
Further information regarding this statistic can be found on [page 31](#)  
Source(s) NPD Group: [0\\_154392](#)

## Exhibit 7: Toy Variety

# NECK AND NECK

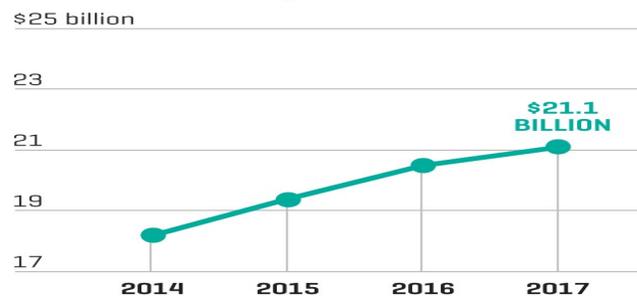
COMPUTERS, TABLETS, AND PHONES ARE NOW JUST AS PREVALENT IN KIDS' LIVES AS TOYS AND GAMES. BUT TOY SALES ARE STILL GROWING.

### ACTIVITIES ENGAGED IN DURING A TYPICAL WEEK BY KIDS 14 AND UNDER

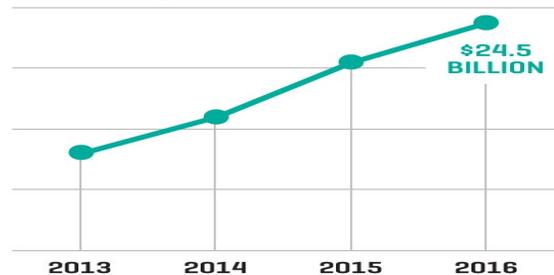


SOURCE: NPD GROUP

### ANNUAL TOY SALES, U.S.



### ANNUAL VIDEO GAME SPENDING, U.S.

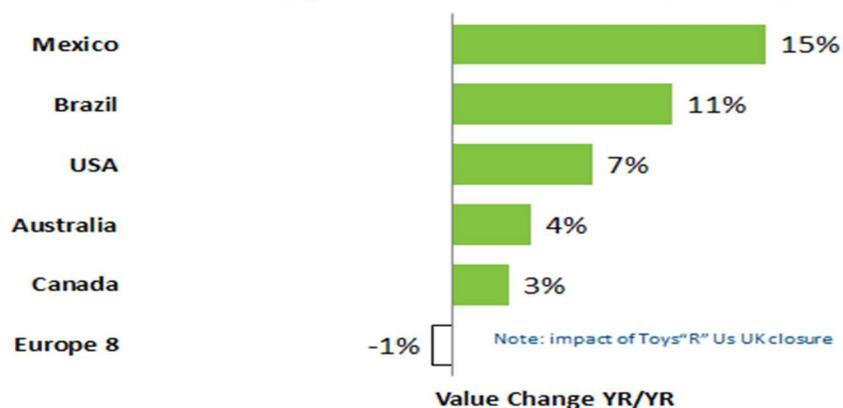


SOURCES: NPD GROUP; ENTERTAINMENT SOFTWARE ASSOCIATION

Source: Lev-Ram, Michal, [Can a Tech Makeover Save the Toy Industry?](#) Fortune, September 22, 2017.

## Exhibit 8: Toy Sales

### Global Toys, Mid-Year Performance by Country



Source: The NPD Group/ Retail Tracking Service, Dollar Sales Adjusted, January-June 2018  
Europe 8 includes Belgium, France, Germany, Italy, Netherlands, Russia, Spain, United Kingdom

<https://www.npd.com/wps/portal/npd/uss/news/press-releases/2018/toy-sales-across-key-global-markets-grew-by-4-percent-in-the-first-half-of-2018-reports-npd/>

## Exhibit 9: Key Indicators Linked to Growth in Emerging Markets; McKinsey Global Institute, 2018.

Our heat map analysis on 13 growth metrics highlights strong regional patterns.

