Accounting for a Sustainable Future™

TOYS & SPORTING GOODS
Research Brief

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TOYS & SPORTING GOODS

Research Brief

SASB's Industry Brief provides evidence for the disclosure topics in the Toys & Sporting Goods industry. The brief opens with a summary of the industry, including relevant legislative and regulatory trends and sustainability risks and opportunities. Following this, evidence for each disclosure topic (in the categories of Environment, Social Capital, Human Capital, Business Model and Innovation, and Leadership and Governance) is presented. SASB's Industry Brief can be used to understand the data underlying SASB Sustainability Accounting Standards. For accounting metrics and disclosure guidance, please see SASB's Sustainability Accounting Standards. For information about the legal basis for SASB and SASB's standards development process, please see the Conceptual Framework.

SASB identifies the minimum set of disclosure topics likely to constitute material information for companies within a given industry. However, the final determination of materiality is the onus of the company.

Related Documents

- Toys & Sporting Goods Sustainability Accounting Standards
- Industry Working Group Participants
- SASB Conceptual Framework

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INTRODUCTION

The Toys & Sporting Goods industry is responsible for developing some of the world's most enjoyable and iconic products. Companies within the industry have a long track record of innovating to meet consumer demands and trends, adapting to changes in technology, and capturing new markets. In recent years, the industry has evolved to include digital media. Given that children use many of the industry's products, product safety and influence on development are extremely important for toy and sporting goods companies.

The emergence of global sustainability issues and enhanced consumer and regulatory awareness of these issues has created a new set of opportunities and challenges for the industry. Specifically, concern over the use of chemicals and potential product safety hazards has led to new legislation and increased stakeholder vigilance. Additionally, the industry's reliance on owned and outsourced manufacturing in emerging markets has led to challenges relating to labor issues within the supply chain. The ability of companies to manage performance on these issues is likely to increasingly contribute to value.

Management (or mismanagement) of certain sustainability issues has the potential to affect company valuation through impacts on profits, assets, liabilities, and cost of capital.

Investors would obtain a more holistic and comparable view of performance with Toys & Sporting Goods companies reporting metrics on the material sustainability risks and opportunities that could affect value in the near- and long-term in their regulatory filings. This would include both positive and negative externalities, and the non-financial forms of capital that the industry relies on for value creation.

Specifically, performance on the following sustainability issues will drive competitiveness within the Toys & Sporting Goods industry:

- Ensuring that products are safe through the management of chemical use and other product hazards; and
- Managing labor conditions within the supply chain.

INDUSTRY SUMMARY

The Toys & Sporting Goods industry comprises two distinct segments that produce leisure products: companies that manufacture toys and games, and companies that manufacture sporting and athletic goods, such as bicycles, golf clubs, fitness equipment, and other similar products.[I]

The Toys & Sporting Goods industry had global revenues of more than $51.2 billion in 2014.[1] The toys and games segment generated more $19 billion, while the sporting goods segment

[I] Industry composition is based on the mapping of the Sustainable Industry Classification System (SICS™) to the Bloomberg Industry Classification System (BICS). A list of representative companies appears in Appendix I. Note: Companies manufacturing musical instruments are also part of this industry, but constitute a negligible portion of industry revenues.

accounted for roughly $27 billion. Several of the industry's top companies are based internationally. Large representative companies in both segments that are located and listed in the U.S. include Jarden, Callaway Golf, Mattel, Hasbro, and Jakk's Pacific. In 2014, these companies generated combined revenues of more than $13.6 billion.[2]

The industry generates revenue globally, with primary markets in the U.S. and Europe. For example, nearly 40 percent of Mattel's 2014 revenue came from outside of North America, with Europe, Latin America, and Asia Pacific accounting for 28, 15, and 7 percent respectively.[3] Emerging markets represent a significant area of potential growth for the industry. Hasbro reports that "in 2014, 2013 and 2012, net revenues in emerging markets grew 20 percent, 25 percent and 16 percent, respectively, from the prior years and represented more than 15 percent of our total consolidated net revenues in 2014."[4]

Companies in this industry primarily sell their products to consumers through retail stores. For example, Hasbro, generated 33 percent of its 2014 revenue from its top three retail store customers, Walmart, Toys "R" Us, and Target Corporation.[5]

Revenue in the Toys & Sporting Goods industry is driven mainly by consumers' disposable income, participation in sports, and demand from retail outlets.[6][7] The toys segment of the industry is characterized by short product lives, rapid product turnover, and seasonal demand, with the holiday season accounting for nearly 40 percent of the toy segment's total sales.[8] [9] The demand for sporting goods is also seasonal and linked to weather patterns, given that many of the industry's products are used outdoors.[10]

According to Hasbro, the toys segment of the industry competes mainly on quality, play value, and price. Hasbro also recognizes that traditional toys are facing increasing competition from digital devices and video games.[11] Competition from new technologies such as mobile devices, tablets, and video games has resulted in the shrinking of toy product lifecycles and a move into more sophisticated offerings. The toy segment calls this "children getting older younger," and it is further shaping industry competition.[12] Toy companies also compete for licensing agreements, which allow them to manufacture products that use the trademark, characters, or inventions of the licensor.[13]

The basis of competition in the sporting goods segment is similar to the toys segment, with some additional factors contributing to corporate performance. Callaway, a large golf ball and golf club manufacturer, states that it "generally compete[s] on the basis of technology, quality, performance, customer service and price."[14] Sporting goods companies also compete for endorsements from professional athletes and must respond to shifts in the popularity of given activities.[15]

In the U.S., both the toys and sporting goods markets have been inundated with cheap-priced imports—as a result, industry concentration is relatively low, while competition remains high.[16] This trend is expected to continue.

