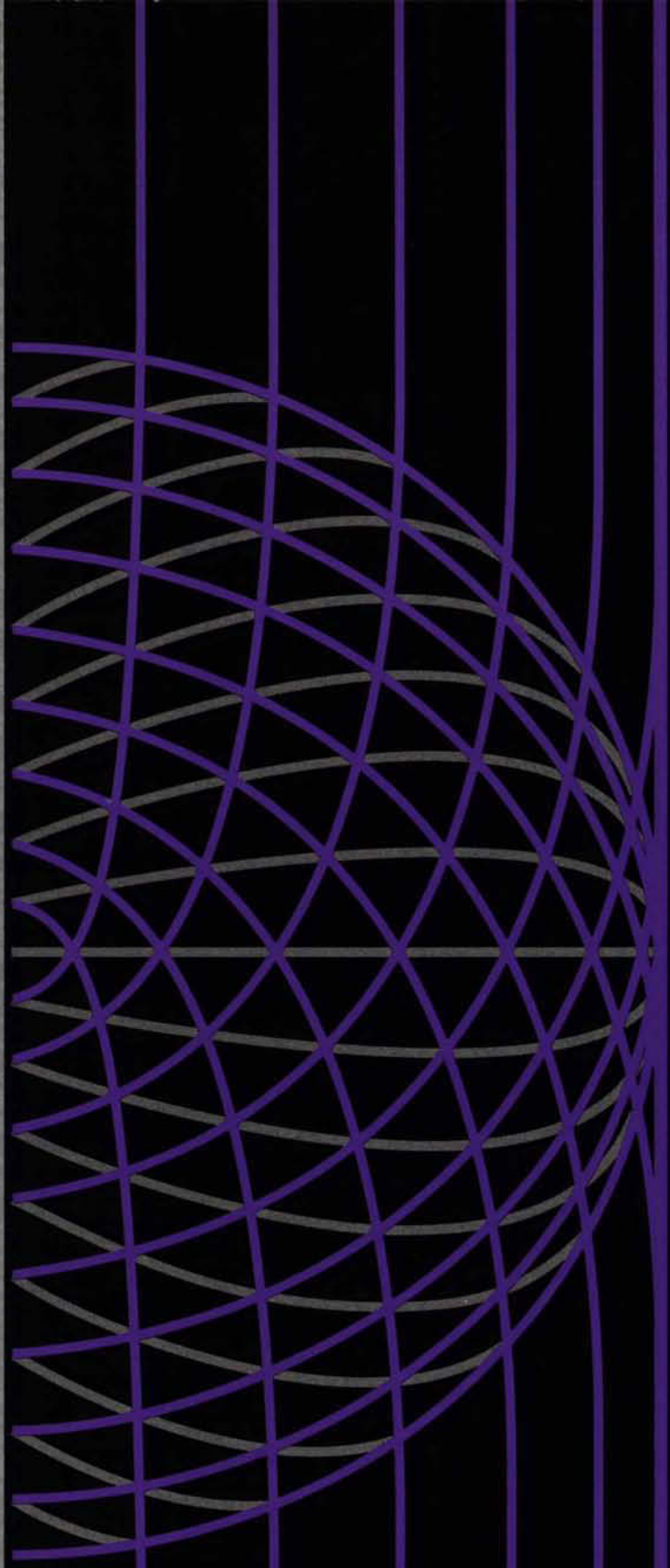
Toys and Games



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I N D U S T R Y P R O F I L E

1990–1991

TOYS AND GAMES

FOREWORD

In a rapidly changing global trade environment, the international competitiveness of Canadian industry is the key to growth and prosperity. Promoting improved performance by Canadian firms in the global marketplace is a central element of the mandates of Industry, Science and Technology Canada and International Trade Canada. This Industry Profile is one of a series of papers in which Industry, Science and Technology Canada assesses, in a summary form, the current competitiveness of Canada's industrial sectors, taking into account technological, human resource and other critical factors. Industry, Science and Technology Canada and International Trade Canada assess the most recent changes in access to markets, including the implications of the Canada-U.S. Free Trade Agreement. Industry participants were consulted in the preparation of the profiles.

