

# *The Lionel Curse: Gone Forever, or Just for Now?*

J. Scott Geare - November 6, 2009

Few people realize it, but their collections of Lionel HO trains dating from the mid 1970's were actually made by none other than Wheaties maker General Mills. General Mills had purchased the right to use the Lionel name and all the tooling to do so from the Lionel Corporation. So, the cars themselves are no different than they would have been had Lionel itself had made them. General Mills, you see, was looking for ways to make more money and one of the ways they thought to do so was to expand into recreational and leisure activities and products. They owned Parker Brothers (maker of Monopoly) and Kenner Toys, among others, and decided that a line of well-known trains would be a nice addition. And so, the folks who invented Wheaties, Betty Crocker, the Pillsbury Doughboy and Hamburger Helper were in the toy business. The Lionel product was sold under the "Fundimensions" Division of the General Mills Fun Group, Inc. It tells you so, right on the box.

But General Mills could not have purchased Lionel unless it was for sale. Your instincts alone would tell you that Lionel would not even be on the block unless there were some good reason to put it there. And the good reason was that Lionel was in trouble. In fact, throughout its storied history, Lionel has spent a lot of time in and out of trouble - up to this very moment. One might even argue that there is a kind of Lionel curse which is triggered whenever there is too much success.

Actually, Lionel had already been sold once before General Mills got hold of it in 1969. The cereal maker bought it from Roy Cohn, a nephew of Joshua Lionel Cowen, from whom the company takes its name. Founder Joshua and his son Lawrence had sold Lionel to Roy in 1959. Roy couldn't make money with Lionel for the same reasons his uncle Joshua couldn't - people just didn't like toy trains as much in the mid century as they did in the preceding decades, back to the turn of the 20th century.

It stands to reason. For the first half of the 20th century, the railroad system and the powerful mechanical beasts which moved people and freight were, in those days, the ultimate visible expression of technological vision and industrial power. The railroads truly were empires in their own right. Even to this day, who is not impressed by the passing of a thundering machine pulling a mile of rumbling steel behind it? But the post-war development of commercial aviation and the interstate highway system prompted newer ways to move goods and people more quickly and with greater independence than the trains could ever manage. Consequently, from the early 1950's until this very day, planes and cars became both more visible and more important in American life. And they, like the railroads before them, were made more powerful, more luxurious, more affordable and more impressive as they years passed. It should come as no surprise that the toy replicas, likewise, assumed a predominant place in the play and imaginations of youngsters. Lionel, alas, was not in the toy plane and automobile business; they were in the toy *train* business. Exactly the wrong place to be.

I say all this with respect to *TOY* trains, which although of the same issue are yet of a different species than *MODEL* trains. In fact, as *toy* trains appeared to fade into the distance during the 1950's and beyond, *model* trains were making a speedy approach and becoming more popular and more available than ever. HO scale trains in particular seized the imagination because the scale seemed to offer the greatest realism both as to detail of equipment and operational possibilities in the confined space of a basement or even a bookshelf. Consequently, while few possessed the space required for permanent larger scale layouts, many already had the room for an HO scale empire.

And when I say that the imagination was seized by rail *modeling* -as opposed to play- I refer to the imagination of an adult male. Indeed, the adult men of the 1950's were the children of the 1920's; they remember the big locomotives of their day and they are the same people who have been buying and building HO scale model trains since the mid 1950's. They're not interested in "toys." They want *models*. Precisely because the HO scale equipment is small and accordingly delicate, it is unsuited to juvenile play activity. Therefore, the HO model railroad -as opposed to a big train circling a Christmas tree- is by its very nature unsuited for the creative exercise of a child's imagination. And that merely adds to the background cultural bias in favor of toy cars and planes. Little wonder that Lionel faced a seemingly insurmountable obstacle in the middle of the 20th century.

I'll advance, as well, a psychological dimension which created a tough marketing environment for Lionel and others (such as A. C. Gilbert) in the same business. Whether as a toy or as model, the miniature railroad, like its real-world counterpart, is "infrastructure intensive." That is, it requires track, scenic elements, convincing operating accessories, an electrical supply and other support if it is to be of enduring interest or fascination. All that requires patience and work -qualities not usually abundant in children, who by nature are more responsive to an immediate reward for their efforts and behavior.

