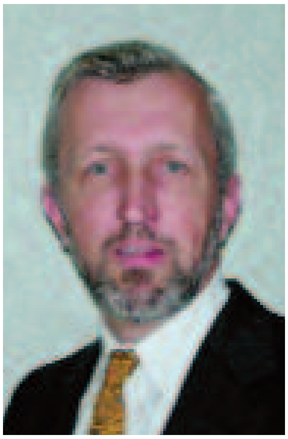
In Search Of A New Retail Formula

A decade ago, as Guitar Center prepared to go public, management expressed the conviction that exciting, well merchandised stores would expand the market. A 1997 GC financial document described its "entertaining and exciting" store atmosphere and the "bold and dramatic merchandise presentations," and concluded that these unique attributes would simultaneously provide a competitive edge and attract a wave of new customers. Soon after, when Guitar Center began expanding nationally, its showcase stores unquestionably generated consumer excitement and spurred other retailers to upgrade their product presentation. The belief in the power of merchandising was put to the ultimate test with MARS Music. Hoping to seize an industry leadership position, company founder Mark Begelman reasoned that if a well-merchandised, 18,000-square-foot Guitar Center store was good, a 40,000-square-foot MARS location would be even better. Although his efforts ended in bankruptcy court, one by-product of this emphasis on merchandising and store design has been better product presentation in virtually all stores from coast-to-coast.

Improved stores did in fact correspond with robust sales growth across most product categories. During the past two years, however, the beautiful stores seem to have lost some of their initial draw. As we report elsewhere in this issue, Guitar Center is in the process of going private through a Bain Capital acquisition. Given the highly leveraged nature of the transaction, Guitar Center management will most likely place a priority on maximizing operational efficiencies and cash flow rather than growth. In simple English, this means fewer new stores.

One of the factors that probably contributed to Guitar Center's decision to seek private ownership was a growing sense among Wall Street analysts that the company's rapid-fire store rollout was no longer generating an adequate return on capital. As one analyst said, "From a shareholder's standpoint, the $160 million they [Guitar Center] put into new stores in the past two years could have been better spent." Put another way, a consensus seems to have formed that a slew of beautiful stores is no longer the magic formula for growth.

Human nature is such that even the most dramatic innovations are quickly taken for granted and viewed as "essentials." A decade ago, the general public marveled at the potential of the internet and email. Today, the same people get testy if their wi-fi service is interrupted at the local Starbucks. In much the same way, a decade ago a wall of 300 guitars, a sound room where systems could be readily A/B tested, and room full of drumsets caused the average customer's jaw to drop. Today, the same display generates only a passing notice and is viewed simply as "the normal state of affairs."



In this environment, where beautiful stores have become sufficiently commonplace to have lost their "wow" factor, the industry faces the challenge of how to generate excitement going forward. Between the internet, which literally provides access to every product on the market, and the existing retail infrastructure, it's safe to say that expanded selection and better product presentation alone won't get the job done.

At the most essential level, every business is an equation that tests whether certain assumptions about consumer demand level and cost structure will produce a return on capital. The current retail equations serving the market are the result of a century or more of evolution. We sense that the industry is on the cusp of testing some new equations that will combine merchandising with some form of service that helps consumers better actually participate in music. As we have pointed out before, the continued resilience of the band instrument business rests in large part on the industry's ability to immerse kids in a satisfying musical experience. Other industry segments should take note and start thinking about the customer's experience after they leave the store.

And on the subject of retail evolution, it's worth pointing out that continual change is the only constant. Two decades ago, mall stores were the place to sell music products; then came big boxes, catalogs, and the internet. In the Top 200 Retail Report, we quantify with a high degree of precision just how the industry is changing.

Brian T. Majeski
Editor
Email: brian@musictrades.com