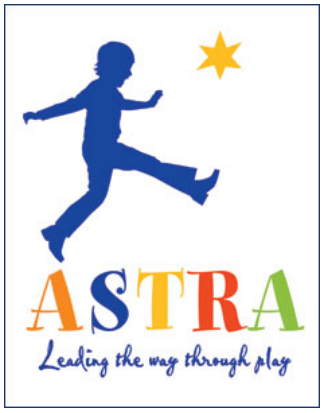

The Growth of Internet Retailing: Implications and Strategies for the Specialty Toy Industry

A white paper commissioned by the
American Specialty Toy Retailing Association

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About the American Specialty Toy Retailing Association

The American Specialty Toy Retailing Association (ASTRA) is a non-profit association that provides leadership and resources to grow the specialty toy industry. It is the largest association serving the specialty toy industry. ASTRA members build their businesses around specialty toys, which generally are designed with a focus on what the child can do, rather than what the toy can do. In other words, our members' products are about the features of the play more than the features of the toy. Our more than 1,300 members include independent toy and children's products retailers, specialty toy manufacturers, manufacturer's representatives, industry affiliates, suppliers and service providers, bookstores, school supply stores, and gift stores. More at www.astratoy.org.

About the Institute for Local Self-Reliance

The Institute for Local Self-Reliance (ILSR) is a 37-year-old national nonprofit research and educational organization. ILSR's mission is to provide innovative strategies, working models and timely information to support strong, community rooted, environmentally sound and equitable local economies. To this end, ILSR works with citizens, policymakers and businesses to design systems, policies and enterprises that meet local needs; to maximize human, material, natural and financial resources; and to ensure that the benefits of these systems and resources accrue to all local citizens. More at www.ilsr.org.

Introduction

This white paper presents the findings and conclusions of a research project commissioned by the American Specialty Toy Retailing Association (ASTRA) and undertaken by Stacy Mitchell, senior researcher with the Institute for Local Self-Reliance (ILSR).

The research project's purpose was to examine the growth of internet retailing and the challenges e-commerce creates for specialty toy manufacturers and retailers, and to explore best practices that would help ensure the long-term viability and prosperity of the specialty toy industry. As part of the research, in-depth interviews were conducted with 14 specialty toy manufacturers and 5 brick-and-mortar retailers. Two surveys gathered additional data and input from 47 manufacturers and 93 retailers.

The final section of this paper presents recommendations for specialty toy manufacturers and retailers. The paper itself also has a larger goal of expanding awareness among both groups of the particular problems and dynamics each is facing in this changing competitive environment. To this end, it quotes (anonymously) many of those interviewed or surveyed.

Lastly, it should be noted that, while this paper discusses some legal issues, its purpose is entirely informational and it should not be construed as providing legal advice.

Growth of Internet Retailing

- **Online toy sales have grown dramatically in the last year.**

  While toy sales overall grew a modest 2 percent in 2010, online sales of toys expanded by 22 percent, more than double the rate of 2007, which was the last period of significant online toy sales growth. This made toys one of the fastest growing categories in online shopping, which grew 13 percent overall last year.[1]

  Among the 47 specialty toy manufacturers who participated in our survey, two-thirds said sales of their products by internet-only retailers had grown more than 5 percent last year. One-fifth reported growth of 10-20 percent and another fifth reported growth through the internet channel of more than 20 percent. On average, internet-only retailers now account for 14 percent of their sales, with their own web sites contributing another 4 percent.

- **Already dominant, Amazon is on track to expand its market position in the coming years.**

  Amazon now accounts for one-third of e-commerce orders in the United States. With revenue increases averaging about 40 percent over the last six quarters, it is growing four times faster than online retail sales overall.[2]

  One driver of Amazon's growth is its Marketplace, the thousands of third-party vendors who use its platform to make sales and may also rely on the company for order fulfillment.

[1] NPD Group and Forrester Research.
[2] Amazon 2010 Annual Report.