The innate desire of immediate gratification among children has been exacerbated by a culture which is focused on -and which *actually delivers*- immediate gratification as the primary reward for a course of action. And thus, the emergence of television as an entertainment medium in the 1950's served to instantly reward those who watched it. Likewise, toy vehicles such as cars and planes are replicas of individual objects which can be put to immediate use, and such supporting scenarios as may make them appealing are designed for quick set-up and take down. A "Hot Wheels" drag strip, for example, may be deployed on the living room floor in a few moments and put back in the box just as quickly. A toy plane or copter may be flown in (or from) the hand. A toy locomotive, of course, may be designed for exactly the same kind of play but by nature is subservient in a world which is defined by objects of transportation whose travel paths are relatively unrestricted.

I hold out that independent action, as well as instant reward, has also played a part in forming juvenile recreational preference. The railroad -the toy one and the real one- operates on a premise of cooperation among, and coordination of, various elements in support of some over-all purpose. Whether as dispatcher or living room player, the human agent must conform to the operational possibilities and limitations of the system; in fact, must understand it AS a system. Not so with toy planes and cars. These are independent entities whose actions are completely within the control of the handler. Of course there are, in fact, restrictions on what a real car or plane can do, but those restrictions reflect the choices of the operator as much the physical reality in which they operate. A child sees and occupies a real automobile in many places; sees it respond to steering and pedal commands of the driver, sees the streets as a part of the natural landscape -they are just *there*. But the train is a thing which is always in the same place -if it is there at all. It doesn't come to you -you must go to it. Perhaps more than anything, the automobile -for child and adult alike- is an expression -if not an extension- of one's individuality and independence.

All of the above culture and psychology created a difficult challenge for Lionel; people did not want the *toy* trains that Lionel marketed, and the *model* trains that people wanted, Lionel did not market. I did *NOT* say Lionel didn't *MAKE* HO scale trains -they did, and good ones. What I said was that they did not *market* them, or rather, market them to the right audience at the right time. Atheran, Atlas, Varney, Rivarossi and others were selling product not as toys, but as *models*. Their audience was adult men whose engagement with the hobby may well have been recreational but could hardly be classified as mere play. Lionel's audience -in its hay day- was not American male youth, but rather their mothers.

*Mothers? Women? Indeed.* In a perhaps apocryphal snippet of history, one article tells the story of a conversation (presumably in the late 1930's) between Lionel founder Joshua Cowen and William Walthers, founder of what today is the world's largest distributor of model railroad merchandise. Walthers, evidently, was dismayed at the starkly unrealistic appearance of the paint jobs on Lionel trains. With his keen eye for realism and detail, Walthers asked Cowen why Lionel trains were dressed up in such unrealistic bright colors. Cowen answered that most of his trains were purchased by mothers, and that women were attracted to bright colors. Whether or not this conversation actually took place I cannot say, but if there is a kernel of truth to it, then it portrays what was a brilliant market assessment at the time, and presaged the almost deadly lack of vision two decades down the line.

I've spent a great deal of time in the mid-century years because it was then that Lionel nearly disappeared for good. Those years mark both a destination from a point 50 years before, and a point of departure to the present day; they are a kind of "union station" in the corporate history. From the start, in the year 1900, Lionel often found it hard to stay on the tracks. Joshua Lionel Cowen and Harry C. Grant founded the Lionel Corporation in the fall of that year and opened shop in New York City. They intended to produce and sell products which worked on a form of energy that was beginning to capture the public's imagination -electricity. Their early products included gadgets such as battery powered fans. Like many innovations, the famed Lionel trains came onto the American scene for reasons that were completely unrelated to the past time as we now know it. Instead, Cowen developed the electrically operated train as an attention-getter for retailers to display in their store fronts. The idea was that passers-by, intrigued by the marvel of a working miniature train, would be enticed into the store. And they were. However, they were more interested in the train than the store's merchandise, and therein was the impetus for Cowen to make trains for sale to the public, and production of toy electric trains commenced.

Lionel the train maker had competitors, to be sure -Marklin, to name one- but by 1919, Lionel was one of the three largest toy train manufacturers in the country. Ives Manufacturing Company was the biggest, but Ives steadily lost market share to Lionel and rival train maker A. C. Gilbert. Lionel and Gilbert partnered to buy Ives after it filed for bankruptcy in 1928. Two years later, Gilbert sold its interest to Lionel.