Ensuring that Canada remains prosperous over the next decade and into the next century is a challenge that affects us all. These profiles are intended to be informative and to serve as a basis for discussion of industrial prospects, strategic directions and the need for new approaches. This 1990–1991 series represents an updating and revision of the series published in 1988–1989. The Government will continue to update the series on a regular basis.

Michael H. Wilson
Minister of Industry, Science and Technology
and Minister for International Trade

Structure and Performance

Structure

The toys and games industry comprises producers of four broad product groups: wheeled toys and doll carriages; dolls, dolls' clothing and parts; a wide range of skill/action games, puzzles, construction toys and stuffed toys; and video and electronic games.[1] Bicycles are described in a separate industry profile on *Sporting Goods*.[2]

In 1988, there were 96 establishments employing 2 033 workers and having shipments of $210.5 million (Figure 1). Canadian exports reached $48.5 million in 1988, representing 23 percent of shipments. The major export market was the United States at $38.2 million, followed by the European Community (EC) at $6.5 million. Imports into Canada in 1988 were $506.6 million, about 76 percent of the domestic market. The main source of imports was the United States at $154.5 million, followed by the Republic of Korea at $50 million, Hong Kong at $47 million and Taiwan at $40 million.

Ontario accounts for 46.8 percent of establishments, and Quebec accounts for 25.3 percent of establishments. The industry is concentrated in Toronto and Montreal. Both cities offer access to large consumer markets and labour pools as well as to input materials and subcontracting facilities such as plastic moulding, packaging and sewing.

The industry is dominated by a few large operations having a wide range of product lines and accounting for the largest proportion of output. In 1988, less than 10 percent of the companies employed 100 people or more, but together

[1]This profile does not include computer games.

[2]The pre-1988 data for toys and games excluded bicycles with wheels over 35.5 centimetres. As a result of the introduction of the Harmonized Commodity Description and Coding System (HS), the 1988 data do not specifically include bicycles, but do include wheeled toys such as tricycles, scooters and pedal cars.

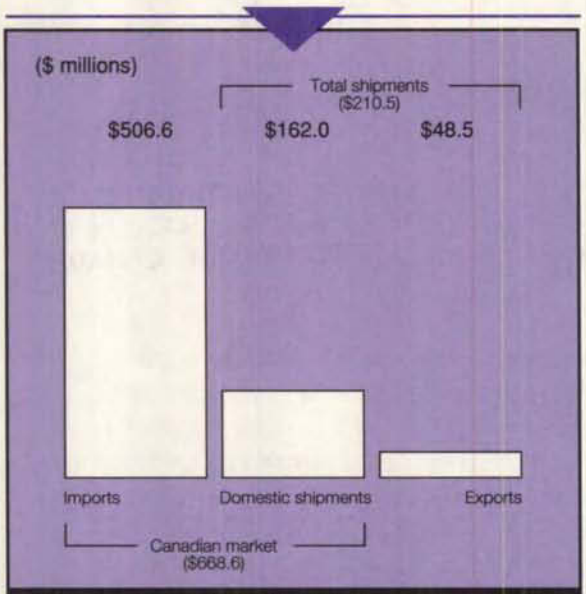

Figure 1 — Imports, Exports and Domestic Shipments, 1988

they produced over 60 percent of industry shipments. In contrast, roughly 75 percent of all companies employed fewer than 20 people, but together they accounted for less than one-tenth of total employment and industry shipments. Most of the smaller firms are privately owned and family-operated and specialize in one or two product lines, such as wooden toys, porcelain dolls and games. With the exception of video and electronic games, virtually all classes of toys and games are produced at least to some extent in Canada. The main sources of imports of video and electronic games are Japan and the United States.

Foreign ownership (primarily American) and dominance by larger operations have both increased since 1973, so that by 1988 foreign-controlled companies represented almost one-half of all establishments and two-thirds of industry shipments.

The majority of toy and game companies are oriented toward Canadian markets. Even the larger Canadian firms manufacture, under licence, products whose export rights tend to be controlled by the large U.S. multinational enterprises (MNEs). Canadian operations also are often used to satisfy short-term U.S. and offshore MNE capacity constraints.