Manufacturing locations vary across the industry's segments. In the U.S., nearly 94 percent of demand in the toys segment is satisfied through imports[17], compared to only 40 percent for the sporting goods segment.[18] The level of manufacturing integration also varies among and within segments of the industry. For example, Mattel owns a significant portion of its toy manufacturing facilities overseas, while Hasbro outsources the majority of its manufacturing to third parties.[19] For both companies, and for much of the industry, manufacturing is based primarily in Asia, with China accounting for a majority of production.[20]

Raw material purchases and wages represent 60 and 11.4 percent of revenues, respectively the sporting goods segment. Main inputs of production include metal, aluminum, plastics, and rubber.[21] Raw material purchases and wages are also the main cost drivers in the toys segment and represent 46 and 15.8 percent of revenues, respectively. Raw materials include plastic, wood, rubber, metal, and fabric.[22] In 2014, the Toys & Sporting Goods industry had an average operating margin of 8.91 percent.[23]

Financial analysis of the Toys & Sporting Goods industry focuses on volume of products sold, operating margin, license agreements, and projected sales. Analysts also consider global economic conditions, fluctuations in currency, and consumer trends.[24] As sustainability issues such as supply chain management and product safety increasingly affect consumer demand, their impact on company value will likely increase.

LEGISLATIVE AND REGULATORY TRENDS IN THE TOYS & SPORTING GOODS INDUSTRY

Regulations in the U.S. and abroad represent the formal boundaries of companies' operations, and are often designed to address the social and environmental externalities that businesses can create. Beyond formal regulation, industry practices and self-regulatory efforts act as quasi-regulation and also form part of the social contract between business and society. In this section, SASB provides a brief summary of key regulations and legislative efforts related to this industry, focusing on social and environmental factors. SASB also describes self-regulatory efforts on the part of the industry, which could serve to pre-empt further regulation.[ll]

The regulatory environment surrounding the Toys & Sporting Goods industry is evolving, particularly as it relates to product safety and the use of hazardous chemicals in children's toys. The U.S. Consumer Product Safety Commission (CPSC) regulates the industry. Regulations applicable to toys and sporting goods companies include the Federal Hazardous Substances Act (FHSA) and the Flammable Fabrics Act (FFA).[25] Manufacturers in the U.S. must also comply with various federal, state, and local environmental laws and regulations such as the Clean Water Act and Clean Air Act.[26]

Recently, concern over the use of hazardous chemicals in children's products has led to new federal and state laws. In 2008, Congress passed Consumer Product Safety Improvement Act (CPSIA) section 106, which protects children from harmful chemicals such as lead and phthalates, and other safety risks such as choking hazards. The regulation requires that toy manufacturers, including those that import their products from overseas, comply with strict safety testing requirements for toys sold to children 14 years old and younger. The law also mandates third party testing for toys aimed at children under the age of 12.[27] These requirements have placed a significant financial burden on the industry, particularly on small manufacturers that cannot sufficiently test all of their products.[28] Failure to comply with these regulations may result in recalls.

[ll] This section does not purport to contain a comprehensive review of all regulations related to this industry, but is intended to highlight some ways in which regulatory trends are impacting the industry.

States including Washington, California, and Maine are introducing or have introduced chemical safety standards, which could affect the Toys & Sporting Goods industry. These standards are typically more stringent than federal standards.[29]

The marketing and advertising of products to children is also regulated. The Children's Television Act of 1990 limits the amount of advertising aired during children's programming. More recently, Congress passed The Children's Online Privacy Protection Act (COPPA), which requires companies that operate commercial websites directed at children under the age of 13 to comply with strict guidelines on the collection of contact information including name, address, email, and phone number.[30] The guidelines established by COPPA were based on those developed by the Children's Advertising Review Unit (CARU). CARU is a self-regulatory program used to evaluate advertising directed toward children under age 13 to promote truthful, accurate, and consistent marketing material within the industry.[31]

Recent government programs aimed at promoting fitness and healthy lifestyles may help to increase participation in sports, which could improve opportunities for the sporting goods segment.[32] In 2008, the Department of Health and Human Services issued Physical Activity Guidelines for Americans, which aim to educate citizens and promote physical activity, including engaging in sports activities.[33]

Given that the E.U. is among the largest sources of revenue for the Toys & Sporting Goods industry, regulatory developments in that region can have significant impacts on companies. The E.U. has implemented legislation aimed at restricting the use of certain chemicals in consumer products. The Registration, Evaluation, Authorization, and Restriction of Chemicals, or REACH legislation, places the burden of proof on companies that sell and market products in the E.U. to determine the environmental and human health risks from hazardous chemicals in consumer products, including toys and sporting goods. These regulations also apply to products that are imported from outside the covered region.[34] The potential addition of more chemicals to REACH's Restricted Substance Annex could present risks to the Toys & Sporting Goods industry.

In 2008, the European Commission conducted extensive research into the existing product safety guidelines for toy manufacturers, wholesalers, and retailers following numerous toy recalls in 2007.[35] In 2009, the Commission issued a new Toy Safety Directive that established stricter protocols for testing the presence of harmful chemicals in toys intended for children under the age of 14.[36]

Many companies in this industry have traditionally outsourced manufacturing to countries with lower costs of labor and production, and less stringent social regulations and enforcement. However, recent examples of poor labor standards have led to increased scrutiny, stakeholder attention, more stringent legislation, and efforts to improve self-regulation.