But there were fiercer competitors than Ives, Marklin, or A. C. Gilbert at hand. The first of these was the Great Depression, which made Lionel's trains a completely unaffordable luxury. Sales plummeted. The other was Joshua Lionel Cowen's own failure to anticipate consumer preference, either as to the type of product or the timing of its introduction to the marketplace. It could be argued that Cowen -whose most expensive toy trains cost more than a car- practically drove *himself* out of business. His introduction of a cheap train set (under the name, "Winner Toys") for a bit more than \$3 in 1930 served only to fragment the shrinking market even more. So there was Lionel, in the midst of a country dealing with economic collapse, selling on the one hand toys that few could afford, and on the other, selling toys of such low value that few wanted to buy them. As we have seen, this failure to align product with market preference would come back to haunt Lionel 50 years later.

It was Walt Disney, oddly enough, who brought relief to Lionel. More accurately, it was Disney's creations: Mickey and Minnie Mouse. The cartoon characters introduced by Disney in 1928 had become quite popular just when Lionel most needed something to stop the bleeding. Lionel introduced a Mickey and Minnie handcar powered by a wind-up spring (not an electrical motor) at a retail price of just \$1 -and it ran on Lionel O gauge track. The Mickey and Minnie handcar was a smash hit -Lionel couldn't make them fast enough. It and several other "character" cars were just enough to keep Lionel in business. By the time the United States entered World War II, the company had regained its prominence and its profitability. It manufactured product for the O and OO gauge market, and abandoned the much larger so-called "Standard gauge" on which its first products were based. Likewise, operating accessories were introduced and snapped up by an eager public. Lionel was *back*.

The war effort demanded that the metal for trains be diverted to tanks and bullets. Lionel adapted, profitably supplying systems for military applications. After the war, flush with cash, it was full steam ahead for Lionel, now under the direction of Joshua's son Lawrence. Lionel roared ahead. 1955 sales were double that of competitor A. C. Gilbert. The Lionel product was becoming more detailed and realistic in appearance than ever before, the product line was innovative, fascinating, animated.

But the same mistakes made decades earlier by his father were repeated by the son, and this time, it was too much. Lawrence failed to see where the market was headed -this time, to the high realism of HO scale railroad modeling and the competition of other kinds of toys -especially automotive models, as we've already discussed. And once again, a knee-jerk and unfocused reaction to the changing market place served to aggravate the problem. On the one hand, the company hastily introduced HO products manufactured under license from others: Rivarossi and Athearn. Lionel also tried cheaper manufacturing sources for their own O gauge product, with consequences for the quality and popularity of the line. On the other hand, they diversified into production of the very products which were eroding their sales. Too little, too late.

At last, Father and son sold out in 1959. The new owner, nephew Roy Cohn, was neither able to compensate for the public's fading interest in toy trains nor able to succeed with competing toy lines in which Lionel had neither a reputation nor experience. A. C. Gilbert couldn't keep up, either, and folded in 1967. Two years later, Lionel sold its train manufacturing equipment and its name to cereal maker General Mills, who manufactured and sold Lionel product from its Model Products Corporation subsidiary and under the "Fundimensions Division."

What remained of the Lionel Corporation -after unhanding itself of the trains- turned from manufacturing to retail sales of general toy goods. The strategy worked, at first -hundreds of toy stores under various names were opened. But here again, the company misunderstood their market. Encroachment by super stores with expanded toy departments and deep discount pricing drove the company under -everything closed by 1993. That may well mark the end of Lionel as a business entity which may be traced back to 1900.

The product, however, lived on -barely. General Mills, selling under the Fundimensions name, attempted to revive the Lionel "HO" gauge line in 1973, manufacturing the trains in the US and the Orient. But General Mills marketing muscle and cash weren't enough to dislodge entrenched model companies such as Athearn who by then were serving the rail modeling market with proven products. It would be difficult, to say the least, to persuade the male advocates of a modeling hobby that cake-maker Betty Crocker should be accepted as an authority on the subject. Nor could General Mills persuade the public to accept the HO train as a toy. They gave up HO in 1978.

But a dwindling market for toy trains does not mean there is no market whatsoever, and General Mills did gain some traction by reviving, in 1979, the American Flyer S gauge train line under the Lionel brand (Lionel bought rights to American Flyer from Gilbert when Gilbert went out of business). But the "Lionel curse" evidently came along with the product. In 1983, General Mills made the bad cost-cutting decision to move production of all its toy lines- Lionel included- to Mexico. Poor quality and failed delivery tarnished the Lionel brand's reputation. The Wheaties people threw in the towel: In 1985, Betty Crocker bundled up Lionel and their other inedible toy lines and spun them off as "Kenner-Parker Toys, Inc." Production of Lionel was thereby switched back to the US.

