ProfitableRevelations From The Auto Industry

With the prospect of a recession, there has been a lot of talk lately about the need to improve the profitability of music retailers. The topic figured prominently in virtually every speech made by a manufacturer at the recent Winter NAMM show. This heightened concern for retail profits does not spring from any altruistic sentiments on the part of manufacturers, but rather from enlightened self interest. They are painfully aware that unprofitable dealers simply can't afford to purchase, let alone promote and service a product.

Generating healthy profits at retail is a challenge under the best of circumstances and requires considerable acumen. Trying to affect a positive change is a daunting task that is beyond realm of any single company or organization within the industry. Unfortunately, one of the major causes of lackluster retail profits can be traced to manufacturer distribution policies.

Different products require different modes of distribution. Low priced, commodity items, like soft drinks and soap, are best served by mass market tactics, where every retailer in a market carries the goods. The same doesn't hold true for high-priced complex items, like a lot of music and sound products. Any music retailer with a few years experience is painfully aware that when a product is overdistributed, everyone loses. Retailers suffer because intense discounting erodes profits. Over the long run, manufacturers suffer as well because retailers loose interest in stocking and promoting a marginally profitable product.

Recently released data from the auto industry offers some useful insights into how manufacturer distribution practices affect retailers. In 1990, BMW and Toyota's new Lexus division each sold about 63,000 high-priced automobiles in the U.S. Both companies spent about $40 million on advertising in the U.S., and both are reported to be equally profitable. There is however one notable difference between the two: BMW has 366 dealers in the U.S. while Lexus has only 121.

Anyone with even modest cognitive abilities can figure out that the average Lexus dealer, who sells about 520 cars a year, is a lot better off than his BMW counterpart who sells only 172 cars a year. Outlining the rationale for such a slim dealer roster, a Lexus spokesman stated, "We want our dealers to be profitable and we want to make sure that they have the financial wherewithal to be able to display and service the product properly."

In the music industry, most manufacturers pay lip service to a similar concept of limited distribution, pledging to their dealers large territories, full support, etc., etc. In reality, few follow through on their promises. Striving to fulfill volume requirements manufacturers toss principle out the window and open dealers wherever they think it will yield a few extra unit sales. After a while though, everyone in the market ends up carrying the line, no one is very happy, and profitability suffers.

Lest this sound like manufacturer bashing, it should be noted that dealers are not without guilt. A good number of retailers try and horde lines simply to thwart competition. What they end up with is a confusing inventory selection consisting of bits and pieces of various product lines, poor turnover, and lackluster profits. Also, a dealer who loudly protests because manufacturer 'X' has opened his arch competitor will in the same breath lambast manufacturer 'Z' for giving another dealer in the market an exclusive.

For anyone serious about improving retail profits, the experience of Lexus and BMW offers some straightforward prescriptions. Dealers need territory to generate the volume and gross margins necessary to make a good profit. Manufacturers need retailers willing to make a substantial investment in inventory, service, and display facilities in order to justify awarding large territories. These are the critical factors that ultimately determine profitability. Anyone who wants to make a positive change has to address these issues. Everything else is secondary.

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