EDITORIAL

On Wal-Mart And Focus

Despite the greatest bull market in the history of Wall Street, the stock of Wal-Mart has remained mired at a two-year low. Sales and profits at the world's largest retailer have continued to grow at a high single-digit rate, and the company continues to expand at the expense of rivals Sears, K-Mart, and J.C. Penny; so what accounts for the lackluster stock performance? In a word, focus. Investment professionals are increasingly concerned that after 25 years of stellar performance, Wal-Mart is facing an identity crisis and management lacks a clear direction. With annual sales of $94 billion, or nearly 20 times the sales of the entire music products industry, Wal-Mart can not be readily compared to any music products retailer. Nevertheless, looking at the problems currently facing the company offers some valuable lessons that are applicable to any business.

Launched in Bentonville, Arkansas, Wal-Mart built its business by opening stores in under-served rural areas and offering rock-bottom prices. With the most sophisticated and cost-efficient distribution system in the world, the company was able to undersell any and all competitive merchants. Now, however, with 2,100 stores in the U.S., Wal-Mart has run out of new small-town locations for additional stores. To maintain its growth, the company is planning to go upscale, adding more expensive lines of merchandise, spiffing up its Spartan stores, and moving into high-rent districts, like Princeton, New Jersey.

There's nothing inherently wrong with Wal-Mart's courting a different customer group; however, what has the stock market concerned is a fear that in wooing the affluent, the company will drive away its core blue-collar shoppers, add to its cost structure, and open the door for lower-cost competition. Put another way, the company runs a risk of diluting its hard-won reputation for value.

So, what does this have to do with the music products industry? In a word, focus. Retailers in this industry are segmented more by product category than by customer income or demographic profile. Nevertheless, there is still the same opportunity for dilution of focus. On a regular basis, we hear of the successful piano and organ merchant who attempts to go into the school music business; the successful school music dealer who plunges into the m.i. market; the m.i. dealer who decides to tackle home keyboards. In some cases the moves are successful, but in too many cases this type of expansion has resulted in some of the industry's higher-profile bankruptcies.

Expansion is a desirable goal, but it should be governed by well disciplined plans and focus. Before opening a new store or entering a new product category, dealers have to ask if they have the capital, the personnel, and some competitive advantage to gain a foothold in the market. And most importantly, will the time and energy required to launch the new venture diminish the original core business and leave it vulnerable to competition, as in the case of Wal-Mart?

The music products industry has grown in the last decade, but due to catalogs, 800 numbers, and increased competition at the local level, the number of retailers has remained constant, or even diminished slightly. Recent developments in the Miami market highlight the increasingly competitive nature of music retail. Guitar Center and Sam Ash, the nation's number one and number two retailers, are each opening two stores on the east coast of Florida, and David Begelman, a founder of Office Depot, has purchased Ace Music there with the stated intention of creating a national chain.

With large stores like this going head to head, survival for the surrounding dealers requires a sharply defined plan and good execution. Whether it's offering lessons, concentrating on used and vintage products, doing sound installations, or providing personal service, they need to find a way to differentiate themselves and carve a defensible market niche. Trying to be everything to everybody is not the answer. Nor is adding product lines or opening additional stores without a major commitment in personnel, inventory, and leasehold improvements.

Last year Wal-Mart's net profit of $2.6 billion exceeded the earnings of Sears, K-Mart, Woolworth, J.C. Penny, and Federated Department combined, yet a lot of smart people on Wall Street are betting that the company's loss of focus is a prelude to big problems down the road. If a lack of focus can undermine a behemoth like Wal-Mart, think what it can do to a music retail operation.

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