

Creating A Small Giant

Instead of top line growth, Chicago Music Exchange's new owner David Kalt is looking to deliver an outsized experience for customers and a meaningful career for employees

David Kalt has one of the most unusual resumes of any music store owner in the nation, which is probably appropriate because Chicago Music Exchange, which he acquired in 2010, is one of the industry's more unusual retailers. Located in the up and coming Roscoe Village neighborhood of Chicago, the 9,000-square-foot location looks more like a high-end gallery than a typical guitar store. Soaring twelve-foot ceilings, gleaming hardwood floors, and bright white walls provide a stunning showcase for an assortment of 2,500 acoustic and electric guitars. Chandeliers, rock 'n' roll memorabilia on the walls, and comfortable sofas add to the tasteful atmosphere. Kalt's goal is to make this elegant showcase "the coolest guitar store in the country, and a destination for players from around the world." At first glance, a guy who spent much of his earlier career writing computer code and trading options doesn't seem like the ideal arbiter of "cool." However, Kalt's numerical aptitude is augmented by a deep seated appreciation of music, and a love of guitars.

A native of Detroit, Kalt grew up playing the guitar and secretly aspired

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”



New owner David Kalt in the main showroom at Chicago Music Exchange.



to a career onstage. But by the time he graduated from the University of Michigan in 1989, a realistic assessment of his musical abilities led to the conclusion that being a rock star just wasn't going to happen. Looking to stay involved with music in another capacity, he took a job at a Chicago recording studio in hopes of becoming, as he puts it, "the next Jimmy Iovine." The glamorous image he associated with being a "record producer" quickly faded as he found himself working 80-hour weeks for minimum wage, turning out jingles and radio spots. After a year and half on the job, he concluded, "there has to be a better way to make a living than this."

Computers were just starting to make their way into the recording studio, and because he had a natural facility with technology, he became the studio's go-to "computer guy." Based on the success he had writing a few programs for an automated mixer and a Synclavier, he decided to sharpen his skills and enrolled in programming classes at nearby

Northwestern University. He got good enough that in 1993 he wrote a sophisticated database marketing program that helped travel agents match customers with appropriate trips. He had gravitated toward the travel industry because his grandmother and parents had operated a successful travel agency in Detroit and he was familiar with the business. The software program found a ready market among independent travel agencies, and Kalt scored his first entrepreneurial success, turning an initial \$20,000 investment into a multi-million-dollar business. He was perceptive enough to recognize that the growth of the internet posed a threat to travel agents, and in 1999 he sold his software business.

Applying his programming skills to another personal interest, a year later he launched OptionsXpress, a platform that allowed individuals to efficiently trade options. "I had taught myself option trading and was doing it on a small scale," he relates. "But Charles Schwab and eTrade treated options like a second class citizen, and it was hard to trade on their plat-



The acoustic guitar showroom at Chicago Music Exchange

forms.” OptionsXpress provided an alternative for independent traders and managed to turn a profit in its first year. Based on strong sales and earnings growth, Kalt successfully took the company public in 2005. Two years later, though, he stepped down as CEO, because “I just didn’t enjoy running a large public company.” In 2010 Charles Schwab acquired Options Xpress for \$1.0 billion.

After a year spent “clearing his head,” Kalt decided to marry his passion for music with his technology skills and open an online music business. He secured the Reverb.com URL, but as he began ramping up the business, he quickly concluded that “it was virtually impossible for an unknown guy to secure top product lines based on a business plan alone.” That’s when he decided he needed to acquire an existing store to accelerate the launch of his new venture. As a loyal customer, Chicago Music Exchange was his first call. “It was the perfect fit,” he explains. “I loved the store and had probably bought \$40,000 worth of guitars there. The real estate was well situated in a great Chicago neighborhood, they had all the major lines, and it was an incredibly cool store.” Two year ago, he struck a deal with founder Scott Silver and quickly began putting his stamp on the business.

Kalt’s passion for music and guitars and his analytical bent are evident in the office he occupies on the second floor of the building on Lincoln Avenue. A large black and white photo of

Tom Petty hangs on the bare brick walls and two outsized Apple monitors sit on his desk, one displaying store financial data, and the other a flashing options trading program. Within easy reach is a rack filled with several dozen vintage guitars, carefully arranged by brand and year. As he scans the monitors, it’s obvious that he’s good at processing data. But when

he reaches over and picks up a pristine 1966 Strat, he also displays a deep-seated appreciation for the art of guitar making. After years immersed in options trading, the novelty of being surrounded by fine instruments definitely provides a thrill. “Some of my friends from my previous life don’t get what I’m doing here,” he explains. “But I’m happy to go to work every day, putting tags on guitars and dealing with customers. I like the immediacy of it.”

