EDITORIAL

BRICK AND MORTAR GETS NEW RESPECT

At past NAMM shows, there was always one product or technology that seemed to dominate conversation for the four-day event. Breakthroughs like MIDI, digital sampling, and more recently, hard disk recording, are a few of the examples that come to mind. Based on the product offerings at this year's NAMM show, the industry's collective R&D efforts remain as fertile as ever. Yet among dealers in the aisles of the Anaheim Convention Center, the phrase "new and improved" was largely greeted with yawns. It's not that the products were unappealing, but rather that the dealers had something else on their mind, namely profit potential.

Over the past two decades, industry growth has been stimulated in large part by better product value. Manufacturers have won well-deserved plaudits for using cutting-edge technology to offer more features and better quality for less money. However, the retailers' role in improving value to the consumer has largely gone unrecognized. While manufacturers were working in the lab and on the factory floor, retailers across the country were scrambling to remain profitable at lower gross margins. What passes as an acceptable gross margin today (28% to 32%) would have been unthinkable not too long ago.

Unfortunately, there are limits to efficiency improvements, and retailers both large and small, have jointly concluded that they simply can't afford to give up any more gross margin points. (An enterprise can't run on enthusiasm alone.) Thus, products at this year's show were judged more for their profit potential than for their engineering.

For the first time in memory, manufacturers seemed to be doing more than paying lip service to retail profit concerns, as evidenced by the flurry of new and more restrictive Minimum Advertised Price (MAP) policies that were rolled out at NAMM. It's no secret that behind closed doors, most manufacturers are fulsome in their criticisms of the industry's retail network. "They don't do any marketing," "Their stores are staffed with minimum-wage idiots," and "They wouldn't recognize an opportunity if it hit them in the head," are just a few of the common complaints. However, as the song goes, "You don't know what you've got 'til it's gone," and manufacturers are starting to realize that their survival depends on the support from brick and mortar stores across the country.

Despite the potential of the Internet, the proliferation of catalogs and 800 numbers, and a multitude of advertising vehicles, the fact remains that product displayed on the floor of a retail store is still the most effective means for raising consumer awareness, developing brand image, and ultimately generating sales. Put bluntly, no presence in stores, no business. Confronted with a large number of retailers who are saying "If I can't make a decent margin on this, it's off my floor" (and they're not kidding), manufacturers are taking notice. The trend is towards more expansive MAP policies that prohibit phone or email price quotes below MAP price, all in a bid to give brick and mortar stores an incentive to lay in inventory.

In past surveys we have conducted, about 35% of retailers say MAP policies aid their gross margins, about 9% say they hurt margins, and the balance say they have no material effect. Whether the new and more restrictive variety are more effective remains to be seen. However, as the NAMM show illustrated, the formula for success has been altered. Brilliant engineering and design are no longer enough. A distribution scheme that enables retailers to make a respectable gross margin is now at least as important.

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