Performance

The demand for toys and games is dependent on a number of complex demographic, social and economic factors. In particular, the level of real personal disposable income is a major determinant of consumer expenditures on toys and games. As well, the number of children under the age of 15 is a major factor. This group is increasing because many baby boomers are having children later in life. Sales are also heavily influenced by consumer outlook and fads (e.g., Pictionary, Cabbage Patch dolls and Teenage Mutant Ninja Turtles). Demand is seasonal, with over two-thirds of sales occurring during the last three months of the year.

From 1973 to 1983, industry shipments grew from $98 million to $240.5 million. The 1984 increase in shipments to $329.8 million was due to the extensive sales of a few key products whose phenomenal success, and often short supply, generated an increased interest in toys and games. Since then, the industry's performance has been poor, with declines in shipments from 1984 to 1987 (Figure 2). In nominal terms, shipments declined over this period by an average of 14 percent annually, but the decline in real terms (constant 1981 dollars) was even greater, falling by an average of 21 percent over this three-year period. In particular, labour-intensive activities were shifted to lower-cost offshore producers. For example, play items such as dolls, which incorporate a number of manufacturing steps, are being manufactured in countries such as China and Taiwan. In addition, two large foreign-owned companies, Coleco and Tonka, ceased manufacturing in Canada in 1987. Industry shipments declined further in 1988 to reach $210.5 million. Consequently, employment in the industry has also been declining.

The number of establishments increased erratically, from 63 in 1973 to 100 in 1986, down to 84 in 1987, and back up to 96 in 1988. New establishments are primarily small operations with up to four employees that have been set up to take advantage of new consumer demands, such as the renewed interest in the board-game market created by Trivial Pursuit and Balderdash.

From 1973 to 1983, exports grew at a very slow rate. However, exports almost tripled in 1984 to reach $84.6 million due to the success of Trivial Pursuit. From 1985 to 1987, exports averaged $55 million annually, declining to $48.5 million in 1988. The decline is at least partly a result of the licensing of the production of games to companies in other countries.

Over the past 10 years, the United States has been the major export market for Canadian manufactured or assembled toys and games, accounting for nearly 80 percent ($38 million) of exports in 1988. Traditionally, exports to the United States have been mainly products for which demand has not been sufficient to be economically produced by American parent firms. Such products included splasher pools, plastic injection-moulded parts and board-game parts.

In contrast to exports, imported products are accounting for an increasing proportion of the apparent Canadian market for toys and games (41.7 percent in 1973 and 75.8 percent in 1988). The major imported products in 1988 were video and

electronic games ($89 million), stuffed toys ($59 million) and dolls and doll parts ($39 million).

Prior to 1981, the United States was the major supplier to the Canadian market. However, in the past few years, Asian countries (such as Hong Kong, Taiwan and the Republic of Korea) have significantly increased their share of the apparent Canadian market. This structural shift of labour-intensive activities to low-cost offshore producers is reflected in the increasing share of imports from Asian countries. In 1988, some 62.6 percent of Canadian imports were largely made up of finished items from Asian countries such as dolls, stuffed animals and die-cast metal toys. These imports have in large measure displaced Canadian manufacturing. On the other hand, imports from the United States were mainly parts requiring further manufacturing in Canada.

Financial statistics for this industry are not available. It is generally believed that profitability and return on investment have been somewhat volatile in recent years. For example, from 1986 to 1990, net earnings for Irwin Toy Limited varied between $0.6 million and $2.3 million. Several large American companies also showed similar fluctuations in profits.

Strengths and Weaknesses

Structural Factors

The world toys and games industry is dominated by a few large multinational enterprises, mainly U.S.-owned, which develop new toys and make production, promotional and marketing decisions on a global basis. The industry is characterized by increasing rationalization and concentration of manufacturing activity designed to enhance MNE market shares and global distribution systems. The result is severe import pressure on North American manufacturing activities as the production of the more labour-intensive products moves offshore to Asian countries, where labour rates are significantly lower. Increasingly, the North American industry has become more and more oriented toward assembly, packaging and distribution.