Third-party vendors account for 33 percent of units sold on Amazon.com. Amazon owns the customer accounts of third-party sellers and derives other benefits from this arrangement, including the ability to offer deep selection without incurring inventory risk and to glean valuable information about product trends from specialty sellers.[3]

Amazon is now a mass merchant, but it began as a book retailer in 1995. Its trajectory in books offers a glimpse of the breadth of its ambitions. Today Amazon is the nation's largest book retailer. It accounts for about one-fifth of the current market, but captures a larger share of where the market appears to be headed, including about 75 percent of online book sales and 61 percent of e-books. Its growth has contributed to the closure of many local bookstores and the bankruptcy of Borders Books. Its increasingly dominant market position has also enabled it to deal aggressively with publishers, several of whom have had their titles suspended from Amazon.com until they agreed to provide bigger discounts or more co-op marketing dollars. More recently, Amazon has begun circumventing publishers altogether and working directly with authors through its two publishing imprints.[4]

- **Shoppers are increasingly using smart-phones to compare prices and check product availability while shopping in brick-and-mortar stores.**

  Apps offered by internet retailers and others enable shoppers to scan product barcodes with their phones and quickly determine availability and pricing at online stores. Several news stories during the 2010 holiday season encouraged shoppers to take advantage of these apps. For example, the *Hartford Courant* advised, "If you're in a store shopping, do a product search and find a better deal somewhere else or show a manager your phone with the results of your search and ask for a price match."

  In our survey, 43 percent of brick-and-mortar toy retailers reported seeing shoppers in their stores using their phones to check prices at least 2-3 times a month, with 15 percent reporting that this has been occurring at least several times a week. Many of those who participated in either an interview or the survey described incidents in which they had spent time demonstrating products to a shopper only to have that person take out their phone and make a purchase online even before leaving the store.

- **State and federal policies tilt the competitive playing field in favor of online retailers by exempting remote sellers from collecting the sales taxes that brick-and-mortar stores are required to collect.**

  These discriminatory policies give an additional price advantage to internet-only retailers in the 45 states that have sales taxes. With combined state and local sales taxes as high as 10 percent in some regions, including much of California, the added tax cost of choosing a brick-and-mortar store can be substantial. That this exerts a significant influence on consumer shopping choices is perhaps best illustrated by the degree to which sales tax issues have driven Amazon's business decisions. According to CEO Jeff Bezos, Amazon chose

[3] Amazon 2010 Annual Report; faberNovel, "Amazon.com: The Hidden Empire," May 12, 2011.
[4] Ken Auletta, "Publish or Perish: Can the iPad topple the Kindle, and save the book business?" *The New Yorker*, April 26, 2010; Colin Robinson, "The Trouble with Amazon," *The Nation*, August 2/10, 2010; Onnesha Roychoudhuri, "Books After Amazon," *Boston Review,* Nov./Dec. 2010.

not to locate its corporate headquarters in California, despite the state's extensive pool of computer talent, in order to preserve its ability to compete sales-tax-free in this large market state. In more than a dozen states, Amazon operates fulfillment centers or other divisions, but has structured these in such a way as to avoid creating a physical "nexus" that would obligate it to collect sales taxes on sales in those states. More recently, it has fought political battles in South Carolina, Tennessee and Texas to ensure that facilities in those states do not trigger an obligation to collect sales taxes.[5]

- **Internet retailers present a significant competitive challenge for independent brick-and-mortar stores, one that is in many respects more severe than that of big-box and other chain retailers.**

One of the main strategies that independent brick-and-mortar stores have used to compete against big-box retailers and toy store chains is carrying a deep selection of specialty toys. But this is not effective against internet retailers, which are able to offer an extensive selection of many specialty brands.

