

November 19, 2003

**MARKETING**

# Wal-Mart Fires the First Shot In Holiday-Toy Pricing War

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 Staff Reporters of THE WALL STREET JOURNAL

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Wal-Mart Stores Inc. has launched the Great Toy War of 2003 and its top soldier is Hokey Pokey Elmo.

In late September, a full three months before Christmas, and a month before hot holiday items normally are promoted, **Wal-Mart Stores** slashed the price on Fisher-Price's newest dancing doll to \$19.46 -- a stunning 22% discount to the **Toys "R" Us** price of \$24.99.

Then, by mid-October, Wal-Mart had cut prices on more than a dozen toys. A survey of the prices for 15 popular toys conducted by Banc of America Securities found that Wal-Mart's prices were 12% cheaper than Toys "R" Us and 8% less than prices at discount retailer Target.

The steep and early price cuts are roiling the industry. Tuesday, Toys "R" Us acknowledged Wal-Mart's moves caught it by surprise and hurt its third-quarter results. Its stock price fell 5.4% Tuesday in New York Stock Exchange composite trading, after falling 11% Monday when company's earnings came out.

While parents may love the lower prices, other competitors are frustrated, saying they are hard-pressed to match prices below their costs. Yet they can't afford to lose more market share to Wal-Mart. And manufacturers fret that the discounting will cheapen their brand names, quash innovation and prompt consumers to buy only when toys are on sale.

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Even toys in short supply are being discounted. Tom Kalinske, chairman of LeapFrog Enterprises Inc., Emeryville, Calif., says Leap Frog's Explorer Globe was reduced by one retailer to \$89.99 from \$99.99,

although the item is hard to get. "We perhaps have conditioned the consumer to realize that prices are at their lowest from Nov. 15 to Dec. 25," he says. "That might accentuate the seasonality of our business."

For Wal-Mart, however, the issue is building its business selling toys, though most of its sales will come during the holiday season. In August, Scott McCall, Wal-Mart's divisional merchandise manager for toys, promised "an aggressive holiday season." In part, the Bentonville, Ark., retailer aimed to jump-start its own toy sales, which have suffered from other industry issues, such as the trend of children moving earlier from toys and dolls to computer games and other gadgets. "We have a 21% market share," he said, "and there is room to grow."

But many toy retailers say they can't afford to match Wal-Mart prices, particularly those below their cost. They note for example that Wal-Mart sells Barbie Swan Lake for \$15.84 -- below the wholesale price of \$17, according to a list of manufacturer prices viewed by The Wall Street Journal. Wal-Mart sells Hot Wheels T-Wrecks Play Set for \$29.74, below its wholesale price of \$42, and Sesame Street Hokey Pokey Elmo at \$19.46, below its \$24 wholesale price.



Though Wal-Mart is believed to pay the same as other large retailers for those goods, it may get other deals, such as advertising dollars or rebates, which lower its overall cost.

Deep discounting by Wal-Mart and others, often selling toys at below cost, is common practice around the holidays, Toys "R" Us spokeswoman Ursula Moran says. "This is the way the toy retailing game is played," she says. This year, however, Wal-Mart has come out of the blocks earlier than usual. "We would prefer that this wasn't the case," she adds, "but Toys "R" Us has developed and refined a strategy that we believe will work."

Although Toys "R" Us prices originally were much higher than Wal-Mart's, the No. 2 toy retailer has made some cuts. For example, the Wayne, N.J., chain sells Barbie Swan Lake for \$16.99, the Hot Wheels set for

\$29.99, and Elmo at \$19.99.

Closely held KB Toys' prices are higher at \$19.99; \$49.99; and \$29.99, respectively. "We don't want to be embarrassed with much higher prices than our competitors, so we'll come down a bit in pricing, but we just aren't able to get down to Wal-Mart's pricing levels," said Michael Glazer, chairman and chief executive of the Pittsfield, Mass., toy chain.

Instead, toy retailers are trying to line up more exclusives rather than go head-on against Wal-Mart. KB Toys, for instance, features a line of toy Craftsman tools under a special agreement with department-store chain Sears, Roebuck & Co. Of the 3,000 toys sold at KB, Mr. Glazer estimates about 20% are

exclusive to the mall-based chain.

Besides eroding retail profits, deep discounts can tarnish the image of a toy brand. That is why manufacturers of videogames and videogame systems commonly set a Minimum Advertising Price, or MAP. Under MAP, videogame makers can refuse shipments to retailers who discount, or they can withhold the advertising money they usually contribute to the retailers' advertising budget, which is why videogame prices don't vary much.

Toy makers fear that too much price pressure will drive down their profit margins and eventually hurt their ability to invest in niftier new toys.

The toy makers also worry that by targeting popular items for rollbacks, Wal-Mart is making the toys seem cheap. "There's an unwritten rule amongst major retailers that you don't want to cut prices unless you have to," says a marketing director of a Los Angeles toy company. "The general consumer thinks that a toy is on sale because it isn't selling well."

Indeed, Toys "R" Us has tried that argument itself. A senior toy-marketing executive recalls, "When I was at Toys 'R' Us, they started the meeting by asking me, 'Why are you selling with Wal-Mart? They're not watching out for you.' " But since Wal-Mart has three times as many stores as Toys "R" Us, the executive says, toy makers must sell to the retailing titan.

And while manufacturers and retailers may groan at lower prices, consumers appreciate them. "Parents are always going to shop for the lowest price," says Amy Severson, a Dallas mother of a son, age 12, and daughter, age 10. Still, Ms. Severson thinks the price battles have their drawbacks.

She says Wal-Mart's selection is too limited, and Toys "R" Us is too focused on big-name brands. She prefers "cool, little boutiques" with more unusual toys; but they've been squeezed out by retail behemoths.

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*Updated November 19, 2003*

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