

Rethinking The Conventional Wisdom

The current narrative dominating the business press is that e-commerce is on track to all but obliterate traditional brick-and-mortar retailers. Customers attracted to the broad product selection, convenience, and lower prices of online sellers are supposedly abandoning the traditional practice of in-store shopping. And it's not just business writers who are touting this storyline, investors have bought into it as well. Consider Best Buy and Amazon, two similarly scaled retailers. Brick and mortar Best Buy had full-year revenues of \$50 billion, and a \$1.0 billion net profit, while online star Amazon racked up revenues of \$48 billion and a \$600 million net. Yet because investors have such a dismal view of traditional retailing, Best Buy is valued at just \$6.2 billion, while Amazon is worth a staggering \$100 billion.

Results from Guitar Center, reported on page 52 of this issue, provide a noteworthy counter-argument to this conventional wisdom. Over the last year, sales at the brick-and-mortar Guitar Center locations have advanced nicely, increasing 4.7% year-over-year at locations open for more than a full year. Gross margins have also edged up slightly, and operating income has advanced 25%. By contrast, the Musician's Friend direct response unit has seen a 6% sales decline, an erosion in gross profits, and an operating loss. What accounts for this counterintuitive performance? GC management doesn't provide a lot of insight in their terse commentary. They attribute the online slump to increased competition and smaller order sizes. As for the brick-and-mortar side of the business, they only note that better advertising programs have driven increased foot traffic. However, their actions speak louder than words. Plans to open between ten and 20 new stores over the next year can only be interpreted as a ringing endorsement of the future of brick-and-mortar.

While Guitar Center management isn't talking much, allow us to speculate on why m.i. stores are not directly comparable to Best Buy, and why, despite the growth of e-commerce, their future is far from bleak. Most retail transactions are tedious businesslike affairs. We seriously doubt there are many whose pulse quickens at the prospect of buying a microwave at Wal-Mart, or perusing the linens department at Bed, Bath & Beyond, or searching for the perfect faucet set at Home Depot. These are utility transactions that we want to conclude

quickly so we can get on to more important things. Anything that speeds up the process, like online shopping, is welcomed.

For the music enthusiast, a trip to the local store and the opportunity to interact with the latest gear is an experience to be savored, not sped up. In most retail situations, the customer's goal is to get in and out as quickly as possible. Not so in a lot of m.i. stores, where customers are more concerned about wearing out their welcome by hanging around too long. If you love the gear, spending an hour or so hanging out in a store is time well spent. And it's an experience not readily duplicated online.



This fact was driven home recently on visits to Chicago Music Exchange, a high-end guitar store in Chicago and

Truetone Music in Santa Monica, California. On off-hour weekdays, both stores were full of people who were viewing the broad, well displayed selection. It wasn't clear how many were buying and how many were just looking, but management didn't seem to care. They were more interested in creating a hospitable environment where enthusiasts could indulge their enthusiasms. Chicago Music Exchange even sports strategically placed couches, intended to keep girlfriends comfortable so they don't prematurely end their partners' shopping expeditions.

We suspect GC management reasons that an inviting store environment will continue to attract paying customers who are looking for a real, not virtual experience. And, their most recent financials bear this out. In terms of size, layout, and product selection, the country's m.i. retailers are a pretty diverse lot. But a common element that defines the more successful enterprises is an atmosphere that encourages customers to linger. "Showrooming" is a real phenomenon, and e-commerce has intensified competition at every level, but brick and mortar retailers should not lose sight of the fact that they have some competitive advantages as well. Guitar Center is aware of this, and every other traditional retailer should be too.

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