Nor are strategies like exceptional service and a compelling store experience necessarily enough to counter the deep discounts at which many specialty toys are now available online. "A 10-12 percent difference is sustainable," explained one retailer. "That we don't have a big issue with. The toy is here. It's gift-wrapped. We can compete with that. It's the 30-50 percent differences." Even loyal customers who value the toy store experience and the expertise of specialty retailers are likely to balk at spending that much more, particularly on higher-ticket items. As a retailer said, "When we say this table and chairs is $100, and the customer returns it three days later and says to us, I found it [online] for $57, it makes us look like thieves. They don't say it, but they are thinking, You are ripping me off."

Although lower prices are a primary factor driving the growth of online shopping, convenience — the ability to shop anytime of day and have items shipped to your door — has also played a role, according to consumer research. This appears to be particularly true during the holiday season when there are many demands on people's time.

Among the 93 retailers who participated in our survey, 39 percent reported that their sales dropped in the 4th quarter of 2010 (by an average of 13 percent). Another 14 percent said sales were flat. Many described the decline in holiday sales as a surprise after the first three quarters of the year, when revenue appeared to be on the rebound after the recession. The declines have continued into the 1st quarter, with 42 percent of respondents reporting that their sales are down for the first three months of 2011. When asked to select which factors most likely accounted for the decline, "the weak economy" and "increased competition from internet retailers" were tied with about 75 percent of respondents. (None of the other items on the list, such as increased competition from chain retailers and shoppers migrating from traditional toys to high-tech items, were identified as factors by more than a minority.)

[5] Michael Mazerov, "Amazon's Arguments Against Collecting Sales Taxes Do Not Withstand Scrutiny Center on Budget and Policy Priorities, Nov. 29, 2010; Amy Martinez, "Amazon.com fights sales taxes after getting other breaks," *Seattle Times*, Jan. 23, 2011.

Implications for Specialty Toy Manufacturers

- **The internet offers opportunities for specialty toy manufacturers.**

  The web offers manufacturers a new avenue to reach consumers and the opportunity to present their full line to shoppers. "On the web, we can show the long-tail of our product line. That makes the web very attractive," explained one manufacturer. "The category where we have seen the most growth is the online business. While it's still smaller than the other categories, that growth has caught our attention and we can't ignore it," said another. "You can't live without the web. Moms today are online all the time," said another. "We need to somehow wrap our arms around it and go forward with it."

- **Even as the growth of e-commerce creates opportunities, it also poses significant risks for specialty toy manufacturers. These include:**

  - ***Loss of perceived brand value and image* —** Many specialty toy manufacturers have succeeded by investing in the development of well-designed, distinctive, high-quality toys and building a strong brand image. But the value of that brand can be eroded on the web by deep discounting, poor brand presentation, and a shopping environment that often lacks a high level of customer service and brand promotion by knowledgeable staff.

  "In most internet presentations, it has nothing to do with telling a story. You throw [one of our products] up on [an e-commerce site], and you'll have it next to a fashion for a five-year-old, next to a toy for a two-year-old and so on," explained one manufacturer. "We are a brand company. Our marketing is not about individual products; it's about the brand. All of our product categories need to be presented cohesively with a story around that category. To me it is not presented properly online."

  "We feel that selective distribution is important," said another manufacturer. "There are certain websites that are consistent with our brand. They talk about the quality and present it in a way that is consistent with the brand image. On other sites, it is sold just above cost with little or no information… positioning our brand in a way that is inconsistent with the best interests of our company."

  Ultimately, what a toy is worth in the minds of consumers is the price it is selling for online. As several manufacturers noted, not only does discounting change the perceived market value of a toy, price discrepancy across channels can also negatively affect brand perception by creating a sense that a brand's prices are arbitrary and at times inflated.

  On the internet, a single seller can set off a cascade of price reductions as the algorithms that e-commerce sites use to scan the web find that lower price and automatically match or undercut it — or, in the case of third-party platforms, when one vendor, vying to be in the "buy box" for a certain item, drops the price. "It's a price adjustment that happens automatically," said one manufacturer. "There's no human involved, except for the clown who starts it. He needs volume, not margin. If he uses their fulfillment, he's not even touching the product."

