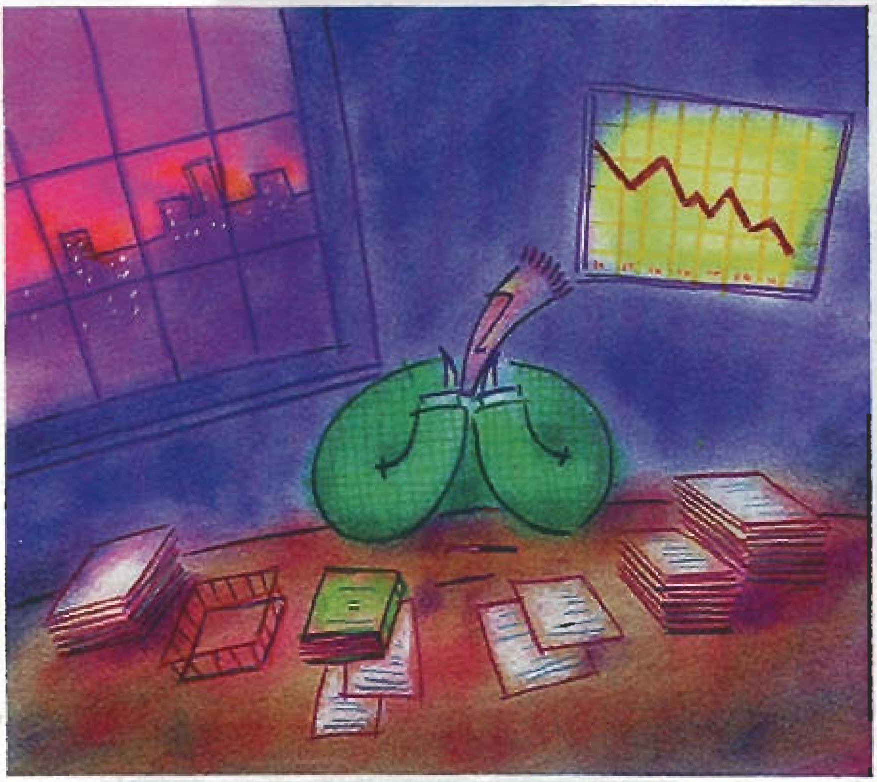

THE INVENTORY BUYING ADDICTION

REMEMBER HOW AS A KID YOU NEVER LIKED GOING INTO DARK BASEMENTS? My fear of basements came a little later in life. I was 32 years old when I walked into the 11,000-square-foot basement of a mid-size music retailer client. All I saw were unending rows and boxes of synths, samplers, drum machines galore, every sound module imaginable and scores of portable recording units, all stacked to the ceiling (not exactly "long shelf-life" goods). As a musician, I started to salivate with ecstasy.

Then I remembered I was an accountant, and I started to choke. To make things worse, the store owner was (and still is) my closest friend. To this day he remains, in my opinion, the best musical instrument and product salesperson I have ever met. But he suffered the same character flaw of most music retailers I've met: a lack of "financial" expertise to run a music store. Combine that lack of formal training in accounting and finance with too many product choices and the typical retailer's natural love for inventory, and you've now created a deadly predisposition to buy too much of the wrong inventory. This will suck the profits right out of any music store and eat a retailer's cash flow alive.

Can anything be done to stop this habitual pattern of overbuying? Yes...as long as you're willing to take a hard look at yourself, recognize the flaws in the way you buy product, adopt an objective approach to managing your inventory, and be strong-willed enough to say "no" to some of the demands and terms dictated by your suppliers. Let's discuss some valuable lessons you probably need to learn.

Love is the Drug

We all know the qualities and characteristics of a "typical" music retailer: a current or former musician, with an entrepreneurial spirit, strong sales and marketing skills, and a keen sense for hot product. Let's continue: a deep affection for gold hardware on curly-maple top guitars, a passion for vintage amps (at any price), a commitment to carry every popular keyboard, sound module, drum machine, sequencer and notation software released in the last year, a pride for having print music for the top 100 songs on the rock, country, rap, blues, dance, funk, gospel, metal, alternative, hip-hop and polka charts, and an addiction to stocking complete and various sized drum kits.

Lesson #1: Fall out of love with your inventory!

Unfortunately, the "typical" retailer also has a less-than-complete appreciation for the importance of inventory turns, product profitability, liberal vendor terms, adequate financing, accounting skills and cash flow management. You may really love the 39 Fenders, 31 Gibsons, 27 Peaveys, 23 Ernie Balls, 18 Taylors, 14 Martins, 11 Ibanezs, 9 Guilds and 5 Warwicks hanging on the wall, but I assure you those overstocked guitars mean absolutely nothing to your vendors, employees, banker and tax authorities when you can't pay their bills and they shut you down. Only your guitar-playing accountant is stupid enough to take payment in the form of strings, cables and picks.