For example, the International Council of Toy Industries (ICTI) developed the ICTI CARE Process. The Process is intended to allow the industry to ensure that its products are manufactured according to the highest standards of safety and humane conditions. Through ICTI CARE's Factory Audit Program, supplier performance is monitored on key labor issues, including health and safety, child and forced labor, working hours and wages, discrimination and disciplinary practices, and social benefits.[37]

SUSTAINABILITY-RELATED RISKS AND OPPORTUNITIES

Industry drivers and recent regulations suggest that traditional value drivers will continue to impact financial performance. However, intangible assets such as social, human, and environmental capitals, company leadership and governance, and the company's ability to innovate to address these issues are likely to increasingly contribute to financial and business value.

Broad industry trends and characteristics are driving the importance of sustainability performance in the Toys & Sporting Goods industry:

- **Concern over chemicals and product safety**: The industry creates and markets products that are directed towards children. As a result, the industry faces increased scrutiny relating to the safety of its products, including the use of harmful chemicals. Companies' social license to operate, and their ability to continue producing and selling products for children, depends on ensuring product safety.
- **Social externalities of manufacturing**: The majority of industry manufacturing takes place overseas in countries with limited oversight and labor practice regulation. The industry is therefore susceptible to labor violations and high-profile examples of sub-standard working conditions, which can damage a company's reputation, increase costs, and lead to supply disruptions.

As described above, the regulatory and legislative environment surrounding the Toys & Sporting Goods industry emphasizes the importance of sustainability management and performance. Specifically, recent trends suggest a regulatory emphasis on product safety and supply chain performance, which will serve to align the interests of society with those of investors.

The following section provides a brief description of each sustainability issue that is likely to have material financial implications for companies in the Toys & Sporting Goods industry. This includes an explanation of how the issue could impact valuation and evidence of actual financial impact. Further information on the nature of the value impact, based on SASB's research and analysis, is provided in Appendix IIA and IIB.

Appendix IIA also provides a summary of the evidence of investor interest in the issues. This is based on a systematic analysis of companies' 10-K and 20-F filings, shareholder resolutions, and other public documents, which highlights the frequency with which each topic is discussed in these documents. The evidence of interest is also based on the results of consultation with experts participating in an industry working group (IWG) convened by SASB. The IWG results represent the perspective of a balanced group of stakeholders, including corporations, investors or market participants, and public interest intermediaries.

The industry-specific sustainability disclosure topics and metrics identified in this brief are the result of a year-long standards development process, which takes into account the aforementioned evidence of interest, evidence of financial impact discussed in detail in this brief, inputs from a 90-day public comment period, and additional inputs from conversations with industry or issue experts.

A summary of the recommended disclosure framework and accounting metrics appears in Appendix III. The complete SASB standards for the industry, including technical protocols, can be downloaded from www.sasb.org. Finally,

Appendix IV provides an analysis of the quality of current disclosure on these issues in SEC filings by the leading companies in the industry.

SOCIAL CAPITAL

Social capital relates to the perceived role of business in society, or the expectation of business contribution to society in return for its license to operate. It addresses the management of relationships with key outside stakeholders, such as customers, local communities, the public, and the government.

Children are generally considered to be a more vulnerable segment of the population. As a result, the Toys & Sporting Goods industry is subject to enhanced scrutiny over the safety of products. State, federal, and international regulations and stakeholder concerns are increasingly focused on the use of chemicals in products, and how their use can expose children to potential harm. Companies that fail to adhere to regulations, and companies that manufacture products that are found to be harmful to children, risk reputational damage and the loss of their social license to operate.

Chemical & Safety Hazards of Products

Consumers and regulators expect the Toys & Sporting Goods industry to ensure that its products are safe and do not cause harm. The use of potentially dangerous chemicals in finished products, including phthalates, brominated flame retardants, and heavy metals, is an important aspect of the safety of toys and sporting goods. The presence of certain chemicals in products—which can be introduced by design or as a result of poor oversight over supply chains—can have chronic impacts on child development and health. Children can be exposed to chemicals through normal usage, or by putting toys in their mouths. Faulty or poorly designed products can also create choking, fire, or other hazards, which can result in injury or death.

The Toys & Sporting Goods industry is affected by significant regulation over the safety of its products. The toys segment in particular is highly regulated in order to protect children, and evolving science on the safety of certain chemicals will likely lead to additional restrictions.[38] As a result, companies in this industry must work at both the design and manufacturing phases to manage the use of certain chemicals while eliminating others to ensure that consumers are not exposed to risks associated with chemical safety.

Failure to create products that are safe for consumers may provoke new regulatory oversight and affect a company's social license to operate. Furthermore, improper product safety testing or evaluation can lead to costly recalls, litigation, or reputational damage that can affect sales and may invite additional burdensome government regulation.

Company performance in this area can be analyzed in a cost-beneficial way through the following direct or indirect performance metrics (see Appendix III for metrics with their full detail):

- Number of recalls and total units recalled;
- Number of Letters of Advice received;
- Amount of legal and regulatory fines and settlements associated with product safety; and
- Description of processes to assess and manage risks and/or hazards associated with chemicals in products.

Evidence

Many toys require the use of certain chemicals. For example, plastic, a commonly used material in children's toys, is made from a range of synthetic or semi-synthetic chemicals that are most commonly derived from petrochemicals. As science evolves, and questions surrounding the safety of certain chemicals, including bisphenol-A (BPA) and phthalates, increase, companies must work within their supply chains to ensure product safety and compliance with evolving chemical regulations. The complexity of the industry's supply chain and its reliance on outsourced manufacturing raises certain challenges, as chemicals can appear in products intentionally or as a result of poor quality control.