➢ ***Short-term sales growth that leads to long-term revenue declines —*** Independent toy stores, which are the top customer segment for the manufacturers who responded to our survey, accounting for 45 percent of their sales on average, are beginning to reduce shelf space for brands that are heavily discounted on the web and to shift their focus to toys that carry margins capable of supporting brick-and-mortar stores. These stores typically have a higher cost structure than that of internet retailers, because of the expense of the retail space and additional customer service staff.

"We are starting to see a reaction of specialty stores saying, I'm taking my 12-foot section and cutting it to 8. We are starting to see that, because they can't compete with [internet retailers]," said one manufacturer whose products have been listed on the web at 20-35 percent off.

"In the short-term, we are probably selling more products," said another. "But in the long-run, the retailer whose overhead structure is higher, because they offer a wonderful shopping experience, may say I can't compete at that price. They may decide not to carry it anymore. That would cost us our main source of distribution."

"You can end up with short-term success, but in the long-term shoot yourself in the foot," said another manufacturer. "My brick-and-mortar customers are dropping my product all over the place."

Of the 93 retailers who responded to our survey, just over half said that they had reduced the space allocated to certain brands because the online price was too low for them to be competitive. About one-quarter said that they had not yet altered their selection based on online competition, but intended to more closely monitor and make adjustments this year. The remaining quarter said that online competition did not affect their buying decisions.

"On just about every order I am writing, I am looking [at e-commerce sites] to decide which brands and SKUs to support," said one store owner. "A rep asked me why I had dropped a manufacturer's product," said another retailer. "It can be 30 percent off online. It's not worth it to me. I'm not turning over enough of it." Still another commented, "We put a lot into hand-selling these things. When they show up on the internet for a much lower price, it makes us think twice about whether we want to put that energy into building their brand."

➢ ***Permanent reduction of showroom space for specialty brands —*** A greater concern for the specialty toy industry as a whole is the potential for large numbers of brick-and-mortar stores to close, eliminating much of the highly valuable showroom space in which specialty brands are now showcased and presented to consumers. More than most products, toys need and benefit from customers being able to interact with them and learn how they work from a sales person. When asked in our survey to rate on a scale of 1-5 how important specialty stores are to their brand, with 1 being not at all and 5 being critically important, 79 percent of manufacturers checked either 4 or 5.

"We sell a higher-end product that is really durable and reliable and full of all kinds of value that you can't see online. We do best when a consumer can look at our product and feel it, and say, Hey this is really well made, it's heavy and well put together, and it's obviously the best choice. That can't happen without brick-and-mortar stores," said one manufacturer.

"The types of experiences that people can have in real toy stores are more valuable for the types of products that we sell," said another manufacturer who produces educational products. "The conversation that a knowledgeable retailer can have with a customer is better than what they can glean in an online store."

Brick-and-mortar showroom space is particularly crucial for new products and start-up brands. Independent toy stores are the place where these brands first connect with consumers. This is where the learning experiences consumers have with new toys and new games happen. In the absence of specialty stores, new brands would have to try to find a place on the shelves of a large chain or an e-commerce site, where they may well languish, lacking the personal introduction to consumers that specialty retailers provide.

Even well-established specialty brands with popular lines are finding that physical stores are where they acquire new customers, not the web. "We recently did research on our [popular product] line and found that 70 percent of consumers who have purchased it found it in a store. It's not from internet surfing. They come across it in a store," said one manufacturer.

Countless games and toys have made it into the larger market by succeeding first in the specialty arena. "What we should all recognize is that the only reason anyone else would be interested in us is because of specialty. The only reason we are having a shot in Target or Toys R Us is because we are doing well in specialty," one manufacturer said.

Brick-and-mortar retailers say shoppers are still coming into their stores to learn about toys, but now more of them are making their purchase online. "Now you can get the experience in the toy showroom and then go online and buy it once you've played with it," explained one retailer. "We have become a demo-ing ground for toys. I don't think we will have a future unless internet pricing and sales tax issues are addressed."