Given how many times Lionel had risen and fallen under the management and control of business people, one might wonder how well the name and the product would fare under the ownership and guidance of an actual model train collector. Such was the avocation of one Richard P. Kughn, a Detroit real estate developer, who, with a group of investors, bought what was left of Lionel in 1986. Kughn's new company was named

Lionel Trains, Inc. Who better to understand the market for model trains than an actual customer? By 1989 sales skyrocketed 150 percent, and market share hit 60 percent. Much of the increase was owed to production of “Lionel Classics,” which were carbon copies of the metal trains that made the predecessor company successful a half century before. Unlike the predecessor owners, however, Kughn and his associates had a prescience for the market they served; introducing on-board cameras, prototype sounds and even a train control system which anticipated DCC. The stage was now set for a more successful and enduring organization, as a fully stoked Lionel thundered into the mid 1990’s with new products, new innovations and new inspiration.

And that stage was soon occupied by rock singer Neil Young (of Crosby, Stills, Nash and YOUNG), who, with Martin Davis (formerly Chairman of Paramount) bought Lionel from Kughn in 1995, naming the new company, “Lionel LLC.” Singer Young’s particular inspiration was remote control technology, which he and Kughn had developed as “Liontech” while Kughn still owned Lionel Trains, Inc. Likewise, Neil Young pursued “Railsounds,” which embedded recordings of actual locomotive noise into the models. Liontech ultimately was developed into “Trainmaster Command Control,” which is very similar to DCC. Today, Lionel’s latest iteration is called the “Lionel Legacy Control System.”

On the business side of the house, Lionel LLC moved production back to the Orient which by 2000 had a proven record of quality production. The company exploited a fruitful cultural niche, producing a “Polar Express” train set that capitalized on the popular 2004 Polar Express children’s movie. Big retailers such as FAO Schwartz and Target eventually welcomed the Lionel product line, expanding the sales floor beyond traditional hobby shops. A popular product, cost control and exquisite market timing, and all of that within an expanding national economy. Things were looking very good. But, then again, there’s that old Lionel curse.

Things *were* good, until, that is, there was, literally, a wolf at the door. Mike Wolf, to be exact. Mike Wolf, owner of Mike’s Train House, the company he started out of his bedroom when he was a kid in 1980, the company known today as MTH. There’s a convoluted and painful history stretching over the years between Mike and Lionel, which I won’t cover in detail here, but suffice it to say that MTH sued Lionel for stealing MTH designs. The jury agreed - awarding MTH a whopping \$40.8 million settlement in 2004. Of course it was appealed and the fight went on, but in the end, it cost Lionel LLC a cool \$12 million according to a wikipedia article which cites an unidentified source at the Associated Press. It’s bad enough to have a wolf at your door, but having an entire railroad company at your door ain’t no Sunday School picnic, either. In particular, the Union Pacific was chuffing at the portal, claiming Lionel had infringed on UP’s trademarks by decorating their models with UP symbols and color schemes. That one cost Lionel over \$600,000 plus royalties on future sales. And at just the wrong time, what with MTH waiting in line.

All of this created quite a stir in the Lionel board room, with the result that Lionel filed for bankruptcy in 2004 and dismissed its CEO Bill Bracy and 17 other big dogs. Gerald Calabrese was named new CEO. Jerry’s expertise is development and operation of loyalty-based enterprises whose customers share an enthusiasm and interest in a cultural focus. He was President of Marvel Comics Group -the “Spiderman” people. He inspired and coordinated NASCAR’s 50th anniversary program and engineered their marketing initiative to kids, with an “NASCAR Racers” show on the Fox Kids Network. He had even been a VP at Playboy at one time. The point is that Jerry understands the difference between merely selling objects and serving a need, supporting and promoting an avocation. To the Marvel Comics customer, Marvel characters are the quintessential expression of heroism and villainy; to the stock car racing fan, NASCAR is the summit of the racing culture and lifestyle. Success in these enterprises is all about the customer -the customer is not merely a buyer, but rather a participant and an advocate. Understand your customers, and you MIGHT succeed. Ignore them, and you ARE SURELY doomed. In successful practice, the customer is understood as a stakeholder, if not a stockholder. Who better than Calabrese to head up Lionel? Given its tumultuous history and the treacherous financial grades

which faced Lionel, about the only asset they had left was their customer's loyalty and interest. Jerry was just the right person to get the company focused.

