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Toy story: Wal-Mart, Target fight for parents' dollars with deep discounts

By Martha C. White

Selling toys during the holidays is hardly child's play; it's a bare-knuckle brawl between big-box behemoths.

"Price competition is always aggressive between the big retailers each holiday season, particularly in toys," Will Coleburn, senior vice president at manufacturer Toy State International, Inc., said via email. "This year they all were much more aggressive."

According to a Goldman Sachs report, Target slashed prices on a basket of toys, undercutting Wal-Mart by nearly 19 percent. Hot toys like Hasbro's Sesame Street Let's Rock Elmo, which has a "regular" price of $60, sold for less than $20 in the final days leading up to Christmas. It's a bonanza for shoppers, but some analysts worry all those cut-rate Elmos — and My Little Ponies, Mario Karts and Pokemons — will cut into profits.

Wal-Mart's heavily touted layaway plan, which it started advertising even before Black Friday, gave it an early edge in the category, thanks to shoppers who can't or won't put their holiday purchases on credit cards. "It was one of those categories Wal-Mart had talked about not being beaten in," said **Joseph Feldman, senior retail analyst at Telsey Advisory Group**.

Target's increasingly steeper price cuts after Black Friday challenged Wal-Mart's initial lead, but Feldman said it's not a risk-free tactic. "From a profit standpoint we wont be surprised if we see a hit to profitability," he said.

"[Target] is getting aggressive and promotional, and it will prove difficult to maintain market share and gross margin," Janney Capital Markets analyst David Strasser said in a recent research note. "It’s clearly not a coincidence that TGT introduced money losing sales Friday Dec. 16th and Saturday the 17th. This coincides with WMT’s deadline on layaway and the last payday before the holiday."

"Target's philosophy is, the only way we're going to capture revenue is by getting them through the front door," said Richard Feinberg, a professor in Purdue University's department of consumer sciences and retailing. "Whatever gets them through the front door, we have a high probability that they're going to spend additional money."

Hot toys, even if the store has to take a loss on them, function as effective holiday-season loss leaders. Wal-Mart, which has been losing business from lower-income customers to dollar stores, got a multiplier effect from its layaway program: Customers have to return to the store at least once and possibly more often to make payments on their items.

Target also has a couple of tactics to mitigate the money it's losing by heavily discounting popular toys. Price cuts have been coupled with $10 Target gift cards on some purchases. Gift cards virtually guarantee a return visit, and customers are likely to dig into their own wallets to augment the "free money." Target also offers 5 percent off purchases for customers who have its store-branded credit card. At around 23 percent interest, cardholders who revolve a balance will return that 5 percent and then some to Target. Doling out extra discounts to cardholders also helps Target attract the spending power of higher-income shoppers.

As attractive as these last-minute price cuts are, though, shoppers might not be able to score them because many hot toys are sold out. Another must-have toy this season, Leap Frog's Leap Pad Explorer, is sold out on both the Wal-Mart and Target sites, and parenting blogs boil over with rumors and tips about where to score one. This pre-iPad for kids aged four to nine never dropped below $99 at major toy sellers, although Target cardholders could at least count on a 5 percent discount. According to Goldman Sachs' tally, out-of-stock items accounted for 68 percent of the toy basket at Target and 60 percent at Wal-Mart.

"Inventory management has become increasingly important for the retailer," said Coleburn. He added that it's also become more challenging because shoppers tend to hold out until the last minute to see if prices will drop, which makes it hard to forecast demand.

"Their whole goal is to sell everything as quickly as possible," said Feinberg. "They've gotten so good they'd rather sell out than have to deal with it after Christmas and have another wave of discounting."