Many consumers seem oblivious to the inevitable consequence of browsing in the store but buying online, namely the loss of a toy store that clearly provides value for them. Specialty toy manufacturers would be unwise to also ignore the implications of this pattern. Physical showroom space has long been a key part of their brand strategy. Without the opportunity to see and experience a specialty product, toy shoppers are likely to gravitate more toward big-brand best-sellers and away from niche toys. This has been the case in other product categories, including books. As mass merchants come to dominate the field, the top-selling products gain market share at the expense of smaller brands. This is true even in the long-tail world of e-commerce sites, where "customers who viewed this item also viewed" algorithms tend to funnel shoppers along well-trod pathways, making the discovery of a new author or an innovative new toy a far less frequent occurrence than it has been at independent brick-and-mortar stores.

➢ ***Dependence on a few large customers —*** Not having a diversified customer base is risky for manufacturers. "The mass market is big but can be very fickle," noted one manufacturer. Large retailers have the lion's share of the negotiating power and they can be unreliable partners. Another manufacturer had this experience: "Last fall, Amazon ordered huge quantities of two items. We were psyched. They had told us earlier in the year they were going to do big promotions of these items. We had to double our production run on one of

the items. Then December rolls around, and they had done nothing to promote the items. And now they are sitting on too much of inventory. They started to discount those items, selling them at 80 percent off." This angered and alienated other retail customers, who were stuck with inventory that they couldn't sell unless they priced it at a loss. The company has spent the last few months rebuilding those relationships. "I don't think most toy manufacturers realize how dangerous Amazon can be as it starts to push its weight around. We hadn't realized that Amazon could be that same type of player as Wal-Mart."

Looking Forward: Recommendations for a Strong Future

- **In light of the sharp rise in online toy shopping during the last holiday season, specialty toy companies should make it a priority to develop an internet strategy that balances the opportunities presented by the web with the need to protect their brand image and the viability of their brick-and-mortar customers, which deliver unique value for their brands.**

  Nearly all of the manufacturers interviewed expressed a sense of urgency on this issue. "We don't want to go through another season like 2010 without managing our brand better," said one. "As manufacturers we are not going to give up the internet. As consumers, we are not going to give up the internet. But how do we make sure all of these things stay vital?" said another. "It should be the number one topic on every manufacturer's mind. What are we going to do to counteract this and be a player? If we do nothing, we are going to be marginalized and pushed out."

  Among the 47 manufacturers who took the survey, 89 percent said they either had already adopted or were considering adopting policies to manage the way their brand and products are presented and marketed online.

- **To protect their long-term interests, specialty toy manufacturers should 1) adopt policies to ensure that their products are sold only by retailers that are committed to their brand strategy and 2) consider pricing policies, in accordance with federal and state laws, that are pro-competitive and recognize the value of promoting consumer awareness and understanding of their brand.**

  Manufacturers in many industries are exerting greater control over the retail prices at which their products are marketed. The U.S. Supreme Court has concluded that manufacturer-mandated pricing policies can have pro-competitive effects and consumer benefits. Such policies encourage retailers "to invest in tangible or intangible services or promotional efforts," such as showrooms, product demonstrations, and knowledgeable employees. Absent pricing policies, such investments may not be worthwhile because "discounting retailers can free ride on retailers who furnish services and then capture some of the increased demand those services generate." Such policies can also foster new product development and expand choices for consumers by inducing "retailers to make the kind of investment… that is often required in the distribution of products unknown to the consumers."[6]

[6] U.S. Supreme Court, *Leegin Creative Leather Products, Inc. vs. PSKS, Inc.*, 127 S.Ct. 2705 (2007). The Court also stated that manufacturer-mandated pricing policies can have anticompetitive effects in some cases, such as when they facilitate cartels among manufacturers or retailers.