In 2008, during an in-depth report on safety procedures and guidelines in the toy industry, the European Commission found that the adoption of a strong safety culture within an organization's supply chain was crucial to complying with product safety regulations. The Commission also found that because of their scale, large companies were much better positioned to address product safety concerns within their supply chains than smaller peers.[39]

Regulations related to child safety, particularly the presence of harmful chemicals and choking hazards, create significant risks for the Toys & Sporting Goods industry. Toy companies are exposed to numerous forms of regulation, including provisions of the CPSIA.[40] The CPSIA requires companies that manufacture children's products to follow strict third-party safety testing requirements, and also bans the selling of products that contain harmful chemicals such as lead and phthalates, even if the products are imported from overseas manufacturers. This legislation affects products aimed at children 12 years old and younger.[41]

Many manufacturers do not have sufficient resources to test every product, and therefore discard any products that might not meet safety standards. The Toy Industry Association estimated that in 2009, the CPSIA cost companies in the industry $2 billion, or 10 percent of overall retail value. According to a survey conducted by the association, more than $1 billion worth of inventory was returned by retailers, was not saleable, or was being withheld for CPSIA verification. An additional $800 million worth of inventory that had previously been considered compliant was at risk of being returned to manufacturers.[42] The potential costs demonstrate why companies must be vigilant about the safety of their products, anticipate evolving regulations, and cost-effectively surpass minimum regulatory expectations.

Originally, the CPSIA contained broad language that affected testing requirements for sporting goods that were intended for use by children under the age of 12. However, in 2009 the Sports & Fitness Industry Association secured an exemption for the testing of phthalates in sporting goods, after it was determined that a threat of children's exposure did not exist. Additionally, many products in the sporting goods segment, including fitness equipment that is not geared toward children under age 12, are considered "general use" products and do not have to abide by the CPSIA testing requirements.[43]

New research and evolving science has led to increased consumer awareness about the presence of harmful or potentially harmful chemicals in products, particularly those used by children.[44] As regulation in this area continues to evolve in response to consumer concerns the sporting goods segment could face regulatory uncertainty and risks related to chemical use.

New legislation like CPSIA could lead to recalls and penalties for non-compliance. In 2009, Mattel, through its wholly owned subsidiary, Fisher-Price, was fined $2.3 million for violating federal lead paint bans. Mattel and Fisher-Price imported more than 2 million non-compliant toys between 2006 and 2007, which led to recalls and spurred government action to strengthen restrictions on the use of lead paint in children's products.[45] After these recalls, the company's operating income fell by $28.8 million, or nearly 50 percent, from $63.5 million during the three months ending June 30, 2007.[46]

In the E.U., the number of notifications issued to toy manufacturers has increased by 58 percent, from 366 in 2012 to 580 in September 2014. Recalls were issued because of problems ranging from choking hazards to high flammability risk. However, violations for excessive levels of phthalates were among the most common.[47] The rise in recalls associated with the presence of restricted chemicals further demonstrates the potential impact this legislation can have on company value.

In response to evolving product safety regulations and stakeholder concerns, toy companies are implementing more stringent management structures to improve performance in this area. For example, Hasbro is working to minimize or eliminate the use of lead, heavy metals, BPA, phthalates, and brominated flame retardants. The company has developed 160 Safety and Reliability Standards, which combine U.S., European, and international safety standards, and require quality control checks throughout the manufacturing process at its owned and third-party factories. The company reports that this management system has resulted in zero product recalls in more than five years.[48]

Other safety concerns can also lead to recalls, resulting in significant costs to companies, or potential lawsuits if products fail to function in a manner that is consistent with consumer expectations.

Riddell, a privately held manufacturer of football helmets, has faced class action lawsuits accusing the company of making false claims that its headgear reduces the likelihood of concussions for youth and high school players. In 2015, a federal judge in New Jersey dismissed one of these suits, but gave plaintiffs an opportunity to revise their lawsuit.[49] In 2013, Riddell was among several defendants in a suit over brain injuries suffered by a teenager in 2008. A jury found that Riddell was negligent in failing to warn consumers about concussion dangers, and ordered the company to pay $3.1 million in damages.[50]

In 2007, Mattel recalled more than 18.2 million toys because of choking hazards, the largest recall in company history.[51] Mattel recognizes the material risk of product safety concerns in its FY2014 Form 10-K. Specifically, the company stated that it "has experienced, and may in the future experience, issues with products that may lead to product liability, personal injury or property damage claims, recalls, withdrawals, replacements of products, or regulatory actions by governmental authorities. Any of these activities could result in increased governmental scrutiny, harm to Mattel's reputation, reduced demand by consumers for its products."[52]

In 2007, Hasbro reported a charge of $10.4 million—or 4 cents a share—as result of an Easy-Bake Ovens safety recall.[53] In its FY2014 Form 10-K, the company acknowledged the importance of product safety and compliance with relevant regulations. Hasbro states, "Any product recall, regardless of direct costs of the recall, may harm consumer perceptions of our products and have a negative impact on our future revenues and results of operations." [54]

Although companies acknowledge the importance of product safety, the CPSC identified thousands of safety violations in children's products between October 2012 and July 2015, including goods produced by privately held companies. Many of these violations stemmed from the use of lead paint and phthalates, third-party certification violations, and choking hazards.[55]

Value Impact

Failure to address product safety issues and chemical hazards can create operational risks, leading to acute impacts on value from recalls and litigation that can result in contingent liabilities and extraordinary expenses. These impacts can affect a company's risk profile, raising its cost of capital. Poor management of product safety can also invite further burdensome legislation, which has the potential to affect the industry's cost structure. New regulations can result in higher compliance expenses, reducing overall profitability.

