IDEAS

ASK ALAN | BY ALAN FRIEDMAN

BEST-CASE SCENARIO

After taking a few months off from writing, I'm back right when a big-box, non-traditional, non-music-retailing giant, Best Buy, has decided it's a good time to get in the musical instrument business. Perhaps this may also be a good time for me to pursue a more lucrative career path, like cardiovascular surgery. I hear there's good money in it, and after all, isn't that the real reason why we should always be willing to deviate from a successful business model?

If you detect a subtle hint of sarcasm, I'm truly sorry. I was hoping it wasn't subtle.

THE $5 RENTAL FLOP

Best Buy's news reminds me of a somewhat similar event a few years ago. Remember all the hoopla when Mars — the store, not the planet — got into the band instrument rental side of the business? There was a lot of noise about the negative effect it would have on music retailing and the impending demise of the band rental business. So much so that *Music Inc.* ran a cover story on Mars founder Mark Begelman with a sidebar titled "The $5 Rental Flap."

So Best Buy has entered MI retail. Anyone remember Mars Music?

I couldn't contain myself and wrote a letter to the editor of *Music Inc.* — the only music trade magazine without enough decorum to print my deranged thoughts and incoherent ramblings, as evidenced by the article you're currently reading. I've asked the good folks at *Music Inc.* to reprint that letter. Take a moment to read, or reread, that piece of self-proclaimed brilliance.

"A Rough and Uncertain Road"

(April 1999)

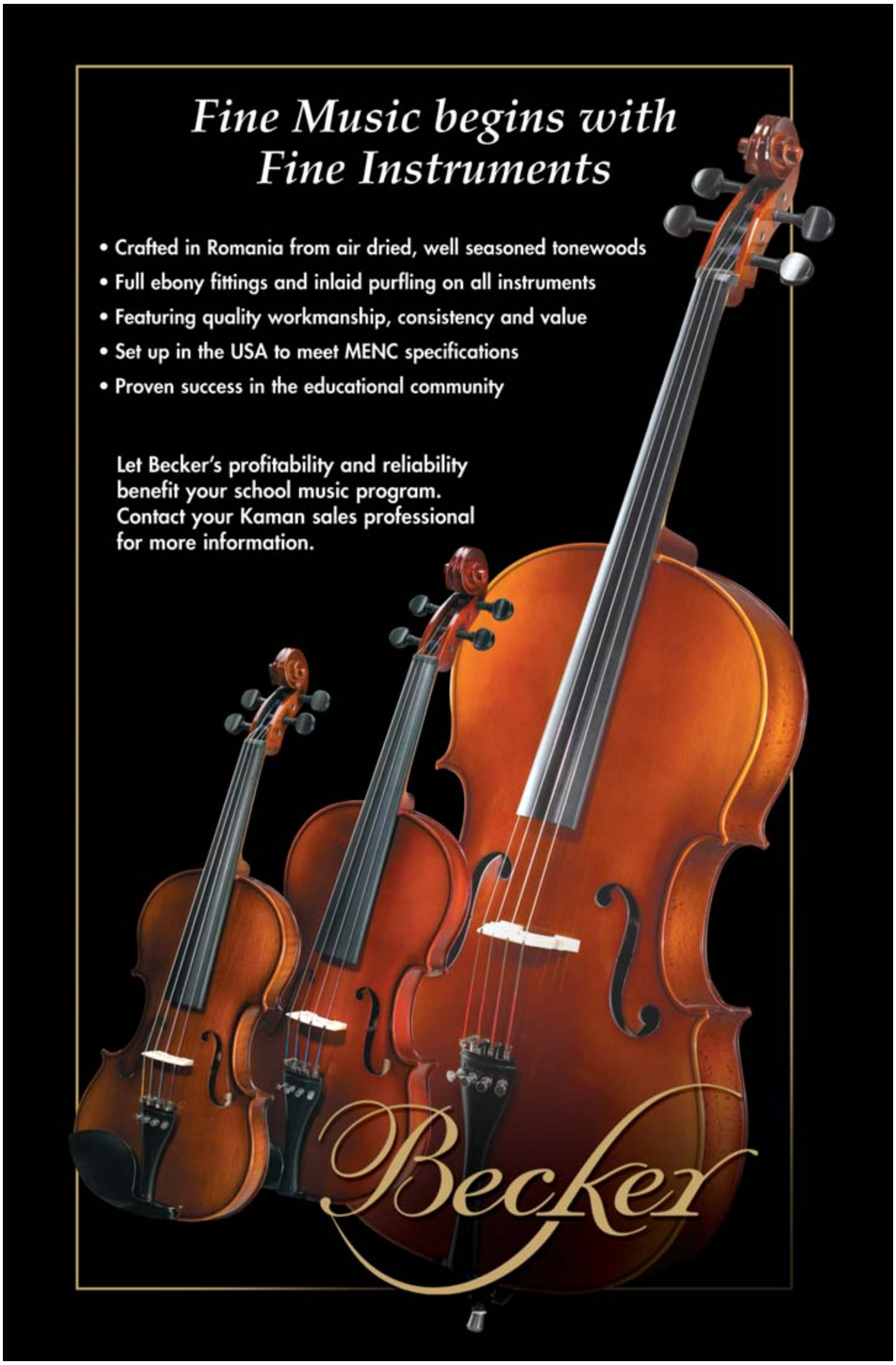
Everyone should read (not once, but twice) the *Music Inc.* interview of Mars founder Mark Begelman. There's a lot to learn from Frank Alkyer's interview of the music retail industry's newest mover and shaker. Accordingly, here's my thoughts.