An increasingly common approach among specialty manufacturers, both in the toy industry and other sectors, is to implement a Minimum Advertised Price (MAP) policy. These policies are unilaterally implemented by manufacturers (they are not agreements with retailers) and apply to all retail customers. They specify that the company's products may not be advertised, including being listed on a web site, below specified prices. Under these policies, a retailer may sell a product for less, but not advertise or list the product at that lower price. On the web, a lower selling price can be shown only after a customer takes a specific step to buy it, such as putting the item in his or her shopping cart or, under some MAP policies, proceeding to the final checkout page. Generally speaking, MAP policies are legal, but they should be drafted by a qualified attorney who can offer advice about appropriate terms, language, penalties and enforcement.[7]

Among the MAP policies reviewed as part of this project, some specified minimum advertised prices at full keystone. Others allowed for discounting of up to 10 or 15 percent. Some applied to all of a manufacturer's products; other to certain lines. Most exempted discontinued products.

Manufacturers who have adopted MAP policies say that their primary motivation is the long-term sustainability of their brand and retail partners. "We wanted to protect brick-and-mortar retailers that have a lot of investment and have partnered with us for a long time. If someone was just going to buy and sell, we could do that ourselves. We could set up an online store and undersell anyone. But we are interested in keeping this brand up and running, and selling it for a long time. We don't think having it in a price war is a good strategy for us," explained one manufacturer. "What I want is for all of our retailers to have a margin that allows them to run a sustainable business," said another manufacturer, who noted that neither his brick-and-mortar nor his internet customers are likely to stay in business for long if some online sellers continue flipping his products for pennies over what they paid for them.

In addition to MAP policies, some toy manufacturers now charge additional handling fees and impose special terms on internet retailers that do not inventory their products but instead rely on third-party fulfillment or drop-shipment by the manufacturer. One manufacturer looked at the additional labor costs they incur supplying internet sellers that use third-party fulfillment services provided by e-commerce platforms and began adding a 15 percent charge to these orders to cover the costs. Another company that produces bulky items will no longer drop-ship for retailers that discount more than 15 percent off keystone. If it's only about clicks on a web site, the manufacturer explained, retailers that don't have to manage the inventory risk or handle shipping "don't care if they make only $10 a click," even on larger, higher-cost items.

[7] In 2007, the U.S. Supreme Court upheld pricing policies that are much more restrictive than MAP policies, ruling in *Leegin* that manufacturers are not necessarily violating antitrust laws if they set minimum prices at which their products must be sold (not just advertised). However, state laws on minimum resale price maintenance vary and, in some cases, are not consistent with the Supreme Court's decision. It will likely take several years for litigation to clarify the extent of manufacturers' ability to mandate actual retail selling prices in certain states.

Although more than 80 percent of the surveyed manufacturers who have a MAP policy, when asked to rate its effectiveness on a scale of 1 to 5, with 5 being very effective, rated it either 4 or 5, many say enforcing a MAP policy is time-consuming and challenging. Some manufacturers have found that a strong initial push can make ongoing enforcement easier. "It takes a lot of diligence. But, as we enforced it, and we cut people off, it became easier to enforce. We have fewer violations," noted one. "What we saw happening with our brand was that at different times of the year, like the end of the month, you'd see [it] go on sale. Maybe they have payroll to meet or rent to pay. We spent time asking them to stop. Then we started cutting them off. Slowly but surely everyone got the message," said another manufacturer who has had a MAP policy for several years.

Other manufacturers have found enforcement more difficult, particularly those that have a large number of SKUs to monitor or who sell to distributors, which makes it harder to trace and correct MAP violations. "We do not have the manpower to monitor, track, and police the entire internet for violations of our policy. It is hard to tell sometimes where/when a violating seller has obtained our products and how much they have (i.e., how big of a problem they are). When we cut one MAP violator off, another one grows up in its place," one complained. "There are rogue stores all over the place on the web. To monitor that is extremely expensive. Even if you get all 10-15 retailers that are selling the product on Amazon to stop undercutting the MAP, then another one suddenly pops up," said another.