Performance within emerging markets (quartile)<sup>1</sup>    ■ First    ■ Second    ■ Third    ■ Fourth

		► Regions <sup>2</sup>							
		Central Asia	East and Southeast Asia	South Asia	Central and Eastern Europe	Sub-Saharan Africa	Latin America	Middle East and North Africa	
Description	% of emerging market population	1	36	30	7	12	10	5	
	% of emerging market GDP	1	47	10	16	5	19	2	
Economic performance	Average GDP per capita Real \$ 2016	5,283	12,604	1,703	12,644	1,751	6,885	4,461	
	Average GDP per capita growth CAGR, 1996–2016, %	5.5	4.4	3.7	3.1	2.5	1.9	1.6	
Productivity drivers	Domestic savings CAGR, 1996–2016, %								
	Government effectiveness Change, 1996–2016, %								
	Market capitalization of listed domestic companies CAGR, 1996–2016, %								
	Global Innovation Index Rank change, 2013–16								
	Foreign direct investment CAGR, 1996–2016, %								
	Inflation Average, 2000–16								
	Government health expenditure CAGR, 2000–15, %								
	Government education expenditure CAGR, 1996–2016, %								
	Income and demand drivers	Household income CAGR, 1996–2014, %							
		Corporate income CAGR, 1996–2014, %							
Exports CAGR, 1996–2016, %									
MGI Connectedness Index Score, 2016									
Infrastructure investment CAGR, 2000–15, %									

1 Represents which quartile of the 71 economies the average of the archetype would fall in. For example, a green-colored square means the average of this archetype has a similar level in an indicator as top-quartile countries.

2 Central Asia: Azerbaijan, Kazakhstan, Kyrgyz Republic, Turkmenistan, and Uzbekistan. East and Southeast Asia: Cambodia, China, Hong Kong, Indonesia, South Korea, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam. South Asia: Bangladesh, India, Nepal, Pakistan, and Sri Lanka. Central and Eastern Europe: Belarus, Bulgaria, Czech Republic, Greece, Hungary, Poland, Romania, Russian Federation, Serbia, Slovak Republic, Turkey, and Ukraine. Sub-Saharan Africa: Angola, Cameroon, Côte d'Ivoire, Ethiopia, Ghana, Kenya, Mozambique, Nigeria, Rwanda, Senegal, South Africa, Tanzania, Uganda, Zambia, and Zimbabwe. Latin America: Argentina, Bolivia, Brazil, Chile, Colombia, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Paraguay, Peru, and Venezuela. Middle East and North Africa: Algeria, Egypt, Iran, Jordan, Lebanon, and Morocco.

SOURCE: World Bank; OECD; IMF; WIPO; INSEAD; WFE; WHO; UNESCO; McKinsey Global Growth model; Global Insight; McKinsey Global Institute analysis

Key indicators linked to growth in emerging economies.

Performance within emerging markets (quartile)<sup>1</sup> ■ First ■ Second ■ Third ■ Fourth

Archetype <sup>2</sup>	Economy	GDP per capita	Real GDP per capita <sup>3</sup>	Real GDP per capita	Domestic savings	Government effectiveness <sup>4</sup>	Market cap of listed companies	Global Innovation Index <sup>5</sup>	Exports	MGI Connectness Index <sup>6</sup>
		Real \$ 2016	CAGR, 1965–2016, %	CAGR, 1996–2016, %	CAGR, 1996–2016, %	Change, 1996–2016	CAGR, 1996–2016, %	Rank change, 2013–16	CAGR, 1996–2016, %	Score, 2016
Long-term outperformers	China	6,894	7.3	8.6	10	33	10	4	14	21
	South Korea	25,459	6.2	3.5	4	20	11	1	9	14
	Singapore	52,601	5.2	2.9	5	5	7	1	7	51
	Indonesia	3,974	3.6	2.6	4	40	5	-6	4	2
	Hong Kong	36,726	4.0	2.6	2	23	10	-2	6	21
	Malaysia	11,028	3.8	2.5	3	11	0	-2	4	8
	Thailand	5,901	4.3	2.4	3	6	7	0	6	8
	<b>Average</b>	<b>20,369</b>	<b>4.9</b>	<b>3.6</b>	<b>5</b>	<b>20</b>	<b>7</b>	<b>-1</b>	<b>6</b>	<b>18</b>
Recent outperformers	Myanmar	1,420	4.2	8.9	6	17				
	Azerbaijan	5,859	2.5	8.2	19	48	0	7	14	
	Turkmenistan	6,987	3.2	6.1	16	1				
	Cambodia	1,078	5.5	5.8	16	2		6	16	1
	Belarus	6,219	2.7	5.6	8	-6		-3	6	2
	Laos	1,643	4.3	5.4	13	13			6	1
	India	1,861	3.5	5.3	8	9	7	0	0	7
	Kazakhstan	10,570	2.3	5.2	9	58	13	3	3	4
	Vietnam	1,770	4.8	5.1	8	31	9	9	14	8
	Uzbekistan	1,961	2.6	5.1	7	47	8		6	
	Ethiopia	511	2.3	4.8	4	44	11	5		
<b>Average</b>	<b>3,626</b>	<b>3.4</b>	<b>6.0</b>	<b>10</b>	<b>24</b>	<b>7</b>	<b>4</b>	<b>8</b>	<b>4</b>	
Very recent accelerators	Sri Lanka	3,759	3.7	4.6	8	-1	9	2	4	1
	Mozambique	515	2.8	4.6	13	-30		18	14	1
	Rwanda	739	2.0	4.5	14	93		13	14	1
	Bangladesh	1,030	1.9	4.2	8	0	9	1	12	1
	Poland	15,049	3.6	4.0	5	0	13	2	8	8
	Dominican Rep.	6,909	3.4	3.9	5	-1		0	4	1
	Peru	6,089	1.3	3.3	6	-8	7	-1	6	1
	Ghana	1,708	0.9	3.2	3	-3	-1	-8	6	1
	Philippines	2,753	1.7	2.9	5	14	4	9	5	2
	Slovak Rep.	19,238	3.9	3.7	4	15	4	0	9	
Consistent growers	Bulgaria	7,929	2.5	3.7	6	14	35	0	3	2
	Romania	10,081	2.5	3.4	5	5	14	-4	9	3
	Tanzania	867	2.2	3.1	14	8	5	7	9	
	Turkey	14,071	2.7	3.0	6	5	5	12	6	3
	Serbia	5,852	3.0	3.0	6	81	-1	-9	10	2
	Chile	15,020	2.6	2.9	3	-8	4	-4	4	2
	Uganda	662	2.3	2.8	8	7		-8	9	1
	Morocco	3,196	2.8	2.6	4	0	0	11	6	2