The Real Cost of Over-Buying

As retailers calculate an appropriate selling price for an item they carry, they tend to consider only one component of that item's cost: the purchase price paid to their supplier. Here's a critical flaw in the retailer's thinking. There are several other inventory-related operating expenses that increase as inventory levels grow, thereby reducing a store's overall profitability. Here's just a few of them:

- Storage and warehousing costs
- Shipping and interstore transfer costs
- Insurance costs
- Set-up costs to make inventoried items "retail-ready"
- Bar-coding and data entry costs to assure proper accounting, product tracking and reporting
- Financing and flooring costs (interest)
- Property taxes on year-end inventories
- Cost of taking a physical inventory
- Security costs (i.e. alarm systems, electronic tags)
- Personnel costs to perform all these functions

It's basically a juggling act. The high cost of stocking and selling inventory means you have to buy enough inventory to (a) always have profitable goods in stock, (b) get the lowest possible cost (which translates into higher profit margins), and (c) take advantage of economies of scale (i.e. shipping costs), while at the same time you must not buy too much inventory to (a) avoid tying up valuable (and possibly limited) cash in slow moving product, (b) avoid having product go out of demand or obsolete while in inventory, and (c) mininiize your inventory management resources.

Lesson #2: Always bear in mind "all" inventory costs when ordering and pricing goods.

Kicking the Buying Habit

Ask any music store owner and I'm confident they'll tell you music retailing is way harder than they ever expected. Every retailer is looking for the easy formula to calculate "what" and "how many" to buy. So, I am now pleased to provide the Supreme Solution to the Inventory Problems that have plagued music retailers since the beginning of time.

Before we begin, I insist you discard any thoughts, contemplation or concerns about quantity price breaks, early payment discounts, reorder opportunities, leverage with certain suppliers, products sold by your competition, and free vendor trips, prizes and T-shirts. These factors merely cloud the truly important and basic issues affecting "what" and "how many" to buy. And don't start giving me that "what works in theory doesn't always work in real life" excuse. Be open-minded. Try it and see if it works. It will.

The answers to the following four questions are the only issues that matter when deciding "what" and "how many" to buy. Let's shed some light on each one, and then I'll give you the handy-dandy formula that combines these buying issues into one easy answer:

QUESTION #1 - Can I sell this product ?

In its simplest terms, is this product really marketable, useable or in demand by "your" customers? Or is your sales rep having a slow month and looking for a sucker? If you realistically can't sell it, don't buy it.

QUESTION #2 - Will I make a profit?

For purposes of this discussion, the terms "profit" and "gross profit" mean the same thing. If you sell an item for $100, and it costs you $60, you made a $40 gross profit (and at a "40%" gross profit percent). So, if you can sell it, but not at a profit, don't buy it.

(Note: I'm assuming at this point you must find this whole simplistic discussion of retailing quite silly—I, on the other hand, find the vast majority of retailers' departure from these simple principles quite silly.)

THE ALL-ENCOMPASSING, EASY-TO-REMEMBER, EASY-TO-APPLY, UNBREAKABLE "HOW TO BUY" GOLDEN RULE OF THUMB

When deciding "whether" and "how much" to buy of a particular product, follow the 3 steps shown in this example.

step 1 Calculate the Gross Profit Percent	step 2 Multipy the Gross Profit Percent Times 360 Days	step 3 Ask Yourself: Can I Absolutely Sell This Product in 90 Days?
Expected Sales Price $1,000 100% Cost 750 75% Gross Profit $250 25%	25% x 100 Days = 90 Days	–If "YES", buy it. –If "NO", dont buy it.

You can now see the correlation between the "expected gross profit" from the sale and an "acceptable length of time" to sell a product. The higher the gross profit, the longer you can afford to have it sitting on your sales floor. The lower the gross profit, the quicker you must sell it.

QUESTION #3 - How quick can I sell it?

Here's a general guideline: If you can sell a product in:

30 days	=	buy "tons"
60 days	=	buy "many"
90 days	=	buy "some"
120 days	=	buy "few"
121+ days	=	don't buy any!!

QUESTION #4 - How soon do I have to pay for it?

The trick is to sell most (if not all) of the product "before" your vendor's payment due date. Otherwise, you'll have cash flow shortages, requiring you to either (a) borrow or invest more money, (b) string your vendors out, or (c) close your doors and say "good-bye."

Notice the order of these 4 questions. As long as you get a "yes," "yes," and "30 to 120 days" answer to questions #1,#2 and #3, respectively, go ahead and buy it. The answer to question #4 has an impact on cash flow only. If cash is tight and terms are COD, don't buy it!!

Now, I'm sure everyone can think of some exception to each of these rules. So I now provide Lesson #3, my all-encompassing, easy-to-remember, easy-to-apply, unbreakable "How to Buy" Golden Rule of Thumb (see chart).

Some Final Thoughts

The key to good inventory management is inventory turns. The faster you turn, the faster you have cash to buy profitable, fast-moving goods. Also, it's human nature to avoid selling an item at a loss.

But the dollars tied up in slow-moving or obsolete items are preventing you from purchasing fresh items that you can sell quickly. Blow that dead stock out!! The loss you take will easily be made up in a lot less time than if you were to hold out for your price (which you'll never get anyway).

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