The Canadian industry is a branch-plant sector, to a large extent having been established to serve the relatively small domestic market behind high tariff walls. The Canadian industry does not benefit from large economies of scale, production cost advantages nor any other inherent attributes. The impact of differences in costs for raw materials and transportation, as well as economies of scale between Canadian producers and their foreign competitors, are significant when make-or-buy decisions are being made.

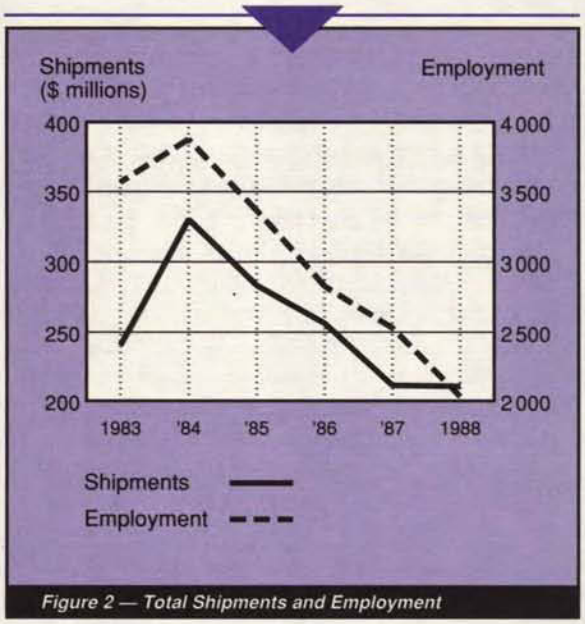

Figure 2 — Total Shipments and Employment

Licensing and promotion in the form of sophisticated, costly advertising campaigns (Saturday morning television, films) are critical elements in creating a demand for toys. The U.S. industry is a world leader in the development of toys and games and is considered to be one of the most sophisticated countries in employing marketing, advertising and promotional efforts to support sales.

U.S. companies tend to license Canadian companies to manufacture large toys for the domestic market to offset short-term U.S. and offshore MNE capacity constraints or to give Canadian operations North American mandates for more mature and/or lower-demand products.

Material costs tend to be lower in the United States than in Canada, mainly because of volume discounts. Many components and parts coming from the United States through intra-corporate transfers are subject to tariffs and exchange-rate variations when imported into Canada. There are several anomalies in the Canadian tariff structure as it applies to imported toys and toy parts, whereby the finished products have a lower duty rate than the parts for these same completed toys. Assembly in Canada is therefore discouraged. Shorter production runs and more frequent change-overs all contribute to higher costs of manufacturing in Canada. There is no significant difference between labour rates in Canada and the United States for toy and game production workers. Transportation costs, on the other hand, may encourage production in Canada of large, bulky toys such as plastic ride-on vehicles and large stuffed toys to serve the domestic market.

Canadian subsidiaries of large American MNEs benefit from the technology, management skills, marketing skills, advertising and promotional as well as financial resources of their parent companies. In addition, to encourage manufacturing in Canada, subsidiary companies can take advantage of a special remission order that allows for the temporary entry of dies, moulds and patterns. Such items may enter Canada temporarily with duty levied on one-sixtieth of the appraised value of the item for each month, or portion thereof, that it remains in Canada. This arrangement eliminates the costly duplication of dies and moulds for short production runs. On the other hand, foreign ownership may place some constraints on independent marketing, exporting and indigenous research and development (R&D), which have tended to limit product mandates to the products destined for more mature market segments.

Trade-Related Factors

The table below indicates the range of tariffs imposed on toy and game products by Canada and its major trading partners. Canadian tariffs tend to be higher than those of the United States, the EC and Japan, but lower than those of Australia. It is estimated that over 60 percent of imports enter Canada under General Preferential Tariff (GPT) rates from developing countries. GPT rates range between zero and 11.5 percent. The United States and the EC have duty-free, preferential tariff rates for developing countries.

