ASK ALAN | BY ALAN FRIEDMAN

Mergers & Acquisitions

Q: It seems there have been many mergers and acquisitions recently in the music product industry, especially in the print music segment. Why is this happening, and what effect will it have on independent music retailers?

—Becky Lightfoot, Art's Music Shop, Montgomery, Ala.

A: Becky, you're absolutely right about the recent increase in mergers and acquisitions, many of which have been more than just noteworthy.

In the last 12 months, we've seen major acquisitions by print music publishers (i.e. Alfred Publishing's acquisition of Warner Bros. Publications), guitar suppliers (i.e. Fender's acquisition of Tacoma Guitars), band instrument manufacturers (i.e. Conn-Selmer's acquisition of G. Leblanc) and pro audio and recording vendors (i.e. Digidesign's acquisition of Bomb Factory Digital). We've also seen several acquisitions of a garden variety among music retailers, the most prominent being Guitar Center's $98 million acquisition of Music & Arts Center.

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With rumors of more newsworthy acquisitions to come, you've got to wonder whether they know something that we don't. Or is it simply that there's strength in numbers and, contrary to conventional wisdom, size does matter?

Having just returned from this year's Retail Print Music Dealer Association's annual convention, where this topic was discussed both in a large public forum and in many a private conversation, I thought it might be fun to explore why mergers and acquisitions occur, why they may work and not work, and, lastly, answer (or guess at) Becky's question as to what effect they may have on our industry.

M&A IS NOT 'MUSIC INC.' & 'ALAN'

Much to my chagrin, I have learned that M&A is the cool, hip abbreviation for "mergers and acquisitions," not for "monkeys and apes" or "martinis and aperitifs." More astonishing is that probably 99 percent of the business consolidations that occur in the music products industry are, in reality, the "acquisition" of one business by another, not the "merger" of two businesses into a new entity.

So why do they happen? For one or all of three reasons. Let's talk briefly about each of these.

1. The "1 + 1 = 3" Theory. Mergers and acquisitions (a.k.a. "corporate restructuring") take place every day, and remain newsworthy because of their potential impact on fortunes made or lost in the years that follow. They often occur because some corporate CEO thinks his or her company will be worth, after the acquisition, an amount far greater than the cost of the merger. For many of these CEOs, making the M&A happen can be the pinnacle of their career. It can also be the primary reason why the CEO gets fired when an acquisition causes significant operating losses or fails to meet expectations.

2. Survival of the Fittest. The "1 + 1 = 3 theory" is most appealing during difficult economic times. When times are tough, strong companies will buy other smaller or weaker companies to become more competitive and cost-efficient. The target companies will often agree to be bought when they realize they'll have a difficult time surviving financially, continuing to grow, tolerating risk from an uncertain future or developing a succession plan.

3. Synergies. Synergies are the magical forces that create "enhanced revenues" and

"reduced operating costs" through opportunities that arise when an acquisition is completed. These synergies are often achieved through staff reductions and economies of scale that reduce operating costs; new technology, systems and operation efficiencies; new name brands and access to new product lines; and improved market reach and industry visibility.

WHY M&A'S FAIL

In every acquisition, owners and investors of an acquiring company must determine "how much" a desired company is worth. It shouldn't come as a surprise that buyers and sellers may have different views on their worth and value. Sometimes buyers will pay a premium for synergies they think they're getting from their target company. Accordingly, they often will "seal their fate" by their "due diligence," or lack thereof, during the weeks or months just prior to the closing of the deal. Here are the main reasons why mergers and acquisitions fail:

1. Flawed Intentions. A booming stock market and vibrant economy encourage mergers and acquisitions, and many acquirers will "over pay" for their target company. Glory-seeking and arrogance by CEOs, as well as greed, public pressure and a fear of the unknown, can cause M&A failures.

2. Unanticipated Obstacles. Coping with the demands of an M&A can cause top managers to spend "too much time" on the acquisition and neglect their core business. Different corporate cultures can also lower morale and prevent employees from getting along. Lastly, too much focus on cost cutting, instead of revenue generation, can divert effort away from profit-generating activities.

3. Sheer Stupidity. For example, just because a music store has success in the combo business doesn't make that management team experts in all aspects of music retailing, like pianos.

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A lack of due diligence in key financial areas (accounting and reporting, inventory mix, employee morale, computer systems, etc.) can guarantee the eventual failure of an acquisition. An emotional attachment or time wasted on making a deal happen can cause the overpayment of a target company. Additionally, not putting up enough assets to make a deal work, or putting up assets one can't afford to lose, can spell disaster before the acquisition is even completed.

TODAY'S PREDICTION (WHICH WILL UNDOUBTEDLY CHANGE TOMORROW)

Becky, you asked what effect these mergers and acquisitions will have on independent music retailers. It's a great question. Unfortunately, no one can really answer it, although I'm sure many of us have strong and varying opinions. I'm fairly certain that acquisitions on the vendor side will result in a combination of better products, easier ordering and increased product availability. However, I'm less confident about the positive affects on music retailing created by "retailing" mega-mergers like Guitar Center and Music & Arts Center.

While the consumer may ultimately win from a one-stop shopping experience, I'm hard pressed to think of any positive effects this will have for independent retailers. I suppose there may be some new opportunities for retailers to sell their music store, assuming Guitar Center is successful in growing the Music & Arts Center division.

Still, this much I am certain of: When retailers start worrying more about big chains, Internet retailers and catalog houses, instead of what they can do in their own business to succeed, they won't have to worry for long.

Instead, stay focused on customer service, inventory management, sales training and fiscal responsibility. Attend all NAMM Shows, if only for the free NAMM University education programs. And join organizations like the Retail Print Music Dealers Association (RPMDA) or National Association of School Music Dealers (NASMD) that strive to bring excellence to their respective industry segments.

No matter what your future holds, it'll be far more prosperous if you keep your nose to the grindstone and do what you do best, instead of wondering whether Wal-Mart will buy Guitar Center. MI

Are financial questions keeping you up at night? E-mail yours to askalan@musicincmag.com.

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