EDITORIAL

LOOKING OUTSIDE FOR HELP

Profit is the lifeblood of all businesses. Take away the profit and they will all wither away. Currently, the biggest threat to industry profitability is not a lack of demand, but rather, a lack of pricing power. As we graphically illustrate on page 114 of this issue, prices on industry staples—for example, five-piece drumkits—have been falling steadily over the past decade. The impact of these sliding prices has been effectively masked by rising unit volumes, but the party seems to be coming to an end. In this climate, retailers and manufacturers can't rely solely on prices increase to offset rising operating expenses. So what to do?

Misery loves company, and our industry should take some comfort in the fact that a lack of pricing power is a problem faces many other industries. In addition to comfort, it's also worth looking to other industries for creative solutions. Take the case of Goodyear tires. Like most segments of the music industry, the tire market suffers from shriveling price competition, shrinking margins, and an acute lack of pricing power. For years, Goodyear had relied a volume-based discount structure that gave larger tire outlets a major cost advantage. Not surprisingly, the bigger players used these discounts to force down retail selling prices and seize market share from smaller competitors.

Last January, Goodyear sharply reduced its volume discounts. For the first two quarters, sales took a hit as larger tire sellers cut back on their orders. However, as the third quarter nears its close, James Vogel, vice-president of consumer tires told *The Wall Street Journal,* "Sales are back on track and as we've closed the gap between the largest dealers and the smallest dealers and established some price discipline. We've seen our revenue per tire move up, which is tremendously significant."

The music products industry has manufacturers offering violins that are based on 300-year-old designs as well as companies that push the technology envelope. The one thing this diverse collection of companies has in common right now is shrinking margins. Perhaps the Goodyear experience offers something of a blueprint for gaining back a few margin points.

The problems manufacturers face in raising prices are nothing compared with those faced by retailers. With ready access to national price information, consumers in increasing numbers are forcing retail prices down. Thus, retailers have to focus their energies on expense control. Aside from the standard exercise of analyzing every line on the P&L, one suggestion comes to mind. A good number of manufacturers have recently invested in online "B-to-B" networks that enable retailers to place orders, monitor product availability, and keep tabs on the timing of shipments. Instant access to this type of information has the potential to enhance inventory management and streamline the entire purchasing process. Yet surprisingly few retailers are taking advantage of this service. Ignoring a productivity tool like this is like leaving the low hanging fruit, which not a particularly good idea in the current business climate.

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IS A 50% MARKET SHARE POSSIBLE?

Speaking of big retailers, just how big can Guitar Center get? As a public company, GC management is legally bound to be cautious in making bold projections about future sales growth. However, at a recent retail conference sponsored by Goldman Sachs, Guitar Center CEO Marty Albertson gave an indication about his vision for the company's future. He said that Guitar Center had identified 67 sites for large format stores, another 160 locations for small format stores, and 425 locations for American Music Group locations. GC's large format stores average around $7 million in annual sales; the new small format stores are projected to do about $3.25 million a year; and we estimate American Music Group locations at about $2 million a year. Do the math and these new stores add up to over $2 billion a year. Add that number on top of Guitar Center's current sales of $1.1 billion and you have a $3.1 billion company. If the company hits that ambitious goal, it will have more than 50 percent of the market. Can it be done?