

# Mass Merchants And Risk

**M**onths before the devastating stock market crash of 1929, Joseph P. Kennedy had the foresight to liquidate his vast stock portfolio. Years later, when asked what prompted him to sell, the scion of one of America's most famous political dynasties said, "It seemed as if the world was convinced that the stock market was the way to easy riches. When I began to hear shoeshine boys exchanging stock tips, I concluded that the run was coming to an end." We were reminded of Kennedy's shrewd insight by the recent proliferation of guitars in the mass market distribution channel. Over the past 12 months the guitar has gone from a strictly niche product to a "hot category" for mega-chains that include Wal-Mart, Best Buy, Target, Costco, Sears,

K-Mart, Sam's Club, Circuit City, and numerous others. As the accompanying sales flyer illustrates, even towel and sheet purveyor Linens & Things has concluded that guitars are a "must have" item. When every retailer imaginable has decided that guitars are "the way to easy riches," is the ten-year "run coming to an end?"

The numbers are somewhat troubling. Despite this major expansion in distribution, all indications

are that growth in guitar sales are slowing. As we reported last month, imports of electric guitars declined 4.6% in the third quarter—the first quarterly decline in the three years we have been tracking imports. Acoustics fared better, advancing 12.5% for the quarter. However, this rate of growth was significantly slower than last year's 22% third-quarter gain. Fourth quarter data is not yet available, but based on countless conversations at the show, we doubt there will be much to cheer about. Specialized m.i. retailers, from the largest to the smallest, reported that mass market distribution of guitar packs significantly reduced their Christmas guitar sales. Apparently, gains at Sears, Wal-Mart, and Linen & Things came at the expense of m.i. retailers.

Out of a combination of self interest and sentimentality, we always root for the m.i. dealers. Realistically though, we recognize that customers will buy from whomever they choose and suppliers have a right to sell to anyone they feel is positioned to serve the market—that includes mass merchants. While a plausible argument can be made that placement on mass merchants' shelves exposes musical instruments to a wider audience and grows the market, suppliers should not conclude going outside the specialized m.i. channel is a risk-free strategy.

Roughly 80% of our retail subscribers have the word "music" in their store name, and another 35% include the word "guitar."



When your business is called Guitar Center, Guitar Emporium, House of Guitars, or Guitar Headquarters, it's not likely that you'll stop stocking fretted instruments if the Christmas selling season is below expectations. The same can't be said for mass merchants. These are number-driven operations that routinely cut product categories that don't produce sufficient gross profit or sales per square foot.

The stock price chart of Singing Machine nearby provides a painfully graphic illustration of what happens when buyers at mass merchants decide that a product doesn't generate the right numbers. In 2001 mass merchants enthusiastically embraced karaoke machines, driving higher sales, profits at Singing Machine, and pushing the share price to \$20. By year-end, five major retailers accounted for 95% of the company's sales. The 2002 holiday season was a grim turning point. Unhappy with sales results, Singing Machine's five top customers sent-back millions of dollars worth of slow moving inventory, nearly bankrupting the company. What followed was a steady reduction in the number of karaoke machine stocked. Singing Machine sales have fallen, and the stock currently languishes at around 32-cents.



Unlike Singing Machine, which was almost exclusively dependent on the mass-

market channel, guitar makers have a broader and more stable distribution channel. Nevertheless, a retailer who can drop karaoke on a moment's notice could just as easily drop guitars and music products. (The average Wal-Mart has over 150,000 SKUs in inventory. Would customers really miss guitars?)

Every business has to craft its own distribution policy and it's presumptuous to offer sweeping advice from the comparative safety of an editorial column. Yet if gains in the mass market channel come at the expense of specialized m.i. retailers, as now seems apparent, we hope guitar makers are asking themselves where they should place their focus: with retailers who have no choice but to sell guitars, or those who, the minute the numbers sag, might replace their guitar display with a selection of gas grills, plasma televisions, or ladies' casual wear.

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