Beyond potential product liabilities and lawsuits, failing to adequately address consumer safety concerns can negatively affect a company's reputation, with the potential to affect long-term growth and revenues.

Enhanced disclosure on recalls, violations, fines, and strategies to manage chemical use will allow investors to evaluate a company's safety performance. Specifically, it will allow for comparison against peers and a measurement of performance over time, and provide investors with an understanding of a company's risk exposure.

Number of recalls is proportional to amount of product liability and related costs. Preemptive or prompt recalls could indicate a conservative approach to limiting potential liability. Letters of advice provide early warnings and provide a forward-looking view into product safety issues. Fines and settlements could be an indicator of governance concerns and high amounts could affect future cost of capital. Management's discussion and analysis of these metrics, including initiatives to manage chemicals use and safety hazards, can provide additional insight into which companies are better positioned to manage impacts in the future.

LEADERSHIP AND GOVERNANCE

As applied to sustainability, governance involves the management of issues that are inherent to the business model or common practice in the industry and are in potential conflict with the interest of broader stakeholder groups (government, community, customers, and employees). They therefore create a potential liability, or worse, a limitation or removal of license to operate. This includes regulatory compliance, lobbying, and political contributions. It also includes risk management, safety management, supply chain and resource management, conflict of interest, anti-competitive behavior, and corruption and bribery.

Companies in the Toys & Sporting Goods industry manage large, complex supply chains and rely on third-party manufacturers for a significant proportion of their goods. Manufacturers are typically concentrated in emerging markets where labor regulations and oversight are limited. Companies in this industry are therefore exposed to labor issues in the supply chain, including forced and child labor, low wages, poor health and safety conditions, and long working hours.

Poor labor conditions in the industry's supply chain have the potential to create significant reputational risks for companies, which can negatively impact their social license to operate. Companies that engage with suppliers to address labor conditions will limit their exposure to potential supply disruptions and reputational damage, thereby gaining a competitive advantage in the long term.

Labor Conditions in the Supply Chain

Fair treatment of workers and safe labor conditions in the industry's manufacturing supply chain are of growing concern for consumers, regulators, and companies in the industry. Labor issues include poor employee health and safety standards, unfair pay, long working hours, discrimination, and forced labor.

The industry is exposed to these issues because of its reliance on third-party manufacturing in emerging markets, where labor standards, labor protection and enforcement of regulation can be weak and violations are common across industries. The majority of the Toys & Sporting Goods industry's manufacturing occurs in China, where costs have historically been lower than in many other countries. According to the U.S. Department of Commerce, nearly 88 percent of all toys sold in the U.S. are made in China.[56] Furthermore, short product lifecycles and pressures to meet evolving consumer demand can increase the risk of labor violations.

Many companies contract with more than 100 different suppliers, adding significant complexity to managing labor conditions. Further, a lack of transparency among suppliers exposes companies in the industry to supply disruptions and reputational damage. Financial impacts can stem from increasing regulation and enforcement in response to high profile safety or labor incidents, strikes and work stoppages, or through a shift in demand from consumers concerned with labor issues.

However, companies are increasingly aware of the importance of this issue, and are using their purchasing power to influence suppliers and improve labor conditions. Toys and sporting goods companies are increasingly engaging with suppliers through audits, partnerships, and enhanced oversight, allowing them to preempt and react more quickly to issues. These efforts can help companies limit their exposure to poor labor conditions within their supply chains.

Company performance in this area can be analyzed in a cost-beneficial way through the following direct or indirect performance metrics (see Appendix III for metrics with their full detail):

- Number of facilities audited to a social responsibility code of conduct; and
- Direct suppliers' social responsibility audit compliance: priority non-conformance rate and associated corrective action rate, and other non-conformances rate and associated corrective action rate.

Evidence

Toys and sporting goods companies source the majority of their products from manufacturers in emerging markets, particularly China. Although the industry's two segments face different sales patterns, both face similar financial, operational, and reputational risks associated with labor violations in their supply chains.

A report following the global economic crisis suggested that toy manufacturing in China was disproportionately affected and harmed by the economic downturn, which led to workers becoming more vulnerable to abuse. The report claims toy wholesalers such as Mattel, Hasbro, and Lego have high degrees of bargaining power over pricing and delivery time, which can lead to violations of workers' rights. For example, the highly seasonal nature of products in the toy industry and the demand for short lead times from wholesalers often leads to employees working excessive hours in order to meet production deadlines.[57]

Mattel has roughly 100 different suppliers in China—including company-owned facilities—that account for nearly 74 percent of the company's total toy production.[58] A 2013 report by China Labor Watch demonstrated the potential for reputational risks associated with labor conditions in China. The nonprofit watch group found that six Mattel suppliers had more than 18 legal and ethical violations including discrimination, unfair wage treatment, excessive hours, health and safety concerns, and environmental pollution.[59] In 2014, China Labor Watch published another report stating that factories that produced products for Mattel, Hasbro and others were found to have labor rights violations.[60]