Most Favoured Nation Tariff Rates, 1988

Country or region	Finished products	Parts
Canada	3.9 – 17.6	0 – 25
United States	5 – 12	0 – 10
European Community	6 – 10.5	5.5 – 8
Japan	3.8 – 4.6	0 – 4.6
Australia	10 – 25	10 – 25

Under the Canada-U.S. Free Trade Agreement (FTA), tariffs are to be eliminated bilaterally in 10 annual, equal steps, but with a requirement that goods have a minimum content of inputs originating in North America. The rules of origin will be particularly important for those companies that currently assemble parts imported from overseas countries and export finished products to the United States, because their products may not be eligible for the FTA tariff reductions. Moreover, duty drawbacks on parts imported from third countries included in products exported to the United States will be eliminated 1 January 1994, five years after the implementation of the FTA. The FTA also provides that efforts be made to harmonize technical standards between the two countries.

Technological Factors

Given the level of foreign ownership, the extent of indigenous R&D and product promotion by the Canadian industry is low in comparison with the counterpart industries in the United States, Western Europe and Hong Kong. As a result, very few products are originally developed by the Canadian industry or are first introduced into the Canadian market. The Canadian industry (both foreign and domestically controlled) depends upon outside sources to a great extent, notably the United States, for purchased or licensed technology, new product ideas, inventions and fads. In addition, the Canadian industry has not kept pace with its American counterpart in modernizing its manufacturing facilities. Capital expenditures, as a proportion of sales, have been lower in Canada than in the United States.

Other Factors

The major regulations affecting the Canadian toys and games industry are the *Consumer Packaging and Labelling Act*, as it applies to bilingual packaging, and the *Hazardous Products Act*, which governs the safety of toys and games. In addition, in April 1980 the Quebec government banned television advertising aimed directly at children under 13 years of age, which curtailed a significant proportion of toys and games advertising in that province.

There are no non-tariff barriers affecting Canada's trade in toys and games. Canada, as with most countries, has regulations pertaining to toy safety, which are developed with the help of the industry. Canadian regulations are considered among the most stringent in the world. The Canadian Toy Manufacturers Association has been active in developing common standards with counterpart bodies in other countries.

Evolving Environment

Recent trends in this sector indicate that more emphasis is being placed on toys as an important child development tool. Faced with less time to spend with their children but more money to spend on them, working parents are demanding toys that, in their absence, develop, educate and teach, rather than merely entertain. There has also been a greater interest in traditional toys that have more educational value. Some of the smaller Canadian manufacturers have successfully

developed new and educational games, and it is anticipated that this trend will continue to offer a stable, growing market over the next few years.

Indications are that imports of toys and games, valued at $621.7 million in 1989, are increasing, particularly for video and electronic games, valued at $191.8 million. On the other hand, exports decreased to $32.7 million in 1989, and this trend is likely to continue.

The restructuring of the North American industry through mergers, acquisitions and divestitures by MNEs aimed at expanding global distribution networks will result in greater ownership concentration. However, it is expected that production will shift to Asia, with a continued displacement of Canadian production in favour of packaging, warehousing and distribution of foreign-produced goods.

As the FTA is implemented and tariffs are eliminated, the Canadian industry will face increased direct competition from U.S. products. Where Canadian companies that now assemble parts imported from overseas countries and export finished products to the United States do not meet rules of origin, they will not qualify for duty-free entry into that country. Those that do meet the rules of origin, will receive the protection of U.S. tariffs from competitors from the rest of the world. Given the importance of massive, sophisticated promotional campaigns undertaken by the larger U.S. companies, their size and the important role licensing plays in the industry, the U.S. manufacturers will continue to dominate the world industry.

At the time of writing, the Canadian and American economies were showing signs of recovering from a recessionary period. During the recession, companies in the industry generally experienced reduced demand for their outputs, in addition to longer-term underlying pressures to adjust. In some cases, the cyclical pressures may have accelerated adjustments and restructuring. With the signs of recovery, though still uneven, the medium-term outlook will correspondingly improve. The overall impact on the industry will depend on the pace of the recovery.

