EDITORIAL

THE INDUSTRY'S HIGHEST MARGIN RETAILER

Whenever retailers talk about brutal price competition, they usually make some mention of the Shure SM58 microphone. One of the best-selling products in the industry, the SM58 is the closest thing we have to a "loss leader." With a street price of approximately $99, it generates a gross profit in the high single digits. Retailers hate the SM58's nearly non-existent margin but grudgingly stock it because so many customers request it. Ask retailers why they don't raise the price and the standard response is, "You've got to be kidding. Customers shop the SM58 to death, and if I was higher than the street price, they'd think I was gouging on everything else."

Gordon Brothers, a liquidating company, is in the process of running "Going Out of Business Sales" at the remaining 37 MARS locations around the country. Banners outside of the stores promise incredible bargains, blow-out pricing, and savings never to be seen again. Yet inside, it's quite a different story. At the MARS location in Minneapolis, customers are willingly shelling out $150 for Shure SM58s—"while supplies last," of course. Just about everything else in MARS inventory is being "sacrificed" at a similarly rich premium. In the next two months, under the guise of offering incredible savings, Gordon Brothers could generate the highest gross margins of anyone selling music products on the planet.

This aggressive pricing should come as no surprise to anyone who followed the MARS bankruptcy. Gordon Brothers agreed to pay $42 million for MARS' $54 million (at cost) inventory. By the time of final court hearing, much of that inventory was damaged, discontinued, slow-moving, or otherwise less than prime, making the offer seem excessively generous. "How can they make money with that kind of valuation?" was a commonly asked question among industry suppliers. What the liquidators knew and we overlooked was that going out of business sales present a rare opportunity to jack up prices.

Most music retailers operate on the assumption that customers know street prices and that any deviation from these prevailing prices will cause a loss of business and goodwill. At Gordon Brothers, the operating assumption is that if you create the impression of big savings and a sense of immediacy, you can charge whatever you want. Customers don't really know what things are supposed to cost, they just want to feel like they got a great deal. Satisfy that psychological need and the actual price is irrelevant.

There are some noteworthy differences between Gordon Brothers and the average music retailer. For one, the liquidator is not a long-term player in the market. By the time the customer realizes they paid $50 too much for a SM58, Gordon Brothers will have moved on to blowing out golf bags or overcoats. Secondly, a court-ordered liquidation creates a unique sense of urgency that the run of the mill anniversary, special invitation, or clearance sale simply can't match.

However, what the Gordon Brothers experience does illustrate is that customers are not as price-savvy as music retailers often think. How else to explain anyone in Minneapolis paying a 50 percent surcharge for one of the world's most familiar and widely available products? It also raises some interesting questions about industry pricing practices. Do retailers have to discount as much to hang on to business? Is there an opportunity to raise prices slightly? In slashing prices to satisfy the one-in-ten killer negotiator, are retailers giving up more than they would gain otherwise?

Pricing is more art than science. Market research and focus groups will reveal what consumers like and dislike, but they don't shed much light on what people are willing to pay. But if a liquidator can command a 50 percent price premium over a full-service retailer, perhaps the industry needs to re-examine its pricing policies.

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