EDITORIAL

The Guitar Center Deal

As we report elsewhere in this issue, a group of venture capitalists has purchased a 50% interest in Guitar Center, valuing the 25-store retail chain at a whopping $251.0 million. The magnitude of the deal is unprecedented and makes Guitar Center one of the most valuable enterprises in the industry. It also raises scores of questions. Will Guitar Center be transformed into a national "category killer" akin to Home Depot or Toys R Us? Are the days of independent music products retailers over? Can we expect a slew of similar financial transactions? No one has the answers yet, but we would like to submit a few thoughts on the subject.

First and foremost, the recent influx of outside capital into the music products industry is largely a reflection of our current good fortune. As we have documented, sales have advanced briskly over the past five years, from $3.93 billion in 1991 to $5.47 billion last year. More importantly to outside investors, future prospects remain bright for a number of very tangible reasons.

The U.S. census shows that the industry's core customer base, people between the ages of 10 and 24, is destined to expand 2% a year through the year 2010. Over the last two years at *Music Trades*, we have received literally hundreds of newspaper and magazine clippings of articles addressing the physical, mental, and academic benefits of playing music. This unprecedented torrent of press coverage reflects a subtle but significant positive shift in the public's attitudes towards music making. It's also worth noting that prices of music and sound products have remained stable while quality has actually increased. Taking together an increasing customer base, positive consumer attitudes, and the best product values in history, it's hard to imagine that the industry will not continue to expand for the foreseeable future. These are the primary factors that have lured outsiders to park some of their money in music.

While the current prices being paid for companies are far higher, this is not the first time outside investors have taken a plunge in the music industry. In the wake of the Beatles and a booming guitar market, CBS Broadcasting bought Fender in 1966, pledging to "elevate the guitar business to a much higher plane." Three years later ECL, a thriving Ecuadorian beer company, acquired Chicago Musical Instruments, the parent of Lowrey, Gibson, Story & Clark, and Olds Brass, to create Norlin. With the baby boom in full swing and school music programs rapidly expanding, publishing giant Macmillan acquired C.G.Conn in 1970. 1975 saw the Pritzker family, with a current net worth estimated at $6.0 billion, acquire Hammond Organ Company. The specifics of each these transactions were different; however, they all had two things in common. First, all were driven by the belief that the music industry was an untapped growth opportunity waiting to be revolutionized by "professional management." Secondly, the deals all soured, investors were uniformly disappointed, and the companies were all subsequently resold. This is not to say that Guitar Center's new shareholders will suffer a similar fate, but rather to point out that outside capital is no guarantee of success and that the smart money on Wall Street is capable of lapses in judgment.

Will Guitar Center take over the industry? The company is eminently well managed, a formidable competitor, and worthy of close examination by every retailer in the country. That said, we don't view it as a genuine "category killer." Consider the following: How many "Mom and Pop" hardware stores are thriving down the street from a Home Depot superstore? Or, have you ever seen a small independent toy store within walking distance of Toys R Us? By contrast, at last count there were eight m.i. stores within half a mile of Guitar Center's flagship location in Hollywood; the number of m.i. stores serving the Boston market has remained largely unchanged since Guitar Center opened there a year ago; and in other markets scores of enterprising retailers have found ways to successfully go toe-to-toe with the chain.

Part of Guitar Center's enviable success is due to the fact that the company has remained focused and has never tried to be all things to all people. The company doesn't offer lessons, doesn't rent equipment, doesn't provide a lot of repair service on-site, and doesn't deal with much used gear. These decisions on the part of Guitar Center management provide four ways for local retailers to set themselves apart from the national chain. Talk to some of the retailers who already compete with Guitar Center, and I'm sure you'll find there are a lot more opportunities for differentiation. In short, Guitar Center is not an unstoppable juggernaut that rolls over everything in its way.

It's also worth noting that Guitar Center is not the first company that attempted to create a national retail chain in the music industry. While Guitar Center currently operates 25 locations, in 1968 American Music Stores operated 63 locations from Philadelphia to Colorado. In 1962, when the company floated a public stock offering, chairman Jack Wainger told *Music Trades*, "We have refined a merchandising concept that we can transplant nationwide. We're on the verge of breaking through to a new level." Few in the industry realized that the "new level" was going to be under, rather than above, ground. Within ten years nothing remained of the company. The moral of the story is simply that success is not decided in a boardroom or in some strategy session with a financier; it's decided on the retail floor in daily interaction with the customer.

If Guitar Center announces plans to open in your town, should you lose some sleep? Probably. Should you throw in the towel? Absolutely not. Like music itself, customers for music products are an intensely fragmented lot. The person out to buy a drum set is dramatically different from the synthesizer customer, who has a of motivations completely different from those of the acoustic guitar buyer. Throw in the fact that the business remains highly personal and customers have to be sold one at a time, and you a create a multitude of opportunities for focused, independent businesses.

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