The Problem With Following A Trend Line

"Unsustainable trends cannot be sustained." It's one of those widely quoted economic adages that sounds like a statement of the obvious. Yet in the real world, it's a truism that is ignored more often than not. The painful aftermath of the national housing bubble is just one example of what happens when you blindly assume that a past trend—two decades of rising real-estate prices—will continue indefinitely. Within the music industry, many have succumbed to the same temptation of extrapolating the immediate past far into the future.

In 1997 when Guitar Center accelerated its national expansion plans, the company had 26 stores and its $200 million top line represented less than 3% of total industry revenues. By 2007, the year the retailer was acquired by Bain Capital, GC presided over 315 stores, and its $2.1 billion revenues accounted for almost 30% of total industry sales. Assessing this unprecedented decade of sales growth, more than a few concluded that it was only a matter of time before GC secured a 100% market share. *(If Guitar Center had sustained a 20% top line growth rate it could have commanded the entire market by 2014.)*

As a multi-store chain with complex logistics, GC had different service requirements than the typical independent retailer, and top suppliers responded by setting up separate "national accounts" sales departments. For much of the past decade, being on the "national accounts" team was a plum job because it generally meant rising sales commissions as GC continued to grow. That is, until the past year.

As a private company, Guitar Center no longer makes regular financial filings, so it's difficult to precisely gauge monthly sales performance. But here's what we do know: At NAMM, virtually every exhibitor reported that sales to independent retailers far outperformed sales to Guitar Center in 2009, and that they expected more of the same in 2010. Big ships take longer to turn, and part of this performance disparity could reflect GC's efforts to reduce inventory levels to align with reduced consumer demand. Suppliers could also be adversely affected by GC's growing stable of house brands, which includes Laguna guitars, Raven amps, Harbinger audio, Orange County percussion, Simmons electronic percussion, Williams digital keyboards, and Road Runner cases among others. However, one thing is clear: predictions of GC's continued market share growth are on hold for the time being.

We suspect that what's taking place is less about GC's management—which deserves plaudits for creating such a large and successful business—and more about a continually shifting marketplace. Historically, the industry's retail distribution channel has regularly gone through cycles of consolidation and fragmentation. The first half of the 20th century saw widespread consolidation as large regional "full-line" stores took business away from dry goods stores, department stores, and other retailers that carried music products as a sideline. Although hard data isn't available, we estimate that by the early '50s, these full-line retailers, which included the likes of Lyon & Healy in Chicago, Whittle's in Dallas, and Grinnell Bros. in Detroit, commanded an 80% market share.

The second half of the 20th century was a period of fragmentation as the full-line model was rendered obsolete by specialized school music dealers, specialized home organ stores, and m.i. stores that offered guitars, amps, sound gear, and related products. By the early '80s the once seemingly invincible full-line stores had been completely supplanted by a collection of specialists.

The close of the 20th century brought about a new wave of consolidation in the form of Guitar Center, which used a potent combination of well-merchandised stores, broad inventory, and aggressive promotions to gain market share. In a diverse country with 300 million citizens and an ever-expanding number of musical genres, it's hard to imagine that any single retail model is capable of satisfying all customers. This simple fact is probably the single biggest impediment to further industry consolidation. What comes next is anybody's guess. A number of independents have found success with hybrid online/brick-and-mortar strategies; the jury is still out on Best Buy and Amazon.com's foray into music; and GC and its subsidiaries, Musician's Friend and Music & Arts, could resume their growth. One thing you can be sure of, though. Any straight-line extrapolation of recent trends will be wrong. This should actually be a comfort. Although the market is bound to take some unexpected turns, the recent downward sales trend is bound to reverse course, which should benefit all.

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