Being bankrupt doesn't mean you're out of business, it just means you're out of money. In March 2008, the judge approved Lionel's reorganization plans which include paying off all the debtors. Private equity specialist Guggenheim Corporate Funding plunked down a tad more than \$37 million to re-light the boilers at Lionel. That gave them nearly a 49% ownership. And who else should come riding to the rescue? None other than the ghost of Martin Davis, that's who. Well his estate, actually, for Martin had already taken the last train out, one might say, in October of 1999. It was Martin Davis, you may remember, who was Neil Young's partner in the 1995 purchase of Lionel Trains from Richard Kughn. Anyway, the Davis estate chipped in about \$22 million, giving them slightly less than a 29% stake. Which is all to say that there is only 20% left over for anyone else -whomever they may be. But we know who it is NOT: Davis' partner, rock star Neil Young. Evidently, he has no ownership whatsoever that I know about. In any event, Lionel was officially out of bankruptcy on May 1, 2008.

CEO Calabrese could not possibly have resurrected Lionel were it not for a great many who believed that Lionel was capable of sustaining itself as a going concern and the significant few with a tolerance for financial risk. He emerges from all of this as something of a renaissance man, for he has been able to discern truth and opportunity in what, to all appearances, are the most unprepossessing circumstances. The stunning evidence of this is the deal he cut with juggernaut MTH who nearly wiped out his company a few short years before. On the very last day of December, 2008, Jerry wrote this Lionel web site news flash: "Lionel is going to license MTH to use its (Lionel's) name on historical tinplate Standard and O Gauge model trains and accessories ..."! (Parenthetical material mine).

The Lionel name on MTH product? Who woulda thunk it? The arrangement seems about as appealing as selling fire insurance to the guy who tried to burn down your house. But as a business deal, it makes sense. It was a new source of revenue for Lionel that capitalized on investments which have already been made and need not be made yet again. But more than that, it bonds adversaries into a cooperative relationship which benefits them both and can only serve to equate self-interest with mutual interest; the former enemies now have a reason not to fight.

Calabrese has also understood the key role of all the players in the distribution chain: upscale retailers like Target can sell (but NOT discount) the train sets, but only the local hobby shop can sell track and accessories. This serves to widen the landscape for Lionel product while still providing specialist support for the customer. While this is not a panacea for the small retailer who resents the monstrous competition of mass merchandisers, it is certainly comprehensible by them as a sensible -and even morally defensible- business model for Lionel. Likewise, Calabrese "gets it" on quality. Lionel's cheapest trains are by no means the cheapest trains anyone can buy, they are simply the least expensive in the Lionel roster; the least expensive that may be sold at the *quality standard* which Lionel has set. And Lionel doesn't produce a "dumbed down" version for the big retailers. Lionel in one place is the same as Lionel in another place. This business model will not, and really cannot, make Lionel the dominant producer of model or toy trains it once was. But what it will do is move Lionel to a superior position with respect to the particular market it serves because the company is dedicated to that market exclusively -and the customers know it. Marvel Comics readers are connected to Spiderman, NASCAR fans are connected to the drivers, and Lionel owners are connected to the very name, Lionel.

And so, Lionel has been reborn yet again. The Lionel models from the General Mills era represent not just a competent -and a very competent- execution of a prototype in HO Scale, but also a snapshot of a company's history. They are the artifacts of Lionel's captivity in the hands of the benign and muscular, yet awkward,

corporate parent General Mills, who clearly recognized the value of its chattel but was unable to restore it to prominence.

So, what will be the destiny of Lionel, down the line? If the web site is any indication, it is very much a going concern and tightly focused on the customer. In many ways, the apparent corporate ethos and very obvious focus seems, at last, to reflect the customer expectancy which made Lionel such a success in its early years.

And the Lionel curse? Never say “never” or “always,” but Lionel as a business certainly appears to be well poised to assure a bright future for itself. That said, we now find ourselves in the midst of the worst economy since the Great Depression that was nearly the undoing of Lionel in the early 1930’s. How well Lionel -indeed, how well all of us- adapt to the new reality will no doubt factor heavily into the unknown destinations which lie ahead of us. Like it or not, we are all aboard for that journey.

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