1 Represents which quartile of the 71 economies the growth rate of each indicator falls in, except if it is in the top decile in terms of level (eg, for government effectiveness, Singapore is green as it has the highest score among all countries).

2 A note on archetypes: Long-term outperformers achieved more than 3.5% GDP per capita CAGR over a 50-year period and outpaced US growth for more than 36 years. Recent outperformers achieved more than 5% CAGR over a 20-year period. Middlers achieved CAGR of 0.95–3.5% over a 50-year period and include very recent accelerators (more than 3.6% CAGR between 2006–16), consistent growers, and volatile growers (exhibited high coefficient of variation in at least one ten-year interval). Underperformers had CAGR of less than 0.95% over a 50-year period.

3 Starting point is 1965 or earliest year available; simple averages have been taken across indicators.

4 The perceived quality of public services, civil service, and policy formulation and implementation, as measured by the World Bank's Government Effectiveness Score.

5 An annual ranking of national innovation in 80 fields, such as politics, education, infrastructure, and business sophistication, by Cornell University, INSEAD, and WIPO. Rank change reflects movement within emerging markets only.

6 McKinsey Global Institute's ranking of 117 countries based on total flows of goods, services, finance, people, and data and communication, adjusting for country size.

SOURCE: World Bank; OECD; IMF; WIPO; INSEAD; WFE; WHO; UNESCO; McKinsey Global Growth model; Global Insight; McKinsey Global Institute analysis



## **Exhibit 11: PREDICTIONS OF THE TOY INDUSTRY IN 2020.**

- Bricks and mortar retail is struggling, particularly big box. Toys "R" Us is in bankruptcy and some have concerns about the entire concept of bricks and mortar retailing. Which of the bricks and mortar retailers will be active and to what degree is anyone's guess.
- E-commerce is on fire and there is no end in sight to Amazon's almost exponential growth. Ironically, they could be the future of bricks and mortar retailing as they enter the market with new ideas and fresh strategies – like having stores with no employees.
- Consumers, particularly Millennials, are less likely to drive to a store than their Boomer parents and grandparents. Why? Because they see a previously unrecognized opportunity cost in driving to the store and not finding what was wanted. Simply put, buying on line saves time and is more efficient.
- An online shopper needs credit and access to the Internet and the lowest economic class has neither. It is for that reason that value operators like Dollar General and Family Dollar are bright spots in bricks and mortar. Simply put, they are the place to go for the digitally and economically disenfranchised. These chains are prospering and therefore energizing an already dynamic market for low, low price items offering outsized value to lowest income shoppers.
- China is emerging as a major consumer market for toys. In fact, Euromonitor predicts that China will replace the US as the number one country for toy consumption by 2021.

Source: Gottlieb, Richard, 10 Predictions for the toy Industry in the year 2022. Spielwarrenmesse, 2018.

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