Handout A.1
Case Study – eToys, Inc. [ETYS]

All information included in this case study is based on public knowledge obtained from the sources listed below.

In 1997, eToys opened for business. It was the first of its kind in the online toy market. Led by Edward (Toby) Lenk, former VP of Strategic Planning for Disney, eToys quickly became a leader by allowing customers to search for toys by age, brand, and popularity. The eToys website also offered tips and product ideas to shoppers, in addition to a wish list and birthday reminder service, which sent e-mail notification three weeks before a birthday along with appropriate toy recommendations.

A successful online retailer knows that attracting customers is the key to success. Lenk spent $3 million to obtain promotional space on AOL for its first two years of business and agreed to a similar contract with Yahoo! Five thousand other sites were also paid to advertise eToys. Payments for advertisements were in the form of a 25% commission on sales for referred customers. Lenk raised money to cover startup costs and advertisement through venture capital firms[1] along with other business partners.

At the end of the first year, eToys had used up all of its cash and was over $2 million in debt, but new investors were still interested. In 1998, eToys entered into an agreement with three other web retailers to promote each other's sites, and investors saw that eToys was building its market. It was widely believed that Toys 'R' Us would soon open its own online store, and it was believed that if eToys had the jump on the market, then eToys could dominate. Although estimated online toy sales were low, investors found that toy sales showed a higher growth rate than any other online category. The growth in online toy sales from 1997 to 1999 was more than 300 percent.

eToys spent more and more money on advertising in preparation for Christmas sales in 1998. eToys marketed their company as a way to "…bring the toy store to you," and people responded. Customer satisfaction was a high priority as the company offered free upgrades to express shipping and gave out $5 coupons to customers if a toy was out of stock. Ninety-five percent of toys shipped within 24 hours.

[1]A **venture capital firm** is a group of investors that provides start-up money to businesses. It is generally believed that these are risky investments because of the high failure rate of many new companies, but it is also believed there is a potential for a greater than average profit.

Coincidentally, the top seller for the 1998 season was a talking toy called Furby. Other retailers had quickly sold out their Furby stock, but eToys had more. The company held online sweepstakes for free Furbies, which attracted many customers to the site. Sales for this quarter of 1998 were 20 times more than sales for the same quarter in 1997. About 3.4 million people visited the eToys site. Competitor Toys 'R' Us only offered about half the merchandise that eToys had and its online sales were a distant second to that of eToys.

Starting with 13 employees in 1997, eToys grew to 235 employees during 1998. The company's growth led to increased spending, and after 14 months of operation, eToys had a deficit [or shortage] of about $17.5 million.

Following its successful 1998 holiday season, eToys decided it was time to begin selling stock. Although eToys projected that operating losses and negative cash flow would continue, it hoped to raise money to expand and pay off debts. In May of 1999, the stock opened at $20 per share. It closed that day at an astounding $77 per share.

eToys fully expected more competition from Toys 'R' Us and Amazon.com. Toys 'R' Us was re-launching its website, and Amazon had just added a new website section just for toys. In response, eToys began rolling out new products. Shortly before the IPO, eToys purchased BabyCenter, a company that marketed baby products. After the IPO, eToys entered into deals with Discovery Toys and Gap.

eToys was still ranked as one of the most visited shopping websites during the holiday shopping season, but its overall spending continued to outweigh its sales—and investors started to lose faith in the company. The stock was at $84.35 in October 1999 but dropped to $26.25 at the beginning of 2000. In January 2000, eToys posted a loss of $62.5 million from the previous quarter.

The value of eToys stock continued to fall over the course of that year. In November, analysts predicted that eToys would not see a profit for another four years and stock values fell to $2.56. The company's hope for another successful holiday season was not realized and it was forced to lay off roughly 70% of its workforce. Finally, in February 2001, the stock prices dropped to a low of nine cents per share. The company announced that it planned to lay off its remaining employees and file for bankruptcy.

Sources:

www.fundinguniverse.com/company-histories/etoys-inc-history
www.ecommercetimes.com/story/7978.html
www.cnet.com/1990-11136_1-6278387-1.html
www.investopedia.com

Directions:

In your group, decide which person (or persons) will answer each question. Briefly write notes in the space provided. Then be prepared to present your answers to the class.

1. What is the company's service or product?

2. Explain any new financial terms used in this case study.

3. Was the IPO successful? Explain.

4. How did the stock perform over time?

5. What are some of the reasons for any change in the stock price?

6. How many people in your group would buy this stock right now? What are your reasons?