



EDITORIAL

WHY SMART PEOPLE FAIL

For a supposedly small and unsophisticated business, the music industry has humbled investors and managers who were hardly unsophisticated rubes. In this issue, we report that backers of Mark Begelman's ambitious retail venture are facing losses of between \$100 and \$200 million now that MARS has declared Chapter 11. In the massive loss department, we also report that Net4Music, a dot-com start-up that offered downloadable sheet music, burned through over \$25 million before abandoning its site to focus on developing software.

MARS investors included highly regarded organizations like Cornerstone Equity, Chartwell Capital, and Prudential Private Equity, not to mention CEO Mark Begelman, who previously distinguished himself as one of the architects of the highly successful Office Depot retail chain. In the case of Net4Music, much of the initial investment was provided by Vivendi, the a large French media conglomerate that operates Universal Film Studios. How did such smart people come to lose so much in a small and "unsophisticated" industry? The short answer is that they grossly underestimated the complexity of the business and the skill of the people in it.

What's the difference between a drum customer and a guitar customer? How do you take a 24-year-old dreaming of a getting a record deal and make him into a passable salesman? How do you strike the balance between enough inventory to impress the customer but not so much that you can't afford the carrying cost? How do you maintain gross margins while remaining cost competitive? It's one thing to address these issues in a prospectus for soliciting investors. However, dealing with them effectively in the real world requires skills that can be acquired only through firsthand experience.

Herein lies the problem. Outsiders with illustrious résumés who enter our business tend to dismiss the importance of this front line experience. They confidently assume that because of their business acumen, they don't have to understand the countless nuances that define different products and customers. When they describe the music industry as "unsophisticated," what they're really saying is that they think people who have spent their careers making and selling

music and sound products aren't very bright and have little useful knowledge to impart.

Unfortunately, people and institutions with this mindset have a sad but predictable career trajectory. Initial enthusiasm, along with bold promises of "transforming the industry," soon gives way to an somewhat chastened "appreciation of the challenges" of the business and a grudging respect for competitors, which is followed by humble promises of "turning the ship around." In the final phase, they stage a quiet retreat as industry "unsophisticates" gloat.

In the late sixties, conglomerates like CBS, The Marman Group, Norlin, Macmillan Publishing, and Gulf & Western plunged into the music industry, snatching up leading companies like Steinway & Sons, Fender, Hammond Organ, Gibson, C.G. Conn, and numerous others. Like most other outsiders, they promised to transform the music industry with their professional management skills. By the mid-'80s, as losses mounted, the conglomerates staged a frantic exit.

The conglomerate experience in the music industry successfully scared off outside investors for over a decade. It wasn't until the late '90s that the financial community reconsidered anteing up to be a part of our business. Losses at MARS, Net4Music, and a few others will probably chase the outsiders away for another decade.

Laurence Tisch, a billionaire who bought CBS and presided over the 1985 disposition of Steinway said, "I don't know anything about pianos, and owning a business you don't understand is asking for trouble." Hopefully, when the next crop of outsiders comes into music, they'll keep his advice in mind.

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