Case 1-5

Lead Paint on Children's Toys: Who Was Responsible?

RC2 Corporation of Oak Brook, Illinois, holds the relatively new position of marketing specialist in the children's toy industry. The company neither develops nor manufacturers the toys that it sells. Instead, it contracts with large media companies and publishing houses for the rights to use the characters developed by others such as Big Bird, Winnie the Pooh, Bob the Builder, and Thomas the Tank Engine. RC2 then designs wooden or stuffed toys based upon those characters; contracts with low-cost manufacturers, primarily in China, to make them; ships the finished toys in low-cost container vessels to the United States and Europe; and distributes them through low-cost retail chains such as Walmart, Kmart, and Toys "R" Us for final sale to the parents. It is a low-cost and high-volume business model that has been highly successful.

RC2 was a relatively small player in the toy market, but its revenues had more than doubled in the five years before the U.S. Consumer Product Safety Commission announced the company had been ordered to recall half a million Thomas and Friends wooden railway train sets that consisted of model engines, cars, and track sections because their paint coatings contained lead.[1]

Parents, of course, were surprised and shocked. Lead is known to be highly toxic. When ingested by young children it can cause learning disabilities, behavioral problems, and growth concerns. In older children and adults, lead poisoning can lead to high blood pressure, kidney failure, and stomach distress. The adverse effects of lead upon health had become known during the 1960s, and laws were passed in the early 1970s throughout the United States and Western Europe to restrict lead amounts in all consumer products, and over time these laws had been extended on a nearly global basis. By 2007, for example, it was illegal in China to use lead-based paint on export goods. Despite the parental concerns and the relevant laws, however, lead paint continued to be found on many children's toys. Soon, news came out that one of the bigger toy companies, Mattell, was also recalling nearly one million toys due to the discovery of lead paint used by a contract manufacturer in China.[2]

What went wrong? It was easy to blame the Chinese toy manufacturing companies, and many people did. They explained that lead paint creates brighter, shinier colors that appeal both to the children who play with the toys and the parents who purchase them. Also, lead paint flows more evenly, so that it is easier and less expensive to apply. And finally, lead paint is much cheaper; it is said to sell in China for a third of the cost of paint that would meet global standards of protection.

[1] "Train Wreck," *The New York Times,* June 19, 2007, Section C, p. 1.

[2] "The Little Engine That Could Poison," *The New York Times,* June 22, p. 22.

The general conclusion of those on this side of "it's their fault" argument was that the Chinese manufacturers had deliberately disregarded both the standards in their purchase contracts and the laws in their country in search of high profits. There were others, however, who disagreed, believing some of the responsibility should be shared by American and European multinational companies that put too much pressure on Chinese companies to supply cheap products in the interest of increasing profit margins.[3]

Those who believed that the responsibility extended beyond the Chinese manufacturers, who admittedly had applied the lead-based paint for reasons of appearance and profit, cited a recent change in the competitive structure of the children's toy industry. Traditionally, this industry had three participants: small manufacturing companies who designed and made toys, regional wholesale firms who distributed the toys, and local retail stores who sold the toys. These toys were almost always generic; that is, they were of the "If you've seen one stuffed bear, cast truck, or wooden locomotive you've seen them all" variety.

Similar to many other industries, however, the children's toy industry began to consolidate in search of the dual economies of scale and scope during the 1980s. This was at the same time that children's television programs such as *Sesame Street* began to dominate the networks with content that was both intriguing to preschool children and acceptable to their parents. The right to market toys based upon the characters popularized on these programs quickly was recognized as a huge competitive advantage by the media companies, who held the rights to those characters, the manufacturers who wanted those rights for their toys, and the retail chains who wanted the high volume sales that would result.

The manufacturers, that over this period had grown by accretion, were caught between large and well-financed media companies that wanted high royalties and the equally large and well-financed retail chains that wanted low prices. Numerous accounts have been published relating the experiences of manufacturers and importers that had come with an appointment and a proposal to the headquarter offices of one of the larger retail chains, had then been told that the chain purchasing department had analyzed the costs of producing the items on that proposal in the expected volumes, and ended by stating, "This is the price (as specific dollar figure) that you're going to have to accept."

There are far fewer anecdotal accounts of manufacturers and/or importers going similarly hat-in-hand to the headquarter offices of the large media companies (generally in New York or Los Angeles, not in Arkansas), but it can be assumed that they also encountered a similar "This is the price you're going to have to pay" rigidity. There was limited bargaining at either end of the value chain in the children's toy industry because both the media companies and retail chains, equally large and well-financed players, held the pricing power.

The manufacturers, given those limits, quickly arranged for far less expensive production abroad and turned themselves into marketing specialists. These changes in the

[3] *The New York Times,* August 25, 2007.