Mattel has refuted many of the claims made by China Labor Watch, and the company supports the ICTI CARE Process. The Process provides a framework for supplier audits on key labor issues, including health and safety, child and forced labor, working hours and wages, discrimination and disciplinary practices, and social benefits.[61]

In August 2015, a Chinese factory that supplies Mattel with Power Wheels toy cars and other products was closed due to insolvency. Former employees gathered to demand three months of unpaid wages, marking the 1,218th strike or worker protest in China in 2015, according to China Labour Bulletin. In 2014, there were 1,379 total incidents. Mattel was informed of the factory closure on the day it closed and announced that it expects to incur losses.[62]

Labor abuses and resulting unrest have also impacted the sporting goods segment of the industry. In July 2014, more than 200 workers at QLT Golf Supplies in Shenzhen went on strike with a list of labor demands, including living wages, fair regulations, and the payment of social insurance and housing fund contributions. QLT Golf Supplies, which makes golf clubs and golf balls for Nike, Callaway, Bridgestone, Ping, Cobra, and Titleist initially refused to negotiate, but ultimately resolved the issue in one day after the government intervened.[63]

In response to these incidents and to assuage stakeholder concern, sporting goods companies are acknowledging the risks associated with labor issues in their supply chains. Amer Sports, a large multinational sporting goods company, states in its annual report that "the violations of labor laws, regulations or standards by Amer Sports' subcontractors, or the divergence of those subcontractors' labor practices from those generally accepted as ethical in the European Union or in the international community, could have a material adverse effect on Amer Sports' public image and the reputation of its brands."[64]

Although the ICTI standard has faced some criticism for failing to meet minimum local labor laws and to make public audit reports that prove factory compliance, it demonstrates an increased effort to manage labor issues within the supply chain.[65] Hasbro also uses ICTI CARE to audit its third-party factories in areas where the program operates, and requires these facilities to maintain a Seal of Compliance. The company reports the seal levels for 51 factories in China that account for approximately 82 percent of Hasbro's toy and game production. According to 2013 audits, 41 factories maintained Class A seals, four maintained Class B seals, one had conditional seals and five were on probation. For those factories put on probation, major areas of non-compliance were identified and a corrective action plan had to be established.[66] In Hasbro's FY2014 Form 10-K, the company reports that "Any failure of our third-party manufacturers to comply with labor, consumer, product safety or other applicable requirements in manufacturing products for us could result in damage to our reputation, harm sales of our products and potentially create liability for us."

In 2013, the New York State Comptroller filed a shareholder resolution requesting that Hasbro require its significant suppliers (those from which Hasbro expects to purchase at least $1 million in goods annually) produce an annual sustainability report. According to the resolution, the independently verifiable sustainability reports should include performance on workplace safety and human rights issues, including worker rights. Although the resolution did not pass, it demonstrates increasing concern over labor abuses in the industry's supply chain that can create legal, reputational, and operational risks.[67]

Failure of the Toys & Sporting Goods industry, together with other industries that depend on emerging markets for manufacturing, to voluntarily improve working conditions within the supply chain may invite new consumer criticism and regulatory action that could harm industry operations.[68] Companies that work proactively to manage this issue may be able to minimize unnecessary or unanticipated regulatory burdens.

Value Impact

Failure to identify or address labor conditions within the industry's manufacturing supply chain can create reputational damage and impact consumer demand for products. Further, poor labor conditions can result in work stoppages and other labor-related troubles, which, along with regulatory investigations, may result in supply disruptions that prevent companies from receiving products on time, which can in turn affect their sales.

With increasing public concern and regulatory oversight of labor issues in emerging markets, the probability and magnitude of impacts associated with this issue are likely to increase over time. Companies that work to manage the labor issues within their supply chains can pre-empt new rules that may have unanticipated or unduly burdensome impacts, reducing their risk profile.

Disclosure of the number of facilities audited and other management tools used to ensure appropriate labor conditions can help investors understand which companies are better positioned to mitigate labor risks in the near and long term. This disclosure also provides information about the insight companies have into their supply chains, and therefore their potential exposure to unanticipated labor issues. Further, reporting on actions to correct non-compliance can demonstrate how effectively toys and sporting goods companies are addressing labor violations that may occur.

SASB INDUSTRY WATCH LIST

The following section provides a brief description of sustainability disclosure topics that are not likely to constitute material information at present but could do so in the future.

Influence of Marketing & Stereotyping Practices: Toys and games play an important role in children's development, and the skills learned through play activities can influence future career choices and successes. Spatial skills in particular have been shown to be important for success in engineering and other STEM[III] fields.[69] There is a disproportionately low number of women in STEM fields today, and some have argued that toys and games that support development of spatial skills—such as construction sets—should be created for or marketed toward girls to address this issue.

Studies have shown that toys such as construction sets, which are traditionally viewed as male-oriented, are the ones that have led to the highest quality of play among girls.[70] Research has found that neutral-typed toys kept girls' attention the longest, followed by male-typed toys, then female-typed. Boys, on the other hand, spent half their time playing with male-typed toys followed by neutral, then female-typed.[71] Some research has also shown that strongly gender-typed toys seem to be less supportive of optimal development than neutral or moderately gender-typed toys.[72]

Given the significant impact of toys and games on children's development, companies in the Toys & Sporting Goods industry and toy retailers have faced pressure over gender-based marketing practices. Product and packaging colors and the gender-specific targeting of ads or products can provide conditioning for children about gender-appropriate desires and interests.[73]

Toys "R" Us in the U.K. agreed to end "gender marketing" in response to a campaign asking retailers to stop promoting some toys as only suitable for girls and others for boys. Due to pressure from the campaign, other retailers in the U.K. have followed suit, and a similar effort has been launched in the U.S.[74] In Sweden, the advertising regulator criticized the company Top Toy for its ads that featured boys and girls playing with toys that conform to gender stereotypes. Top Toy then announced that its Christmas catalog for 2012 would be "gender-neutral."[75]

Strongly gender-typed toys, particularly highly sexualized dolls, might also negatively influence children's self-image.[76] The toys segment of the industry has also faced criticism for racial stereotyping.[77]

While many of these criticisms are not new, companies may soon need to address them, as they can have an impact on company value. Campaigns against stereotyping are pressuring companies to change tactics in some markets. With a shortage of STEM skills in the economy, and the low proportion of women in STEM, toys and games are considered one way in to influence girls' future career choices.

