

Solve One Problem, Cause Another

When I first began writing this column in the early '80s, the burning issue of the day was runaway inflation. Costs were rising too fast for retailers to pass them along to their customers; consumers, suffering from acute "sticker shock," were reluctant to visit stores; and interest rates hovered around 20 percent. No wonder profits were in the tank and stores were closing up at an alarming pace. In a 1981 interview, one long-since-retired retailer asked rhetorically, "Can you imagine what it would be like if prices actually went down?" We now know that if he had hung around for a few more years, he would have had the chance to find out.

Twenty years later, with inflation just a dim memory, the industry is now experiencing what it's like when prices go down, and it's not the easy ride that many expected. As amply documented in our Music Industry Census, which begins on page 70, the selling price of just about every type of music and audio product is falling. Five years ago guitars left music stores at an average selling price of \$569. Today, the price stands 33 percent lower at \$386. In the same time frame, the selling price for mixers has fallen 25 percent from \$700 to \$520, while grand piano prices have tumbled 18 percent from \$14,000 to \$11,500. Unfortunately, as selling prices have headed south, the cost of doing business has continued to inch up, which has put retailers in the difficult position of having to move more boxes just to stay even.

The immediate causes of this deflationary trend are fairly apparent. Dramatic productivity gains on factory floors around the world have played a part, as has the emergence of Chinese production facilities, where labor costs are about one-tenth of the level in the U.S. Another cause is massive overcapacity, which is mostly due to the unprecedented factory expansion currently underway across China. Whatever product category you pick, there is more capacity to produce than there is demand to buy, which forces managers to shave prices in an effort to keep their plants running at an efficient level. Needless to say, these lower prices ultimately find their way back to the consumer.

Unlike the retailer two decades ago, today's lament is more likely to be, "Can you imagine what it would be like if prices went up?" Based on a cursory review of the news, we think it won't be too long before the



industry finds out. A surging Chinese market has prompted a meteoric rise in commodity prices. Over the past 12 months, copper prices are up 78 percent, silver has risen by 51 percent, crude oil is up 22 percent, and natural gas is up 19 percent. Simultaneously, dwindling availability on cargo ships has sent shipping rates up to triple their 20-year average.

We suspect that at some point these increased costs will bring about an increase in the wholesale prices of music and audio products. At the very least they will stem the downward spiral.

These rising costs are indisputable, and it's fairly easy to predict that they will have some future impact on our pricing structure. The harder question is whether this will be a good or a bad thing. Will rising prices slow demand? Will they lead to further margin pressure at retail? Or, will they meet little consumer resistance and help retailers and suppliers generate some much needed top line growth?

In the last days of his administration, President Gerald Ford was handing out buttons inscribed with WIN, for "Whip Inflation Now." It seemed like a good idea at the time, but no one envisioned that a complete victory, with inflation virtually banished, would present an entirely new set of challenges.

When the current deflationary phase is over, we're not sure what the new challenge will be. But, if the past is any guide, there will surely be *something* for people to complain about. What is encouraging is that the public interest in creating music has remained incredibly stable, despite wild and unpredictable swings in the economy. We get whipsawed like everyone else; fortunately, the innate desire to make music is more dependable.

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