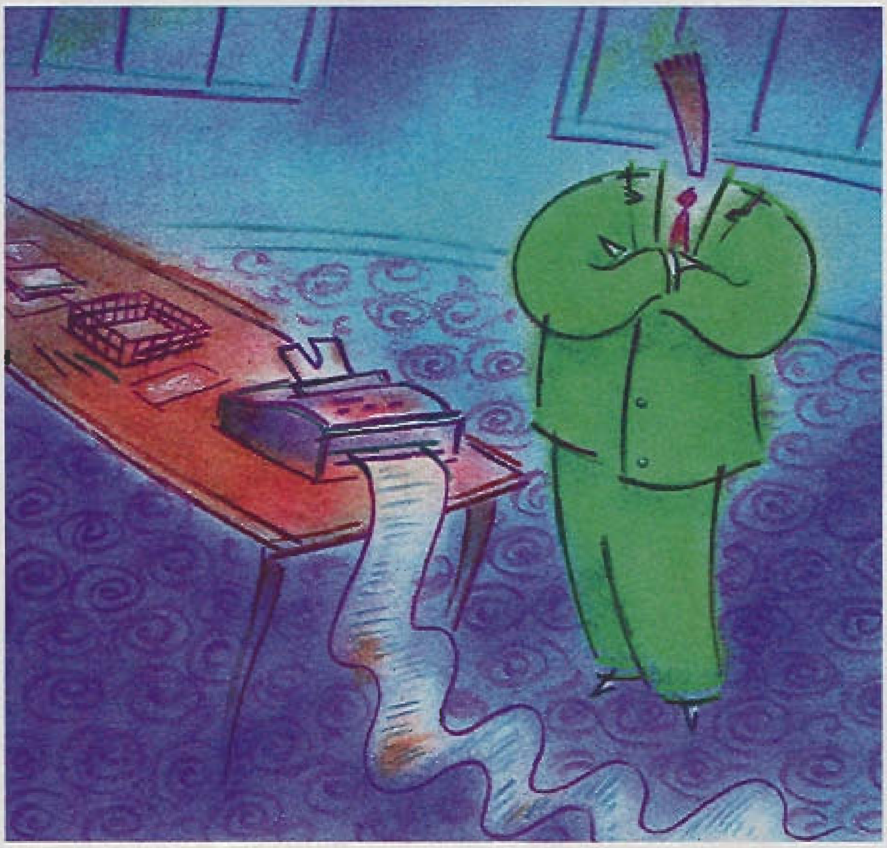
 By Alan Friedman



I was almost embarrassed to give him the "correct" answer, which is to make money. That's not to say I don't love my work or find it stimulating, it's just that the big picture can get lost in the daily grind. Making money flow into your business is not only essential, it's more important than the ability to deliver goods and services.

Is that placing a bit too much importance on cash flow? Consider this–if you fail to satisfy a customer and lose that customer's business, you can always work harder to find and please the next customer.

But if you don't have enough cash to pay your suppliers, creditors or employees, you're out of business! Proper management of your cash flow is critical.

Understanding the components of cash flow is the first step toward effectively managing it. Since cash flow is comprised of "inflows" and "outflows," the key to increasing cash flow is "accelerating inflows" and "delaying outflows."

The idea sounds simple enough, but the execution is a continuing business challenge. Sometimes you'll have unavoidable cash flow gaps, which require borrowing, infusing capital or stringing out your vendors. And sometimes you'll need to know what to do with a cash surplus that doesn't always come from profitability (like when a customer gives you a big deposit on a sound system). So let's discuss how to handle each of these cash flow components so you can be the next Donald Trumpet.

How to Make Cash Flow, Not Drip

CASH FLOW IS THAT ELUSIVE TERM YOU HEAR BANTERED AROUND BY YOUR BOOKKEEPER, BANKER AND ACCOUNTANT. You see it scrutinized by vendor credit managers and hailed at NAMM University courses.

You even hear about it at cocktail parties (one of the best sources for useless or misguided information). Everyone talks about it, some understand it, few have an abundance of it, and even fewer know how to make more of it.

In our office, cash flow has been affectionately renamed "Cash Drip."

Poor cash flow is one of the leading reasons why businesses fail. And to make matters worse, adequate cash flow seems especially hard to maintain.

Poor cash flow may be due to tight vendor credit, large opening orders for new product lines, a retailer's love for lots of "cool" inventory or simply a lack of training in accounting and finance.

