EDITORIAL

INTERNET WOES

We were starting to feel left out. For several months now, the news has been filled with stories of high-flying Internet ventures, in every conceivable industry, crashing to earth. Petstore.com, WebMD.com, Internetcapital.com, Doubleclick.com, and countless other "new economy" startups have inflicted untold damage on investors in an extraordinarily short time frame. Yet the music products industry was noticeably under represented on the casualty list. Until now that is. As this issue went to press, zZounds Music earned the dubious distinction of becoming the industry's first notable Internet casualty. After an apparent financial crunch prompted several major suppliers to curtail shipments, the high-profile Internet retailer was acquired by American Musician's Supply, a leading catalog retailer.

We don't know all the inner workings of zZounds, and as this issue went to press we were unable to contact any of company's principals. However, on the surface, the company saga appears to follow the trajectory of numerous other Internet ventures. It started with some bright people with an idea. In this case, prominent lawyer Ray Campbell crafted a business plan illustrating how e-commerce could transform a mature industry, like music retailing. After the idea stage came the hunt for capital. Eager to gain first-entrant advantage, Campbell secured an investment of approximately $15 million from Microsoft founder Paul Allen, to fund an aggressive roll out. Then came the challenge of operations. Following the Amazon.com model, zZounds offered the industry's most aggressive pricing in an effort to drive consumers to the site. After a year of loss leader pricing, zZounds was forced to retrench dramatically and ultimately ended up as part of a traditional retailer.

We live in an age characterized by instantaneous communication and an incredible volume of easily accessible information on every subject under the sun. Yet despite this exponential increase in data, the same irrational enthusiasms and herd mentality that marked the dark ages are still very evident today. zZounds and the other now flagging Internet ventures painfully illustrate this fact.

All successful retail businesses rest on a combination of management expertise, solid internal systems, and the ability to generate adequate gross margins. Purchasing, inventory management, order fulfillment, promotion, and all the other aspects of running a store, require skills and knowledge that take time to acquire. Yet during the height of Internet mania, "visionaries" sold a lot of the general public on the idea that none of these gritty details mattered. If you managed to stake out a presence online, everything else would take care if itself, and everyone would get rich. Less than a year later, the verdict is in. On or offline, basic business skills still matter and the Internet wields no particular magic.

Brick and mortar music retailers should take heart from all this. The problems at zZounds, and other etailers too numerous to list here conclusively prove that ecommerce, despite the hype, is not going to replace the traditional store anytime soon. Furthermore, etailing is not a low cost mode of doing business, and any etailer with hopes of staying afloat simply can't afford to offer slash-and-burn pricing.

Ecommerce may yet live up to its initial promise. However, before that happens, a lot of smart people will have to go back to the drawing board.

Brian T. Majeski
Editor

WHAT IS VALUABLE?

Just eight months ago, tiny Sonic Foundry, a company offering software for transmitting music online, was the industry's second most valuable company. Yamaha, with sales of $4.7 billion and over 18,000 employees topped the ranking. But Sonic Foundry, with sales of just $14 million and huge losses, wasn't far behind, valued at a whopping $955 million. As the accompanying chart indicates, investor sentiment has changed rather drastically and Sonic Foundry shareholders have taken a major haircut. Obviously, a rethinking of online business potential is underway.

	Market Valuation		Projected 2000	
	3/12/2000	12/6/2000	Sales	Earnings
YAMAHA	$1,500.0	$2,100	$4,700.0	$70.0
SONIC FOUNDRY	$955.0	$65.0	$24.0	(-$24.0)
KAMAN CORPORATION	$215.0	$320.0	$1,010.0	$33.5
GUITAR CENTER	$200.0	$256.0	$785.0	$20.0
STEINWAY MUSIC	$170.0	$154.0	$314.0	$17.0
MACKIE DESIGNS	$72.0	$75.0	$205.0	$7.3

Valuation figures represent closing stock price as of December 2, 2000, multiplied by the number of outstanding shares. All figures are in millions of dollars.