EDITORIAL

JUSTIFYING A RETAIL MARGIN

IN A LENGTHY FEATURE elsewhere in this issue, we outline a lawsuit brought by the American Booksellers Association against Barnes & Noble and Borders Books, alleging unfair competitive practices. The legal action is notable because of a number of parallels between distribution trends in the book business and the music products industry. To summarize briefly, independent retailers in both industries feel that major chains have been able to use their buying power to extract better terms and pricing from the suppliers and to achieve an unfair competitive advantage. The booksellers are going to court in an attempt to force publishers to offer Barnes & Noble-style deals to smaller dealers. As our coverage indicates, there are a sizable number of music products retailers who wish someone would instigate a similar legal action in our industry.

We remain skeptical of any effort to address marketplace issues in the courtroom. Class actions, anti-trust suits, and other restraint-of-trade litigation take forever to prosecute and cost an exorbitant sum. At their conclusion, the legal adversaries are invariably exhausted and disappointed, little has changed in the competitive balance, and the only clear winners are the lawyers. Our skepticism of these legal complaints, however, goes beyond just a pragmatic assessment of the legal system.

Reduced to its most basic elements, the complaint of independent booksellers and music products retailers is that they are not getting enough in the way of price concessions from their suppliers. The issue goes beyond the pursuit of that highly touted, Utopian "level playing field" that's supposed to exist somewhere. Whether it's free freight, more generous co-op advertising allowances, extended dating, return privileges, or an extra 5%, the independents don't want just simple fairness; they want the same goodies the big dealers get.

If you compare retail to a theatrical production, the business of negotiating with suppliers is a little like the work of the stagehands who hustle backstage moving props and scenery. In both cases, the audience and buyers have little or no interest in these unseen activities; they're just looking for a satisfactory experience. And in this pursuit for the extra deal, we wonder if some retailers are not losing sight of the needs of their customers.

In any product displayed at the NAMM show, from the highest-tech digital recording system to the most traditional violin, the single largest component in the consumer purchase price is the retail gross margin. At somewhere between 20% and 40% it's way ahead of R&D expenses, marketing, labor, or material costs. To earn that margin, retailers ostensibly display product, explain it to the customers, advertise and promote within their trading area, and provide some level of after-sale support.

When retailers both large and small start demanding concessions, however, they're not just asking for money, they're asking someone else to do their job for them. Bigger and better co-op programs imply that manufacturers should pay for the advertising. The need for an endless stream of supplier-sponsored clinics suggests that retailers are incapable of explaining products to the buying public. And if manufacturers are supposed to pay for display fixtures and provide all warranty claims, it's not a stretch for them to raise the question, "Why do retailers need any mark-up at all if we're underwriting so many of the functions?" The above scenario is obviously a bit on the extreme side, but it illustrates a trend on the part of retailers to get manufacturers to subsidize what should be basic operating procedures.

The largest and smallest retailers both face the challenge of justifying their services to a buying public determined to get the most for its hard-earned money. This buying public has a way of shifting money away from organizations that don't provide adequate value. Just consider the case of General Motors. Twenty-five years ago the giant commanded a 52% share of the U.S. auto market. Today its share is under 30%. The forces capable of humbling the world's largest company are certainly capable of pulling dollars away from music products retailers who don't fully earn their mark-up.

Putting aside issues of fairness for a moment, we think retailers should ponder what value they are adding to each transaction. Simply trying to shift responsibility to the shoulders of suppliers seems to be a sure-fire formula for marginalization.

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