

IDEAS

>>> Inside IDEAS

> The Lesson Room Page 38

> Marketing Page 40

> Customer Whisperer Page 42

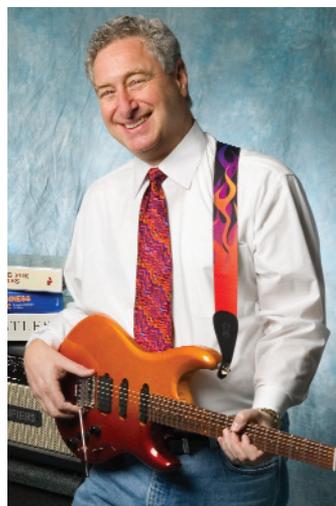
> Indie Retail Page 46

ASK ALAN | BY ALAN FRIEDMAN

THE EFFECT OF BAD DEBT ON RETAIL CREDIT

In this fifth installment of a six-part series on credit in music products retail, we're getting down to the bottom-line issues with regard to tightening credit in the industry. Every dealer seems to be wondering — but doesn't have the nerve to ask suppliers — what effect recent supplier bad debt write-offs are having on suppliers' willingness to extend credit to the rest of the music retailing community.

Being neither a retailer nor supplier, I thought I'd ask the question. So I did during my panel discussion with credit professionals, called "The Loan Rangers of Music Retailing," held during the 2007 winter NAMM show. The panel consisted of Larry Dunn, CFO and vice president of finance for Kaman Music; Karren Salter, general manager of customer financial services for Yamaha Corp. of America; Jim Satterberg, vice president of GE Commercial Finance; and Greg Grieme, CFO of BGE Financial — in other words, the financial voices of a major supplier, distributor, inventory flooring financier and



Credit managers on how bad debt write-offs influence other retailers

rental instrument lender. The following is an edited transcript.

Me: How upset and/or concerned do you get when you're forced to write off one of your accounts receivables? Does this, understandably, cause you

to be more stringent with your other retail store customers? C'mon people, do you get upset when this happens? (laughs)

Dunn: Nah, we have a party.

Obviously we get upset, as nobody likes to lose money, but it is part of doing business. There are two ways you can look at it: Is it a single, isolated situation that caused the [retailer] to fail, or is it a trend we're experiencing? If it's a single company, you chalk it up as a loss. But if it's a trend, that's something we have to be more concerned about. Right now, we're seeing some bad trends, things are getting a little tighter, and there has been a slowdown in the economy. With a slowdown comes a tightening of credit. So, don't be surprised if you get a few more calls from your vendors with a slightly elevated level of panic.

Grieme: We're a secured lender but with that security comes a relatively low margin, and our revenue volume is significantly less than many of the other [major] suppliers. So, we're not set up to take large losses, and when we do, we're not happy about it. What we do

is look and see if it's something we're doing wrong, and if so, we'll change our credit policies. A single incident generally doesn't make us react and cause us to change our credit policies for everyone, but it may cause us to be more diligent with our underwriting procedures.

Satterberg: Also, from our standpoint, we have close working relationships with our dealers. So when we give you a credit line, we become your partner, which means there are now certain requirements and commitments we make to each other. We're going to give you money, but for that, you need to reciprocate by paying us on time and providing timely financial information. We need these commitments because we're trying to manage this relationship as best we can. So, if there is a problem and bad things happen, open communication becomes vital. What we don't understand is when we're trying to talk to a dealer and that dealer isn't calling us back — that makes us very nervous. But if there is a problem, we know there's always a [reason

for] the bad trend or poor cash flow.

So it's important that we hear from you, so we can work with you. Of course we get upset if we have problems, but usually we're trying to work for you and understand if payments are a little late or a little short. All of these things are in your best interests to avoid a catastrophe. Frankly,

sometimes these problems are unavoidable.

Salter: We do perform a post-mortem analysis on some of the larger losses and lessons learned, and it's a very in-depth analysis. We try to understand what part of our business process can be changed and what part is just the cost of doing business in this industry. One of the things we've

identified is the cash-flow issues our band rental instrument dealers often wrestle with and the fact that they are trying to pay for the product in a shorter period of time than their income stream allows. So we've partnered with BGE Financial for some special financing programs that allow Yamaha dealers to better match income streams with their payment terms.

Me: There are two points I'd like to make just to show what kind of risk these people take every day. First, Jim's company is involved in inventory flooring — or floor-planning. This means when you buy goods from your supplier, his company will pay off your supplier, and then you, the retailer, pay his company back over time as the product is sold. So, he's basically a lender.

The way his company makes money is by maximizing the difference between its cost to borrow funds to pay off your suppliers and the interest it collects on the money you owe. This difference is called the spread, which is the difference between the interest they charge you and the interest they pay on funds borrowed to pay off your suppliers. Just like most banks, that spread is very, very small, maybe five, six or seven points. When you think about the kind of money they put at risk compared to the return they get on those funds, you begin to appreciate just how huge the risk is for Jim's company with [its] relatively small profit return. Now think about the trauma caused every now and then when they have to write off a floor-planning receivable and recognize a bad-debt loss.

My second point is the same thing is true with suppliers like Kaman and Yamaha. When they are forced to write-off a receivable for \$100,000, they probably have to generate another \$1 million in sales just to make up that \$100,000 loss, when you take into account their cost of goods sold, sales commissions and related taxes, interest costs, and other direct and overhead expenses. It's not an easy task. The way they do their jobs well is by managing risk, and this is risky business. Right?

Everyone: Right! **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.

IMPROVE YOUR BOTTOM LINE.

SHIPPING COSTS CAN ACCOUNT FOR UP TO 4% OF GROSS SALES AND ARE ONE OF THE TOP OPERATIONAL EXPENSES. GET TUNED IN TO HOW MUSIC FREIGHT CAN REDUCE YOUR COMPANY'S SHIPPING COSTS.

ACCESS BAGS & CASES, AMERICAN MUSICAL, BASSON SOUND, BOYNTON PRO AUDIO, CLEARSONIC MFG., DIAMOND AMPLIFICATION, HEAD KASE, JR MUSIC SUPPLY, KRANK AMPLIFICATION, MADISON AMPS, MUSICAL DISTRIBUTORS, MUSICAL INDUSTRIES, POWER ALLEY, PRO STAGE, RED ROBOT ENTERTAINMENT, ROAD READY CASES, SAGA MUSIC, STAGE RIGGING, SWEETWATER SOUND, TEI ELECTRONICS, THE MUSIC LINK, THUNDER AND LIGHTING, AND WHACKY MUSIC HAVE ALL REDUCED THEIR SHIPPING COSTS USING MUSIC FREIGHT.

CALL US TODAY TO LEARN HOW.

MUSIC FREIGHT

FANS
HELPING OUR CLIENTS ACHIEVE
A HEALTHIER BOTTOM LINE.

MUSICFREIGHT.COM **(866) 647-6933**