EDITORIAL

WILL IT DELIVER AS PROMISED?

For over a century, a large part of our editorial coverage has been devoted to the ongoing tug-of-war between manufacturers and retailers trying to maximize their profits. The names and some of the specifics have changed over the years, but the basic issues have been as constant as the tides.

For retailers, bigger margins are the source of improved profits, so they have spent the last hundred years single-mindedly pushing their suppliers for exclusivity and price guarantees. Increased volume is where manufacturers start to rake it in, so they have continuously looked for ways to sell more product, pressing their customers to load up on inventory, opening new sources of distribution, or tweaking discount structures to encourage incremental sales gains.

Guitar Center's new 505,000-square-foot distribution center is perhaps the single largest structure ever constructed in this industry. Of equal significance, the vast facility adds an entirely new facet to the manufacturer/retailer debate. (The details of how the structure works are covered in a feature that appears on page 132 of this issue.) Instead of merely pressing for a lower price, Guitar Center management is now asking its suppliers to ante up to make the entire distribution process more efficient.

Guitar Center has spent an estimated $13 million on a distribution center to boost its inventory turnover and reduce administrative expenses. In addition to making the company run better, the chain's managers contend that this investment will yield significant efficiencies for GC's numerous vendors. Instead of having to send merchandise to 100 stores, the say, suppliers will enjoy reduced freight costs by shipping to a single location. By dramatically reducing the number of purchase orders and shipments to track, GC also promises a dramatic reduction in paperwork and administrative overhead. For delivering these benefits, Guitar Center execs justifiably want to be rewarded, and they are reportedly asking their vendors for an additional two percent to five percent "distribution center discount."

Needless to say, manufacturers aren't eager to give up margin points. Given that Guitar Center's distribution center represents a new concept for the industry, their skepticism is heightened. "Will it work?" is one common refrain. "If I don't see the efficiencies that are promised, can I get the discount back?" Another widely held concern was voiced by the supplier who said, "Am I giving up margin just so they can put all my other customers out of business? Is this fair?"

But perhaps the biggest fear is that any price concessions made in the name of distribution efficiencies will just be passed directly through to consumers. Last year, because of lower street prices, in numerous product categories unit volumes edged up while sales revenue dropped. This deflation is the single biggest reason why profits have trended down at every publicly traded company in the industry, Guitar Center included. (We think it's safe to assume that the industry's privately held company felt similar profit pressures.) Will giving the industry's biggest retailer an extra two- to five-percent cushion simply accelerate the deflationary trend?

By virtue of its size and prominence, Guitar Center generates plenty of invectives, and there's no question the company is a hard-knuckled competitor. But then, the job of GC management isn't to win popularity contests, and it deserves credit for investing aggressively in cutting-edge technology. Furthermore, in the feature in this issue, they make a compelling case for the benefits of a centralized distribution system.

As the recent turmoil on Wall Street illustrates, all investments don't pan out, and the unanswered question remains: Will this slick new distribution center deliver as promised, or will it just intensify the industry's already withering price competition? Anyone doubting the magnitude of the stakes involved should consider a comment made by Guitar Center Co-CEO Marty Albertson at a presentation at the NAMM Economic Summit earlier this year: "If this investment doesn't produce the desired return, I won't be Guitar Center CEO."

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