However, this pressure also provides an opportunity for companies to expand their revenues and increase growth, despite the external competition from video games and a general slow-down in sales of some previously popular toys.[78] *The Economist* reported that in the second quarter of 2013, Hasbro's sales of toys aimed at boys fell 35 percent, while sales of girls' toys increased by 43 percent. Toys created and marketed as gender-neutral have the potential to attract both boys and girls. Educational toys can be particularly attractive gender-neutral options. The Toy Industry Association's top toy trends of 2014 include "[e]ducational toys, games and crafts that teach kids STEAM subjects (Science, Technology, Engineering, Arts and Math)."[79]

Companies in the industry may have opportunities to reinvent their marketing strategies and product offerings to capture demand for products that provide educational value and that fit outside the traditional gender or racial mold. Companies have begun addressing these concerns, although some

[III] Science, Technology, Engineering, and Mathematics.

argue that these attempts play to gender stereotypes rather than encouraging girls to break free of traditional social boundaries. [80] For example, when companies market construction or other toys traditionally thought of as male-oriented to girls, they sometimes rely on gendered colors and other features associated with girls' toys. Companies often justify these decisions by pointing to market research that shows that girls prefer these features; however, research often does not account for the fact that children may be conditioned to give responses that they think they are supposed to.[81]

Nonetheless, companies can capture new market segments by producing gender-neutral toys or marketing traditional boys' toys toward girls. For example, Lego launched its Research Institute line of products that feature women in professional settings instead of stereotypical images of partying and playing. Within days of the product's launch, the set was sold out on the company's website and at major retailers.[82] Mattel introduced the first Barbie construction set in the doll's 50-year history, called Mega Bloks Barbie Build 'n Style, a move that was influenced by changing patterns of buyers (with fathers increasingly buying toys in two-income households) [83] as well as demand for engineering toys for girls.[84]

While this trend might make the influence of marketing and stereotyping practices material to business results over time, current evidence suggests that this issue is not likely to be material to companies' results today.

APPENDIX I

FIVE REPRESENTATIVE TOYS & SPORTING GOODS COMPANIES[IV]

COMPANY NAME (TICKER SYMBOL)
Jarden Corp. (JAH)
Callaway Golf Co. (ELY)
Mattel, Inc. (MAT)
Hasbro, Inc. (HAS)
JAKKS Pacific, Inc. (JAKK)

[IV] This list includes five companies representative of the Toys & Sporting Goods industry and its activities. This includes only companies for which the Toys and Sporting Goods industry is the primary industry, that are U.S.-listed but are not primarily traded over the counter, and for which at least 20 percent of revenue is generated by activities in this industry, according to the latest information available on Bloomberg Professional Services. Retrieved on June 30, 2015.

APPENDIX IIA:
Evidence for Sustainability Disclosure Topics

Sustainability Disclosure Topics	EVIDENCE OF INTEREST				EVIDENCE OF FINANCIAL IMPACT				FORWARD-LOOKING IMPACT		
	HM (1-100)	IWGs		EI	Revenue & Cost	Asset & Liabilities	Cost of Capital	EFI	Probability & Magnitude	Exter-nalities	FLI
		%	Priority								
Chemical & Safety Hazards of Products	56*	100	1	High	•	•	•	High			No
Working Conditions in the Supply Chain	33	100	2	High	•	•	•	Medium	•		Yes

HM: Heat Map, a score out of 100 indicating the relative importance of the topic among SASB's initial list of 43 generic sustainability issues; asterisks indicate "top issues." The score is based on the frequency of relevant keywords in documents (i.e., 10-Ks, 20-Fs, shareholder resolutions, legal news, news articles, and corporate sustainability reports) that are available on the Bloomberg terminal for the industry's publicly-listed companies; issues for which keyword frequency is in the top quartile are "top issues."

IWGs: SASB Industry Working Groups

%: The percentage of IWG participants that found the disclosure topic to likely constitute material information for companies in the industry. (-) denotes that the issue was added after the IWG was convened.

Priority: Average ranking of the issue in terms of importance. One denotes the most important issue. (-) denotes that the issue was added after the IWG was convened.

EI: Evidence of Interest, a subjective assessment based on quantitative and qualitative findings.

EFI: Evidence of Financial Impact, a subjective assessment based on quantitative and qualitative findings.

FLI: Forward Looking Impact, a subjective assessment on the presence of a material forward-looking impact.