Whatever the reason, maintaining adequate cash flow isn't something that should be left solely to your bookkeeper, banker or accountant. You need to understand the basic principles yourself and use them on a daily basis. Besides, most accountants think stocking accordions is a good use of cash.

Sales, Service or Cash?

One of my more successful clients once asked me this: "When you get up in the morning, do you go to work to do tax returns, or to make money?"

Your Cash Ain't Nothing But Trash (Not!)

Your store's cash inflows arise from several revenue sources, including the sale of goods, instrument rentals, repair services and music lessons. Clearly though, the key to increasing cash inflow stems from the timely movement of inventory in and out of your store, and the attentive collection of any outstanding accounts receivables. Accordingly, here's some important guidelines to accelerate cash into your store:

1. Concentrate more on inventory turns, than on gross profit margins. Yes, margins are very important, but holding out six months or longer for your price makes no sense when you could have turned that same item four times during the year at a slightly lower margin. This is one of the biggest mistakes made by most retailers today. On an average, today's music retailer is turning inventory 1.6 times a year; that's downright horrible. The key is to buy less, but more frequently, even at a higher cost.

2. When you've purchased a loser, accept the mistake and blow it out. It's human nature (and therefore understandable, even though totally misguided) to avoid taking a loss on an inventoried item. But if you've got an item that's been sitting around for a year (like that accountant's accordion), it's tying up valuable dollars that could be invested in some other item that will turn to cash in 60 days (or six times a year). Think how quickly you'll make up and surpass that loss!

3. Keep a tight lid on credit to customers. Make sure your customer deserves the extension of credit (up front, not five months later when they file for bankruptcy). If you do extend credit, make sure someone in your organization communicates with your customers as their payment due dates approach. The assessment of finance charges on delinquent receivables may be a good way to keep your customers motivated to pay you on time.

Baby Please Don't Go

Cash outflows arise from the purchase of inventory, paying of expenses, acquisition of equipment and repayment of loans. Therefore, another way to improve cash flow is to delay all outflows of cash as long as possible, while still meeting your obligations on time. Delaying cash outflow helps you create more cash to take advantage of trade discounts and special pricing deals from your vendors.

Here are a few basic rules regarding cash outflows:

1. Pay your bills on time, but never before they're due.

2. Always try to establish, and then increase, vendor trade credit. Without trade credit, you'd have to pay for all goods and services at the time of purchase.

3. Don't be afraid to negotiate better payment terms with your suppliers (remember, everything is negotiable).

4. Use a business credit card for travel, lodging and trade show costs, instead of a company check. Just make sure the balance is paid off before high finance charges kick in.

5. Use float (can you believe I'm recommending this?). Although somewhat risky, float (the time between when a check is written and cashed) can cover temporary cash shortages, when all other more prudent measures have been exhausted.

The only exception to delaying a payment is when a trade discount

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is offered for early payment. But make sure it's worth it. Generally speaking, a trade discount (i.e. 2% off the invoice if paid within 10 days) is worth taking if you have to pay the invoice in full in 30 days or less.

Finance Fixed Assets with Long Term Debt

Make sure your store's fixed assets (furniture, fixtures, computers, rental instruments, etc.) are financed with long-term debt, not with trade credit and lines of credit. Because these assets don't convert to cash, they should be paid for over a long period of time (three to seven years). Given that trade debt is generally due within 30 days, and most banks require lines of credit be paid off each year, you'll quickly lose credibility with your vendors and banker if you don't have enough cash to pay them on time. Review your balance sheet with your accountant and/or banker to assure your store is properly financed. Just another way to make your cash flows, instead of going drip... drip...drip...drip.

Alan Friedman, C.P.A., provides accounting and financial services to music industry clients. He is a frequent NAMM University speaker and can be contacted at (860) 521-3790.

Tips to Accelerate Cash Inflows, Delay Outflows

How to Accelerate Inflows

1. Concentrate more on inventory turns than on gross profit margins.
2. When you've purchased a loser, accept the mistake and blow it out.
3. Keep a tight lid on credit to customers.

How to Delay Outflows

1. Pay your bills on time, but never before they're due. Quick-pay discounts are the exception to this rule.
2. Always try to establish, and then increase, vendor trade credit.
3. Don't be afraid to negotiate better payment terms with your suppliers.
4. Use a business credit card for travel, lodging and trade show costs, instead of a company check.
5. Use float (the time between when a check is written and cashed) when all other more prudent measures have been exhausted.