According to the manufacturers interviewed for this project, Amazon generally responds to requests to correct MAP violations for its own product listings. But the company is unwilling to help manufacturers enforce MAP policies among its third-party vendors or use its web platform to set an advertised price floor on products that are covered by a MAP policy. "Amazon's policy is to make manufacturers do all the work. They won't help enforce MAP for the vendors. Instead they use it as an excuse to lower their own price below MAP," said one manufacturer. Amazon's third-party sellers often cloak their identity or, if they also have a brick-and-mortar store, operate under a different online name, making it impossible for manufacturers to figure out who they are. Amazon refuses to provide contact information. "The hidden cloak that Amazon provides to these retailers is my number one frustration with the online market right now," another manufacturer said.

The difficulties of tracking and correcting MAP violations point to the need for the other component of this paper's policy recommendation for manufacturers, which is to develop strategies to manage distribution up-front to ensure that their products are sold only by retailers that are committed to their brand's long-term health and viability.

Authorized Retailer agreements are one approach. Retailers must apply to sell the brand, meet certain defined standards of customer service and adhere to stipulations about how the brand is presented, including the manufacturer's MAP policy. Some manufacturers have mandated that Authorized Retailers must have a brick-and-mortar store. "Anytime we get an order, it goes out to the rep in that territory. The rep is suppose to verify that the retailer has a physical presence and that it is someone we want to sell to," one manufacturer said, but added that this is not entirely foolproof as some brick-and-mortar retailers, "even some ASTRA members," are selling online under a different name.

Other companies have implemented Authorized Internet Retailer agreements that limit who can sell their products online and govern how their products are presented on the web. One manufacturer requires a minimum $5,000 order for web-only retailers in order to weed out "fly-by-night" operations that have no commitment to the specialty toy business.

To address enforcement challenges, at least one manufacturer has also developed an Authorized Distributor agreement that requires distributors to sell only to Authorized Retailers. Manufacturers might also explore the possibility of including provisions in their Authorized Retailer agreements the cover the enforcement issues created by internet retailers that not only sell their products, but offer their web platform to other sellers.

Ultimately the effectiveness of both MAP policies and distribution agreements hinge on the willingness of manufacturers to drop violators. "The real key to all of this is the manufacturers saying no," said another manufacturer, who is beginning to close accounts with internet sellers that do not present his brand properly. He hopes that brick-and-mortar stores will respond by carrying more of the line. Too often, he says, specialty retailers expect manufacturers to sell exclusively to their channel, but then only stock a few of the brand's products themselves. "When you walk into their store and see the actual volume, you see that manufacturers have to find other outlets."

"For us, the biggest challenges are in the immediate term," said one manufacturer. "Like it or not, from a business standpoint we have enjoyed growth from [the internet] channel. The immediate challenge is, How do we support our business but take significant volume out of it? If we took the step to refuse to sell to certain customers, that volume would not be made up for by other retailers. We would plan on a two-year dip in our sales before that would be made up. But if you don't take that step, what is the future of your brand three, four, five years down the road? Has it become a commodity out there?"

Another way that manufacturers can support the added value that specialty brick-and-mortar stores provide is by creating exclusive buying opportunities for retailers that present the line in a physical space and support it with a certain level of promotion. Manufacturers can reserve a portion of their products for sale only by retailers that meet these criteria, which creates clear competitive opportunities for brick-and-mortar stores, as well as an incentive to focus their resources on promoting those products. Some manufacturers also offer special discounts to select retailers that support their brand with a brick-and-mortar presentation and in other specific ways. Both of these approaches help to level the playing field and account for the additional investment that brick-and-mortar retailers make in showcasing a company's products.

- **ASTRA should monitor how these issues are playing out in other industries on an ongoing basis and share that information with its members.**

The challenges created by the growth of e-commerce are not unique to the toy industry. Manufacturers across a wide range of industries are working to address the same issues. An executive with a company that monitors online retailers for compliance with manufacturers' policies estimates that nearly half of consumer product producers have adopted some type of policy to manage distribution and/or advertised pricing for some or all of their products.

