Dealing With The World As It Is, Not As You'd Like It To Be

Wherever you go at the NAMM show, chances are you'll hear someone tick off a list of woes facing the music products industry. Here are a few of the more commonly diagnosed ailments: Online retailers, led by Amazon.com, are crushing margins, draining profits from the business. Kids find social media and spending time on their smartphones more appealing than making music. The suppliers are all headed by idiots (retailer viewpoint). Retailers are lazy and unwilling to promote (supplier perspective). There aren't enough popular musicians inspiring a new generation to take up music. Electronic gear keeps getting cheaper. The economy is still struggling, and if the industry is populated with morons, those presiding in Washington D.C. are even worse.

Giving vent to these complaints in an occasional rant can even have a cathartic effect, sort of like yelling after you've banged your thumb with a hammer. But here's another more important truth: complaints like these have been a constant at NAMM shows for about as long as there have been NAMM shows. Profitability has always been a challenge, the industry has been continuously locked in competition with other goods and services for consumer discretionary dollars, manufacturers and retailers always had been critical of each other, and depending on whom you ask, there have been between nine and 15 economic downturns in the past 50 years. This would seem to indicate that complaints, no matter how loud and eloquent, don't do much to change things. The challenge is to find a way to operate in the world as it is, not as you'd like it to be.

Along with railing about generalized industry woes, an equally popular NAMM passtime, is criticizing Guitar Center. Criticism is to be expected of the biggest, highest-profile player on the field. However, the level of criticism has ratcheted up lately, after GC management made some tough decisions. A round of layoffs at headquarters drew complaints of "gutting the organization." Efforts to trim inventory have made suppliers unhappy. However, as we report elsewhere in this issue, GC management's efforts to operate profitably in a sluggish market appear to be producing positive results. Revenues at the chain dipped 3.6% for the third quarter to $509 million. But, earnings before interest taxes, depreciation, and amortization (EBITDA) have jumped 72%. Management doesn't publicly discuss financial results, but they are apparently prioritizing profits over revenue growth. The word in financial circles is that tighter internal cost controls and faster-turning inventory, coupled with a willingness to forgo less profitable sales, have dramatically improved cash flow. Apparently, the tough decisions are paying off.

It's a popular cliché to talk about misguided corporations sacrificing their long-term viability on the altar of short-term results. We suspect that there exists somewhere the corporate equivalent of the farmer who sells all his seed corn for a quick profit and then finds himself with nothing left to plant for next year's crop. But, from our vantage point, a far more common scenario is the company that waits too long to respond to changes in the market—taking a long-term approach—then proceeds to rack up losses, and then either folds or ends up seriously diminished. Arguing against long-term planning is like arguing against motherhood and apple pie: who can be against it. But enterprises that don't address immediate market pressures usually won't be around to even worry about the long term. How GC will be faring five years from now is an open question, but it's impossible to dispute that improved cash flow will improve their ability to address whatever market conditions are forthcoming.

GC's efforts to trim its SKU count to increase inventory turnover holds another important lesson for the industry's other retailers. Namely, a retail business doesn't exist to help its suppliers run factories and distribution operations at full capacity. Rather, retailers, in both the short and long term, need to optimize inventory for their profitability, not their vendor's order books. While not privy to the details of the inventory strategy, we suspect GC management has embraced this approach.

Judged against the standard of idealized perfection, all human activity appears wanting, including activities in the music industry. We suspect that failure to achieve the perfect accounts for much of the complaints. However, if you strip away unrealistic expectations, the state of the industry is actually pretty remarkable by any historic standpoint. Industrious enterprises offer an amazing array of products that give consumers unprecedented value. Music products have never been more accessible. The distribution network is evolving, but thousands of individuals can still earn a decent living by advancing a marvelous art form. Challenges are there, but so are the opportunities for those who can deal with the world as it is.

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