Competitiveness Assessment

The Canadian industry is not considered to be internationally competitive and will continue to be at a competitive disadvantage in the foreseeable future. The Canadian toys and games industry is, to a large extent, a branch-plant sector serving the domestic market. It is dominated by a few large foreign MNEs that, in effect, control the industry worldwide. Plants in Canada are relatively small and do not benefit from economies of scale, lower production costs or any other inherent advantages. With the increasing movement of more labour-intensive production to low-cost offshore manufacturing facilities, the Canadian industry is becoming more and more oriented toward packaging, warehousing and distribution.

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PRINCIPAL STATISTICS[a]

	1973	1983	1984	1985	1986	1987	1988
Establishments	63	79	96	78	100	84	96
Employment	4 408	3 568	3 878	3 363	2 829	2 531	2 033
Shipments ($ millions)	98.0	240.5	329.8	283.5	256.5	211.3	210.5

[a]See *Other Manufacturing Industries,* Statistics Canada Catalogue No. 47-250, annual (SIC 3932, toys and games industry).

TRADE STATISTICS[a]

	1973	1983	1984	1985	1986	1987	1988[b]
Exports ($ millions)	13.7	28.4	84.6	56.3	56.0	53.9	48.5
Domestic shipments ($ millions)	84.3	212.1	245.2	227.2	200.5	157.4	162.0
Imports ($ millions)	60.3	293.8	337.8	325.0	372.0	455.0	506.6
Canadian market ($ millions)	144.6	505.9	583.0	552.2	572.5	612.4	668.6
Exports (% of shipments)	14.0	11.8	25.7	19.9	21.8	25.5	23.0
Imports (% of Canadian market)	41.7	58.1	57.9	58.9	65.0	74.3	75.8

[a]See *Exports by Commodity,* Statistics Canada Catalogue No. 65-004, monthly; and *Imports by Commodity,* Statistics Canada Catalogue No. 65-007, monthly.

[b]It is important to note the 1988 data are based on the Harmonized Commodity Description and Coding System (HS). Prior to 1988, the shipments, exports and imports data were classified using the Industrial Commodity Classification (ICC), the Export Commodity Classification (XCC) and the Canadian International Trade Classification (CITC), respectively. Although the data are shown as a continuous historical series, users are reminded that HS and previous classifications are not fully compatible. Therefore, changes in the 1988 levels reflect not only changes in shipment, export and import trends, but also changes in the classification systems. It is impossible to assess with any degree of precision the respective contribution of each of these two factors to the total reported changes in 1988 levels.

SOURCES OF IMPORTS[a] (% of total value)

	1983	1984	1985	1986	1987	1988
United States	43.0	34.3	25.3	28.3	30.5	30.5
European Community	10.7	6.0	5.9	6.5	5.5	5.0
Asia	44.0	50.7	63.0	60.3	60.0	62.6
Other	2.3	9.0	5.8	4.9	4.0	1.9

[a]See *Imports by Commodity,* Statistics Canada Catalogue No. 65-007, monthly.

DESTINATIONS OF EXPORTS[a] (% of total value)

	1983	1984	1985	1986	1987	1988
United States	67.3	92.9	90.7	86.0	87.0	78.8
European Community	14.4	3.8	4.8	9.5	6.0	13.4
Asia	4.0	2.6	0.5	0.8	1.3	3.5
Other	14.3	0.7	4.0	3.7	5.7	4.3

[a]See *Exports by Commodity,* Statistics Canada Catalogue No. 65-004, monthly.

REGIONAL DISTRIBUTION[a] (average over the period 1986 to 1988)

	Atlantic	Quebec	Ontario	Prairies	British Columbia
Establishments (% of total)	6.1	25.3	46.8	10.4	11.4
Employment (% of total)	X	X	55.3	X	1.6
Shipments (% of total)	X	X	63.6	X	1.8

[a]See *Other Manufacturing Industries,* Statistics Canada Catalogue No. 47-250, annual.

X: confidential

MAJOR FIRMS

Name	Country of ownership	Location of major plants
Amav Industries Ltd.	Canada	La Salle, Quebec
Hasbro Canada Inc.	United States	Longueuil, Quebec
Irwin Toy Limited	Canada	Toronto, Ontario
Little Tikes (Canada) Inc.	United States	Guelph, Ontario
SLM Canada Inc.	Canada	Beauport, Quebec

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