Particularly relevant are those industries that also have some differentiation between mass and specialty products. In the running industry, for example, all seven of the major running shoe brands that are sold at specialty stores have adopted MAP policies. "Years ago, we were selling to anyone who wanted us. [The company] has since closed accounts and cleaned up where its products are available online," noted one running shoe manufacturer, which has implemented both a MAP policy and an Authorized Internet Retailer agreement. "We do enforce the policy. But it really starts with new accounts. We don't open those that will not present the product in a premium way, and we say we can shut down any account without giving a reason with 30 days notice."

In the bicycle industry, the implementation of policies to manage distribution and advertised pricing has been more uneven. Some companies work strictly with Authorized Dealers that provide a certain level of promotion and service, and others strongly enforce MAP policies. But, as with the toy industry, some companies are struggling with monitoring and enforcement, particularly those that sell through distributors.

In the book industry, publishers, increasingly concerned about being at the mercy of a single online retailer, have moved toward an "agency model" for e-books, in which the retail price is set by the publisher and the retailer retains a 30 percent commission. This model was first implemented by Macmillan in early 2010. Although one internet retailer initially balked and removed the company's titles from its listings, it relented after a few days. Now all six major publishing houses have adopted agency pricing for e-books. This has diversified the market, opening the way for competition from other e-book retailers, including independent bookstores which are now selling e-books through a partnership with Google.

- **Specialty toy manufacturers and brick-and-mortar retailers, perhaps under the auspices of ASTRA, should establish a partnership to explore and develop mobile applications and other strategies to leverage the web to drive traffic and sales to specialty retailers.**

The web is becoming increasingly integral to how most consumers shop, even if they complete the purchase in a brick-and-mortar store. According to Forrester Research, by 2014 over half of all retail purchases will either be made online or influenced by online research and browsing. This past holiday season, 84 percent of holiday shoppers made at least one purchase online.

Specialty retailers cannot ignore these trends and need to look for ways to integrate the web, and the convenience and selection that it offers, into their own businesses. Becoming a third-party vendor on an established internet platform, however, is not a very fruitful strategy for specialty retailers, given the intense competition, cut-throat margins, and dependence on the host company, which owns the seller's customer accounts. But then neither do independent retailers have the capacity and resources to develop web and mobile solutions on their own.

A more promising approach would bring together both retailers and manufacturers to explore and develop joint solutions, perhaps through a working committee that could tackle such questions as: How might independent retailers leverage their competitive advantages, including their product expertise and their community presence, through the web? Could stores use web kiosks and drop-shipment by manufacturers to offer more selection and

convenience for customers? Are there opportunities to drive local traffic and sales through mobile apps?

- **Specialty toy manufacturers and retailers should urge state and federal lawmakers to rectify the unfair playing field created by government polices that require brick-and-mortar stores to collect sales tax but not their internet-only competitors.**

  Half a dozen states over the last two years have enacted laws that extend the requirement to collect sales taxes to large online retailers that use in-state sales affiliates to drive traffic to their sites, including Overstock and Amazon. More states are now considering similar bills. At the federal level, a proposal introduced in Congress, the Main Street Fairness Act, would expand the authority of states to impose sales tax collection on large remote sellers regardless of their in-state affiliate relationships.

  Passage of these bills should be a top priority for the specialty toy industry, because sales tax disparity imposes a significant competitive disadvantage on brick-and-mortar retailers and, by extension, harms the specialty manufacturers that rely heavily on this channel for distribution. ASTRA has been working with other trade associations, including the American Booksellers Association, to disseminate information and mobilize members to contact lawmakers, testify on behalf of bills, and advocate for sales tax fairness in local news media.

  Given the current momentum on this issue, ASTRA members should all commit time over the coming months to educate and lobby their state and federal representatives.