

Misfit Toy Management



Attempting to keep up with the changing pace of the toy business at the turn of the century, category-killer-turned-killlee Toys“R”Us shot for a strategic partnership in an area where it didn’t show core competencies: the expanding online retail space. The company entered a ten-year agreement to be the exclusive toy supplier for a prominent online retailer, a move praised by analysts as strategic. The partner? Amazon.com, an emerging e-commerce giant. The same company that would join Walmart on the hunt for brand mascot Geoffrey the Giraffe years later. The clicks-and-mortar partnership ended in 2006 after a two-year court battle, and Toys“R”Us limped along until announcing the liquidation of its 735 U.S. stores on March 15th, 2018.

Why did Toys“R”Us falter at every step? Did it get beat at its own game by competitors’ cheaper prices and better experiences — the latest victim of the retailpocalypse? Or were the company’s cash flow problems to blame?

The toy titan’s last 20 years give a case for both arguments.

Competition

In the 1960s and 1970s, Toys“R”Us dominated the industry by offering low prices, putting many smaller toy shops out of business. However, by 1995, Walmart’s 2,133 U.S. stores, surpassed Toys“R”Us’ 618 stores by undercutting prices. Despite this competition, Toys“R”Us resisted change. In 1998, the Federal Trade Commission intervened, ordering the company to stop unfair practices like pressuring manufacturers not to sell to rivals. By the end of that year, Walmart had become the nation’s top toy seller. While popular toys were available everywhere, Toys“R”Us couldn’t keep up with Walmart’s competitive prices and posted a net loss of \$132 million in January 1999.

At the same time that wholesaling giants were etch-a-sketching away at Toys“R”Us’s





market share, e-commerce became the second competitive transformation the toy chain failed to join. In 1999, newcomer eToys.com was nearly tripling Toysrus.com's sales. To make matters worse, Toys"R"Us ruined Christmas by failing to deliver toys on time. Finally, after an exclusive ten-year partnership contract with Amazon fell apart, Toys"R"Us began making significant sales on its online store after distribution investments. However, the once-leading toy company found itself in a tough spot due to competition from online and large retail stores, and it needed help.

Cash

A cohort of private investment firms led by Bain Capital took over the chain that Charles P. Lazarus started with only \$5,000, it did so with the "help" of a \$6.3 billion loan. Just to make the yearly loan payments, the new owners would have to find a way to double Toys"R"Us' annual net profits. And like the former managers of Toys"R"Us, the Bain Capital cohort underestimated the retail price wars, the growth of e-commerce, and the ensuing drop in retail real estate values. As it turned out, Bain Capital and company never brought Lazarus's company back to life.

With Toys"R"Us' meager profits paying the massive debt interest, the company couldn't

afford changes to evolve with the ever-changing retail space. Fierce reinventions and reinvestments kept many category killers alive during the market's shift, but with cash problems keeping Toys"R"Us stagnant, customers increasingly turned toward Amazon and Walmart as their preferred toy stores. In Toys"R"Us' 2017 bankruptcy filing, 12 years after the leveraged buyout, it claimed it was still spending \$400 million per year to pay off the buyout deal's debt.

Conclusion

When Toys"R"Us stumbled at the crossing of bricks and clicks with the Amazon train headed its way, would-be heroes didn't swoop in to save it — they tied it to the tracks. So is the train (the competition) or the hero-turned-bandit (cash problems from the buyout deal) really to blame? In truth, it was both: while Amazon and Walmart did indeed steamroll the original category killer, Toys"R"Us might have escaped them had it not been chained by the buyout deal's debt. If there's any bright news in the Toys"R"Us story, WHP Global acquired a controlling interest in Toys R Us (now Tru Kids) with plans to open stores in Macy's. Maybe the third owner of this kid will see it grow up.

Activity

Below you'll find a figure comparing Toys“R”Us’s cash position and number of stores to other retailers’. Review this information thoroughly and then use your business acumen to discuss the items at the bottom of the page with your team.

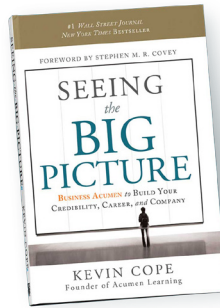


1975	Stores	51	125	49	N/A
1995	Stores	618	2,133	670	N/A
2004	Cash	\$1.25 B	\$5.19 B	\$2.25 B	\$1.30 B
	Cash Flow	\$746 M	\$5.044 B	\$4.45 B	\$567 M
	Stores	681	3,551	1,308	N/A
2017	Cash	\$432 M ^(Q3)	\$6.76 B	\$2.64 B	\$20.52 B
	Cash Flow	\$730 M ^(Q3)	\$28.34 B	\$6.92 B	\$18.43 B
	Stores	735	4,761	1,822	N/A

1. How did Toys“R”Us’s number of stores in 1975 help it put mom-and-pop shops out of business? How did Walmart’s number of stores in 1995 help it pressure Toys“R”Us?
2. The founders of Toys“R”Us and Walmart each espoused their chains’ low prices, but by the late 90s, Toys“R”Us was no longer the low-price leader. In what ways could Walmart afford to offer lower prices than Toys“R”Us?
3. Imagine you’re an executive at Toys“R”Us in 1998. Walmart is poised to take your position as market leader, and online startups are already selling more toys than Toysrus.com. What risks do you take? Why?
4. What was the intention behind Toys“R”Us’s partnership with Amazon.com? What risk was Toys“R”Us taking by entering into the partnership?
5. Compare each companies’ cash and cash flow from 2004 and 2017. What happened?
6. What opportunities did Toys“R”Us miss out on by spending so much of its cash ?
7. Now that you’ve completed the case study with your team, write down three lessons you’ve learned that will help you make better business decisions in the future.

At its heart, *business acumen* means knowing how your company makes money and making better decisions around the money-making process. As a business leader, you are in a unique position to bridge the gap between functions. You can grow the business in a way nobody else can.

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