Wal-Mart Wants $10 CDs

Biggest U.S. record retailer battles record labels over prices

Wal-mart wants every CD you buy to cost less than ten bucks. And the nation’s largest retailer -- which moved a quarter of a trillion dollars’ worth of goods last year -- usually gets its way. Suppliers who don't accede to Wal-Mart’s "everyday low price" mantra often find their products bounced from the chain's stores, excluded from being sold to the 138 million people who shop at a Wal-Mart store every week.

In the past decade, Wal-Mart has quietly emerged as the nation's biggest record store. Wal-Mart now sells an estimated one out of every five major-label albums. It has so much power, industry insiders say, that what it chooses to stock can basically determine what becomes a hit. "If you don't have a Wal-Mart account, you probably won't have a major pop artist," says one label executive.

Along with other giant retailers such as Best Buy and Target, Wal-Mart willingly loses money selling CDs for less than $10 (they buy most hit CDs from distributors for around $12). These companies use bargain CDs to lure consumers to the store, hoping they might also grab a boombox or a DVD player while checking out the music deals.

Less-expensive CDs are something consumers have been demanding for years. But here's the hitch: Wal-Mart is tired of losing money on cheap CDs. It wants to keep selling them for less than $10 -- $9.72, to be exact -- but it wants the record industry to lower the prices at which it purchases them. Last winter, Wal-Mart asked the industry to supply it with choice albums -- from new releases from alternative rockers the Killers to perennial classics such as Beatles 1 -- at favorable prices. According to music-industry sources, Wal-Mart executives hinted that they could reduce Wal-Mart's CD stock and replace it with more lucrative DVDs and video games.

"This wasn't framed as a gentle negotiation," says one label rep. "It's a line in the sand -- you don't do this, then the threat is this." (Wal-Mart denies these claims.) As a result, all of the major labels agreed to supply some popular albums to Wal-Mart's $9.72 program. "We're in such a competitive world, and you can't reach consumers if
Tensions are not as high now as they were last winter, but making sure Wal-Mart is happy remains one of the music industry's major priorities. That's because if Wal-Mart cut back on music, industry sales would suffer severely -- though Wal-Mart's shareholders would barely bat an eye. While Wal-Mart represents nearly twenty percent of major-label music sales, music represents only about two percent of Wal-Mart's total sales. "If they got out of selling music, it would mean nothing to them," says another label executive. "This keeps me awake at night."

Wal-Mart would not directly comment on tensions with the labels, but Gary Severson, Wal-Mart's senior vice president and general merchandise manager in charge of the chain's entertainment section, did allude to the dispute about music prices. "The labels price things based on what they believe they can get -- a pricing philosophy a lot of industries have," he says. "But we like to price things as cheaply as we possibly can, rather than charge as much as we can get. It's a big difference in philosophy, and we try to help other people see that." Virtually no industry executives would publicly comment about their company's relationship with Wal-Mart. But off the record, many record-industry executives shared their concerns. "I don't think there is a music supplier in America who really enjoys doing business with Wal-Mart," says one major-label rep.

No one in the music business ever expected Wal-Mart to become the most powerful force in record retailing. In the past, the business was shared among smaller local and regional chains such as Musicland, which once had an estimated ten percent of the market. But as Wal-Mart and other national discount operations such as Target and Best Buy have grown -- approximately half of all major-label music is sold through these three -- an estimated 1,200 record stores have closed in the past two years, according to market-research firm Almighty Institute of Music Retail. Last February, Tower Records, with ninety-three stores, declared bankruptcy and is now up for sale; Musicland has already changed owners, with many local outposts shuttered.

Wal-Mart is like no traditional record seller. Unlike a typical Tower store, which stocks 60,000 titles, an average Wal-Mart carries about 5,000 CDs. That leaves little room on the shelf for developing artists or independent labels. There's also scant space for catalog albums, which now represent about forty percent of all sales. At a Wal-Mart Supercenter in Thornton, Colorado, for example, there were no copies of the Rolling Stones' *Exile on Main Street* or Nirvana's *Nevermind*. While most of the latest hits were priced at $13.88, some records -- from the *O Brother, Where Art Thou?* soundtrack to the latest by Yellowcard -- were displayed for $9.72. Says Severson, "Paying fifteen dollars for a piece of music is a difficult value equation for customers."

For the music industry, having such a dominant retailer is like being stuck in a bad marriage. Whereas traditional music retailers took advertising money from the labels to push new releases in Sunday newspaper circulars, Wal-Mart barely advertises locally. It relies on national campaigns, where it promotes its own low-price policy. "Wal-Mart has no long-term care for an individual artist or marketing plan, unlike the specialty stores, which were a real business partner," says one former distribution executive. "At Wal-Mart, we're a commodity and have to fight for shelf space like Colgate fights for shelf space."

In the same way that Wal-Mart made it difficult for local mom-and-pop retailers to compete with its low prices, it has hurt smaller music stores. "When you're buying CDs for twelve dollars and selling them for ten like Wal-Mart, it makes the rest of us look like we're gouging the customer, when we're not," says Don Van Cleave, head of the Coalition for Independent Music Stores, a retail consortium. "It's supertough to compete with that price point."