For a guy who built what became a large business, Kalt’s objectives at Chicago Music Exchange are surprisingly limited. He has no interest in opening more outlets to challenge the national chains, or in creating a large full-line direct-response company. Rather, he wants to build what he calls “a small giant.” By that, he means an exceptional store with a compelling selection and service that draws customers from around the globe. “We aim to be the coolest guitar store in the world,” he explains.

Chicago Music Exchange scored high on the scale of coolness well before Kalt acquired it. Its stunning showroom

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A newly opened drum department contributed close to \$1.0 million revenue last year.

attracted a long list of celebrity customers and a global following of high-end guitar collectors as well. Since taking over, Kalt has been carefully refining the business in hopes of creating an enterprise that provides a satisfying career for the store's 24 employees.

His first move was to alter the product

mix. When he bought the company, vintage guitars accounted for 60% of sales and new guitars accounted for 40%. But watching as dozens of customers came into the store every Saturday and then walked out empty-handed, he did some quick calculations and concluded that a bigger selection of new instruments,

even at lower margins, made financial sense. "We were spending heavily to attract customers with our marketing and our showroom," he explains. "But after they got here, they'd leave for Guitar Center because we didn't have the new products they were looking for." Through a systematic rebalancing of inventory, new guitars now account for 60% of sales, and store revenues increased from around \$4.0 million in 2010 to an \$8.0 million run rate in 2012.

About 20% of Chicago Music Exchange revenues are direct internet sales, and Kalt estimates that another 40% come from outside the Chicago metro area. However, he says that the brick and mortar location and a content-rich website work in concert. The website obviously raises the profile of the store beyond the immediate geographic region. However, online photos and videos of the beautiful store have made it a destination for customers from around the world. Although Kalt doesn't have precise data—at least not yet—he is continually amazed at the number of internet customers from Europe, Asia, or other parts of the U.S. who stop



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by the store when they visit Chicago. He expects this synergy between brick-and-mortar and online to drive sales growth for the foreseeable future.

Rather than dividing sales into “online” or “in-store” categories, Kalt says he and his team simply focus on “blowing away every customer we come into contact with.” That means jumping through hoops for customers who come into the store and spending as much time as necessary with them, or promptly answering every email that comes in. Salespeople are cross-trained so they are equally adept at handling both walk-in traffic and online inquiries. While some retailers complain about customers who go online to read every spec sheet and blog post before they visit a store, Kalt actually welcomes them. “Before I was involved with the business, I didn’t realize just how involved the purchase decision was for many guitarists,” he says. “We have customers who come in several times and spend hours with a guitar before they finally make the purchase. These are well-informed customers, and our job is less to ‘sell’ them than to help them validate their decision.”

Although he’s not looking to get “big for the sake of being big,” Kalt is investing to expand the business. He bought the building next door, and is in the process of reconfiguring the basements of the two buildings and installing an elevator to create a more efficient shipping operation to handle expanded online sales. The additional space also houses a well-equipped photo and video studio that churns out fresh content to keep visitors coming back to the website.

Although company founder Scott Silver dealt only with guitars, he intentionally named his business Chicago

Music Exchange to leave open the option of expanding into other product categories. Kalt has done just that, using space in his new building to open a well-stocked drum department. In its first year, the department did close to \$1.0 million in sales. Kalt attributes the success of the new division to a “really talented manager” who understands the market and the customers.

Kalt feels that his goal of “creating the coolest” music store depends primarily on the quality of his staff. And because he quit his first recording studio job over the paltry salary, he also understands better than most that “you only get what you pay for.” That’s why he talks about creating career paths, not just jobs, for his staff. There are different ways to reinvest in a business. For Kalt, the most important is providing the kind of tangible benefits that create committed, long-term employees. “I’m trying to build a business that will be around for 50 years or more, not just milk it for a livelihood,” he says. “And the key is developing an amazing staff. That’s what lasting success is all about.”

Kalt has developed a numerous metrics for quantifying the performance of various aspects of the business. However, when it comes to measuring the “coolness” quotient, he uses a different standard. On a Wednesday afternoon, early in the afternoon, two “twenty-somethings” are staring intently at a wall stacked with three rows of Fender Strats. High-end vintage instruments are closest the ceiling, next comes a row of pricey Custom Shop models, and at floor level is the selection of standard models. As one of the potential buyers turns to his friend and says, “amazing!,” Kalt smiles and notes, “that’s what we’re trying for.”

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