CASE

Toucon Collections, Inc.

Toucon Collections, Inc. is an importer and distributor of a wide variety of South American and African artifacts. It is also a major source of southwestern Indian—especially Hopi and Navajo—authentic jewelry and pottery. Although the firm's headquarters is located in Phoenix, Arizona, there are currently branch offices in Los Angeles, Miami, and Boston.

Toucon (named after the national bird of Belize) originated as a trading post operation near Tucson, Arizona, in the early 1900s. Through a series of judicious decisions, the firm established itself as one of the more reputable dealers in authentic southwestern jewelry and pottery. Over the years, Toucon gradually expanded its product line to include pre-Columbian artifacts from Peru and Venezuela (see Exhibit 1) and tribal and burial artifacts from Africa. Through its careful verification of the authenticity of these South American and African artifacts, Toucon developed a national reputation as one of the most respected importers of these types of artifacts.

In the mid-1990s, Toucon further expanded its product line to include items that were replicas of authentic artifacts. For example, African fertility gods and masks were made by craftspeople who took great pains to produce these items so that only the truly knowledgeable buyer—a collector—would know that they were replicas. Toucon now has native craftspeople in Central America, South America, Africa, and the southwestern United States who provide these items. Replicas account for only a small portion of total Toucon sales; the company agreed to enter this business only at the prodding of the firm's clients, who desired an expanded line. The replicas have found most favor among gift buyers and individuals looking for decorative items.

Toucon's gross sales are about $25 million and have increased at a relatively constant rate of 20 percent per year over the last decade. Myron Rangard, the firm's national sales manager, attributed the sales increase to the popularity of Toucon's product line and to the expanded distribution of South American and African artifacts:

> For some reason, our South American and certainly our African artifacts have been gaining greater acceptance. Two of our department store customers featured examples of our African line in their Christmas catalogs last year. I personally think consumer tastes are changing from the modern and abstract to the more concrete, like our products.

Toucon distributes its products exclusively through specialty dealers (including selected interior designers and decorators), firm-sponsored showings, and a few exclusive department stores. Often, the company is the sole supplier to its clients. Rangard recently expressed the reasons for this highly limited distribution:

> Our limited distribution has been dictated to us because of the nature of our product line. As acceptance grew, we expanded our distribution to specialty dealers and some

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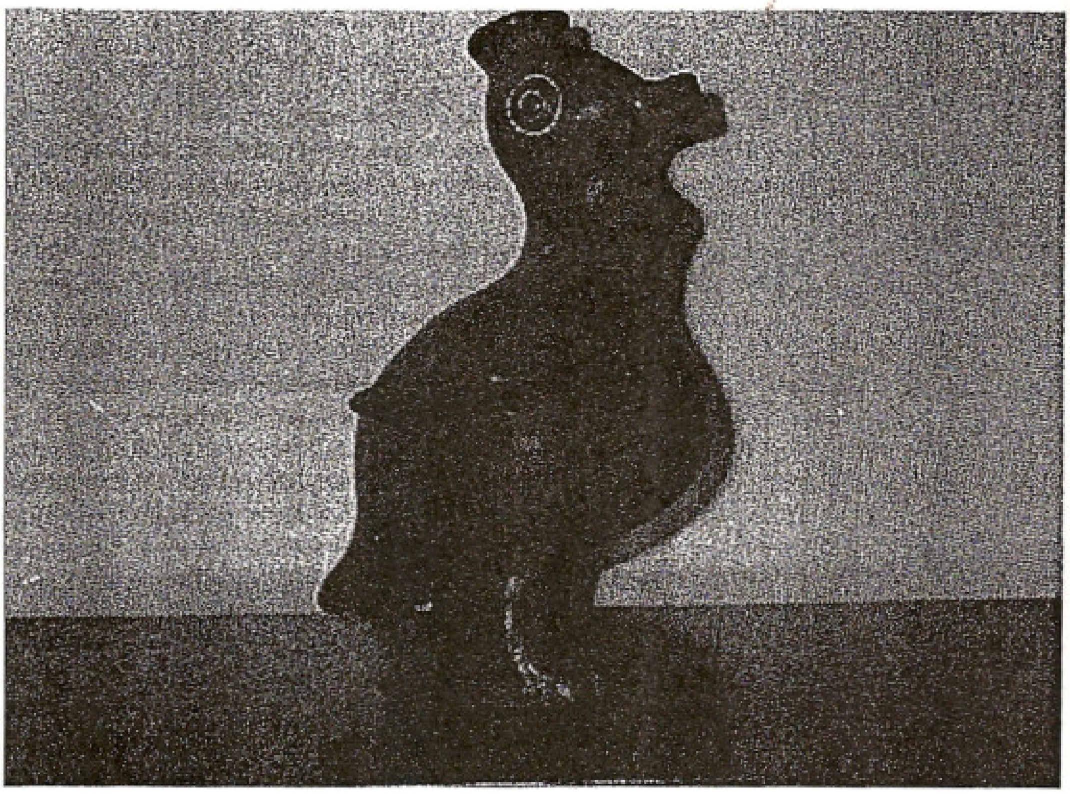
EXHIBIT 1