Even online, Wal-Mart sells songs for eighty-eight cents, compared with ninety-nine cents at the market leader, Apple iTunes Music Store.

Getting Wal-Mart excited about carrying a record is at the top of every label's to-do list, but it's harder than it sounds. There is an immense cultural chasm between slick industry executives and Severson's team of three music buyers at Wal-Mart headquarters in Bentonville, Arkansas. Only one of the three had ever worked in music retailing -- until that person moved to a new division in August and was replaced by someone who previously bought Wal-Mart's salty snacks. (Wal-Mart also relies on buyers at its two distribution companies, Handleman and Anderson Merchandisers, who purchase records as well as stock the Wal-Mart stores.)

"Content-wise, Wal-Mart is limited about what they sell," says one label chieftain. "Wal-Mart is Middle America's shopping headquarters, with different buying habits and consumer tastes than those who live in Manhattan and L.A." When founder Sam Walton christened the first Wal-Mart in 1962, music was never a priority -- it wasn't an
everyday, easy-to-stock product like light bulbs, since the Top Ten changed so much. The chain also had specific objections to music. Walton wanted all stores to remain family-friendly, and in the rural South, rock & roll had the potential to turn away many customers. In 1986, the Rev. Jimmy Swaggart led one such campaign to ban music from Wal-Mart, saying rock fostered "adultery, alcoholism, drug abuse, necrophilia, bestiality and you name it." Albums and magazines about rock (including *Rolling Stone*) were temporarily pulled from the Wal-Mart shelves.

Wal-Mart’s wariness about music ended once the music industry adopted a voluntary advisory sticker on albums deemed to contain adult language or sexual content. Today, before any new album is released, someone at each label is charged with asking, "Do we have any Wal-Mart issues?" If an advisory sticker is placed on an album, the label will put out a clean version about ninety percent of the time. Since the edited version of a hit record usually averages only about ten percent of a record's total sales, they do it mostly to keep Wal-Mart happy.

Wal-Mart has loosened up a bit, too. Eminem's albums, stickered or not, are not carried by the chain, but it does sell the *8 Mile* soundtrack. And it carries an edited version of 50 Cent's debut. Since the labels are so adept at self-policing, though, censorship controversies are now rare. "There have been examples in the past, but it's not a current issue," says Severson.

Wal-Mart has also urged the labels to create exclusive new products that would lower music prices. In a short-lived test, Universal excerpted seven songs from existing albums by acts such as Sum 41 and Ashanti and sold them at Wal-Mart for $7. Few other labels wanted to participate. "They proposed it to a bunch of artists and managers, but everyone was worried that we are sending a message that instead of the sixteen-track album we sold, those nine extra songs were filler," says a label executive.

Some record executives think they can survive Wal-Mart's push. They argue that the hottest acts will always command a premium price. "50 Cent sold 7 million copies," says one rep, "and I guarantee that many of those sold for fifteen, sixteen dollars." And they believe that Wal-Mart will want to carry those hits because they draw customers. "If they can't find a record at Wal-Mart, people will go elsewhere," says one executive. "We should play hardball." But each label is watching the others to see if any make major concessions to Wal-Mart's demands for lower prices. A label that gives in could gain shelf space at the expense of another. "If you lose an account, one of your rivals could get more product in the store and get one up on everyone else," says a major-label rep. "You have to tread cautiously."

The tug of war between the labels and Wal-Mart isn't going away soon. The chain is aggressively opening new stores -- fifty-seven in October -- including some in urban areas. So unless it makes good on its threat to cut back on its music section, it will continue to grow as the top record store and become even more powerful. Laments one industry rep, "There is some impending doom associated with us not helping them."

**Price War: Does a CD have to cost $15.99?**

Major labels insist that the low prices mass retailers such as Wal-Mart and Best Buy demand are impossible for them to achieve. But Best Buy senior vice president Gary Arnold counters, "The record industry needs to refine their business models, because the consumer is the ultimate arbitrator. And the consumer feels music isn't properly priced." Labels point to roster cuts and layoffs as evidence that they can't sell CDs cheaper.

This breakdown of the cost of a typical major-label release by the independent market-research firm Almighty Institute of Music Retail shows where the money goes for a new album with a list price of $15.99.

- $0.17 Musicians' unions
- $0.80 Packaging/manufacturing
- $0.82 Publishing royalties
- $0.80 Retail profit
- $0.90 Distribution
- $1.60 Artists' royalties
- $1.70 Label profit
- $2.40 Marketing/promotion
- $2.91 Label overhead
- $3.89 Retail overhead
RS MUSIC STORE: Top 10 Songs for 49¢

1. "My Boo"  |  Usher
2. "Lose My Breath"  |  Destiny's Child
3. "Over And Over"  |  Nelly
4. "Let's Go"  |  Trick Daddy
5. "Give A Little Bit"  |  Goo Goo Dolls

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