Of Big Macs And Guitar Strings

There are 13,673 McDonalds restaurants in the U.S. They all have pretty much the same menus. They all get their raw materials from the same place at exactly the same price. (Federal franchise laws specifically forbid any form of volume discounts or preferential pricing). And they all rely on the same promotional programs, spelled out in painstakingly specific detail by a centralized marketing office. For all this standardization, the one area where the restaurants vary considerably is in their bottom-line performance. Company documents indicate that after-tax profits for McDonald's franchisees range from a low of one percent of sales to a high of 11 percent of sales. The filings also detail significant variations in all major expense categories, including cost of goods sold, payroll, occupancy costs, utilities, and maintenance. If customers can't tell one McDonalds from another, regardless of what part of the country they're in, why the big performance differential? McDonald's management has a ready answer: "The expertise and initiative of the franchisee."

The music industry lacks McDonald's level of uniformity, yet there is an interesting parallel between the two. In the accessory department, where all dealers have access to the same product lines and where sales require little or no added service, there are major variations in the gross margins achieved. The difference between the high price and the low price in major accessory categories varies by about 30 percent, as detailed in a report that begins on page 92 of this issue.

How do you account for such a wide variation in prices on products that are the closest thing the industry has to a commodity? It's not easy, and we're still groping for the answer. Logic would suggest that the lowest prices would be found in major operators like Guitar Center or Sam Ash, which can use their buying power to gain better discounts. Logic would also prompt one to conclude that tough metro area competition would push prices down. However, our research indicates that these "logical conclusions" don't tell the whole story.

As for the big stores, their prices tend to be smack in the middle of the pricing range. They may have a lot of buying power, but they also have high fixed costs and they need to make a profit. Geography and population don't help explain pricing either. We found stores in major metro areas such as Chicago and Philadelphia that achieve top

dollar for sticks, strings, and straps. We also found some of the lowest prices anywhere in semi-rural Midwest towns. So why the price differences? We suspect that, like McDonalds, it has a lot to do with the "initiative and expertise" of the person in charge.

These pricing disparities also indicate that most consumers are not terribly price-conscious when it comes to small goods. If it's there in front of them, and if the perceived value seems reasonable, one or two extra dollars won't make much of a difference in their decision to purchase. However, those one or two dollars could make a huge difference in a retailer's profitability. How huge? Just ask yourself how your net would look if you made 50 points, instead of 40, on your guitar string wall.

Accessory sales have long been one of the most profitable segments of music retail. Margins are good, turnover is quick, and you don't have to worry about products becoming obsolete or getting damaged on the floor. Yet a lot of retailers are not coming close to maximizing their small-goods profits.

Pricing is as much art as science, and we're not recommending anyone institute an across-the-board price hike. Yet do you have to be ten percent below Guitar Center to move strings? Is it enough to match the prices on zZounds.com , or is the ability to carry a set of drumsticks out the door worth a slight premium? We would urge managers to view their stores as something of a laboratory and begin experimenting. Big Macs may all taste the same, but some generate more profits than others. By the same token, most dealers carry the same accessory items; some just make more money from them. The first step towards achieving the higher end of the profit range is a careful analysis of pricing.

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