Pre-Columbian Water Vessel from Peru



exclusive department stores. Previously, we had to push our products through our own showings. Furthermore, we just didn't have the product. These South American artifacts aren't always easy to get and the political situation in Africa is limiting our supply. Our perennial supply problem has become even more critical in recent years for several reasons. Not only must we search harder for new products, but the competition for authentic artifacts has increased tenfold. On top of this, we must now contend with governments not allowing exportation of certain artifacts because of their "national significance."

The problem of supply has forced Toucon to add three new buyers in the last two years. Whereas Toucon identified five major competitors a decade ago, there are 11 today. "Our bargaining position has eroded," noted David Olsen, Director of Procurement. "We have watched our gross margin slip in recent years due to aggressive competitive bidding by others."

"And competition at the retail level has increased also," injected Rangard. "Not only are some of our larger specialty and exclusive department store customers sending out their own buyers to deal directly with some of our Hopi, Navajo, and African suppliers, but also we are often faced with amateurs or fly-by-night competitors. These people move into a city and dump a bunch of inauthentic junk on the public at exorbitant prices. Such antics give the industry a bad name." Rangard acknowledged that high-quality, authentically made decorative items were also available on the Internet (see, for example, authenticafrica.com and novica.com).

A recent article in *Time* magazine supported Rangard's observation.[1] According to the article, which featured African artifacts:

> It's best to buy from a dealer you can trust since a growing number of fakes are turning up on the market. Throughout Africa, artisans in "craft centers" simply churn out copies of authentic items. And sometimes, "traditional" art is created in the absence of any tradition. In Kenya, for example, masks made by the Masai people sell for anywhere from $50 to $200. But the Masai have never carved masks. [According to an authority on African antiquities] "90% of what's coming into the U.S. are replicas or tourist art that's being made to look old."

In recent years, several mass-merchandise department store chains have begun to sell merchandise similar to that offered by Toucon. Even though product quality was often mixed and most items were replicas, occasionally an authentic group of items was found in these stores, according to company sales representatives. Subsequent inquiries by both Rangard and Olsen revealed that other competing distributors had signed purchase contracts with these outlets. Moreover, the items were typically being sold at retail prices below those charged by Toucon's dealers.

In early January 2003, Rangard was contacted by a mass-merchandise department store chain concerning the possibility of carrying a complete line of Toucon products and particularly a full assortment of authentic items. The chain was currently selling a competitor's items but wished to add a more exclusive product line. A tentative contract submitted by the chain stated that it would buy at 10 percent below Toucon's existing prices, and that its initial purchase would be for no less than $750,000. Depending on consumer acceptance, purchases were estimated to be at least $4 million annually. An important clause in the contract dealt with the supply of replicas. Inspection of this clause revealed that Toucon would have to triple its replica production to satisfy the contractual obligation. Soon after Toucon executives began discussing the contract, Toucon's president, Andrew Smythe, mentioned that accepting the contract could have a dramatic effect on how Toucon defined its business. Smythe added:

> The contract presents us with an opportunity to broaden our firm's position. The upside is that we have the potential to add $4 million in additional sales over and above our annual growth. On the other hand, do we want to commit such a large percent of our business to replicas? Is that the direction that the market is going? What effect will this contract have on our current dealers, and, I might add, our current customers?
>
> I want you both (Rangard and Olsen) to consider this contract in light of your respective functions and the company as a whole. Let's meet in a few days to discuss this matter again.

[1] "Looting Africa," *Time* (July 30, 2001): 49–52.