APPENDIX IIB:
Evidence of Financial Impact for Sustainability Disclosure Topics

Evidence of Financial Impact	REVENUE & EXPENSES							ASSETS & LIABILITIES				RISK PROFILE	
	Revenue			*Operating Expenses*		*Non-operating Expenses*		*Assets*		*Liabilities*		*Cost of Capital*	*Industry Divestment Risk*
	Market Share	New Markets	Pricing Power	Cost of Revenue	R&D	CapEx	Extra-ordinary Expenses	Tangible Assets	Intangible Assets	Contingent Liabilities & Provisions	Pension & Other Liabilities		
Chemical & Safety Hazards of Products	•						•		•	•		•	
Working Conditions in the Supply Chain	•			•					•			•	

MEDIUM IMPACT HIGH IMPACT

APPENDIX III: Sustainability Accounting Metrics | Toys & Sporting Goods

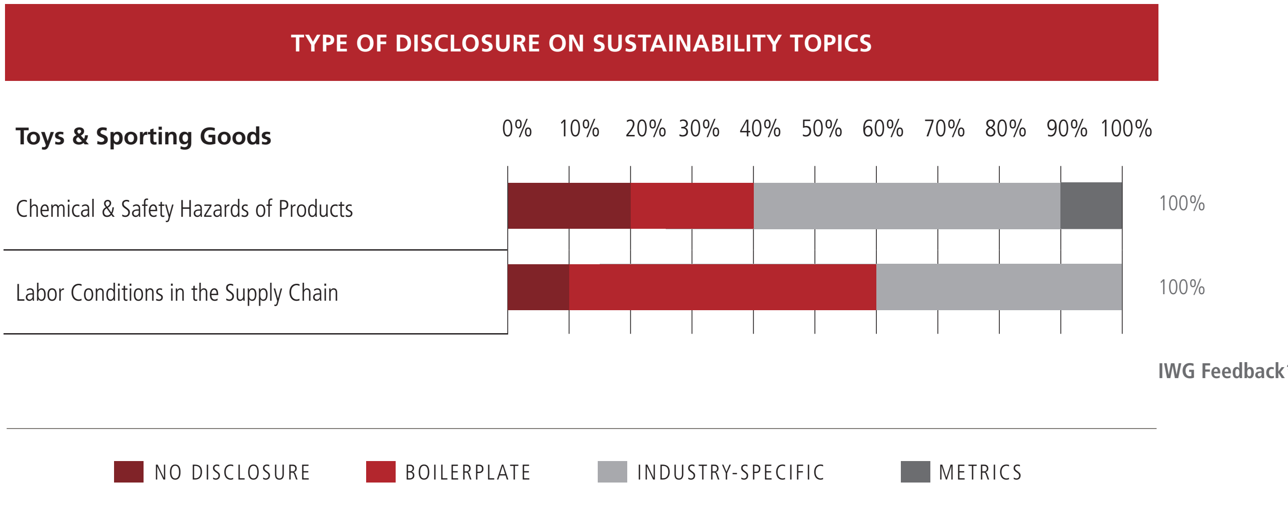
TOPIC	ACCOUNTING METRIC	CATEGORY	UNIT OF MEASURE	CODE
Chemical & Safety Hazards of Products	Number of recalls and total units recalled*	Quantitative	Number	CN0604-01
	Number of Letters of Advice (LOA) received	Quantitative	Number	CN0604-02
	Amount of legal and regulatory fines and settlements associated with product safety**	Quantitative	U.S. Dollars ($)	CN0604-03
	Description of processes to assess and manage risks and/or hazards associated with chemicals in products	Discussion and Analysis	n/a	CN0604-04
Labor Conditions in the Supply Chain	Number of facilities audited to a social responsibility code of conduct	Quantitative	Number	CN0604-05
	Direct suppliers' social responsibility audit compliance: (1) priority non-conformance rate and associated corrective action rate and (2) other non-conformances rate and associated corrective action rate	Quantitative	Rate	CN0604-06

* Note to **CN0604-01**—The registrant shall discuss notable recalls such as those that affected a significant number of units of one product or those related to serious injury or fatality.

** Note to **CN0604-03**—Disclosure shall include a description of fines and settlements and corrective actions implemented in response to events.

APPENDIX IV: Analysis of SEC Disclosures | Toys & Sporting Goods

The following graph demonstrates an aggregate assessment of how representative U.S.-listed Toys & Sporting Goods companies are currently reporting on sustainability topics in their SEC annual filings.



*Percentage of IWG participants that agreed topic was likely to constitute material information for companies in the industry.

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[2] Data from *Bloomberg Professional* service accessed on July 1, 2015, using the ICS <GO> command. The data represents global revenues of companies listed on global exchanges and traded over-the-counter from the Toys & Sporting Goods industry, using Levels 3 and 4 of the Bloomberg Industry Classification System.

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[5] Hasbro, Inc., FY2013 Form 10-K for the Period Ending December 29, 2013 (filed February 26, 2014), p. 17.

[6] IBISWorld, *Industry Report 33993: Toy, Doll & Game Manufacturing in the U.S.*, p. 4.

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[15] IBISWorld, *Industry Report 33992a: Athletic & Sporting Goods Manufacturing in the U.S.*, p. 22

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[21] IBISWorld, *Industry Report 33992a: Athletic & Sporting Goods Manufacturing in the U.S.*, p. 21.

[22] IBISWorld, *Industry Report 33993: Toy, Doll & Game Manufacturing in the U.S.*, p. 24.

[23] "Author's calculation based on data from Bloomberg Professional service, accessed July 1 2015 using Equity Screen (EQS) for U.S.-listed companies and those traded primarily over-the-counter (OTC) that generate at least 20 percent of revenue from their Toys & Sporting Goods segment and for which Toys & Sporting Goods is a primary SICS industry."

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