I believe Mr. Begelman is merely taking advantage of the same business opportunities afforded to all businesses. He's taken his entrepreneurial skills and experience, coupled with an ability to raise capital, and has infused them into his new business venture of personal passion. And lo and behold, he's become one of the three largest music retailers, and has found himself in the desirable position to flex a little financial muscle with both suppliers and competitors. Is this why he's disliked by so many retailers? It sounds more like jealousy than unscrupulous business practices.

Let's see: He orders tons of merchandise (which keeps certain manufacturers in business and people employed); he pays his bills on time; he wants to leave a legacy of ethics and success to his kids; he has a bonus and stock option plan for his employees; he admits to making mistakes and learns from them; he's extremely pro music education (self-serving or not, it's noble and much-needed); and he does what he promises. I can think of far worse character traits.

Don't get me wrong. Given the number of music retailing clients our firm services, I am also concerned about the financial effect Mars (and the other two superstore chains) will have on our clients' ability to survive. But this I know for sure: Survival will depend solely on what each competing retailer does to learn, survive and flourish. Music retailers need to pay more attention to what's going on in their own stores, not Mars.

Personally, I think Mars is in for a rough and uncertain road given the tenacity of many music retailers, both large and small. I could be wrong, but I think they're overly optimistic about achieving the gross profits (not sales) needed to cover superstore-related operating expenses and still have funds left over to



pay profit dividends to Mars investors.

Also, if their $5-a-month rental program is part of a rent-to-own contract, they're violating an IRS rule (as you can't have uneven rental payments). "Bigger" and "smarter" don't always go hand-in-hand.

It's probably natural to like, love, hate, loathe, fear or feel indifferent toward Mr. Begelman given the impact he's had on music product retailing in just two years. For the same reason, I think respect should accompany our emotions, as well.

MY BEST BUY PREDICTION

Knowing I had a one-out-of-two shot of being right about Mars' future, I took a shot and got lucky. And I believe there's a common, recurring, time-tested notion that always applies when facing new competition: Forget what the other guy is doing, and pay attention to what you're doing. That's not to say ignore your competition's every move — we can learn from both their successes and failures. But when you consume yourself with your competition at the expense of tending to your own business, you will most assuredly fail.

Besides, you don't know half the problems your competition faces. Once again, big-box retailers have inherently high rent and operate on thin gross profit margins. They can ill-afford to devote expensive retail floor space to products that don't turn quick enough to generate enough gross profit dollars to cover their high overhead.

You don't have to be Nostradamus to guess my prediction for Best Buy's longevity in music retailing. While it will take some market share away from other retailers in the short term, my guess is it's probably going to affect Guitar Center more than any independent retailer. In the long run, which may not be all that long, some Best Buy upper-management financial dude may ultimately ask why it deviated from an otherwise successful model to get into music retailing.

I know, I've got a 50/50 shot of being right. But so far, I'm batting 1,000 with my one-out-of-one successful prediction rate, and once again, I feel lucky. Anyone want my presidential pick, too? **MI**

Alan Friedman, CPA, provides accounting and financial services to music industry clients. He is a frequent speaker at NAMM U. seminars and can be reached at 860-521-3790 or alan@fkco.com. Visit his Web site at fkco.com.