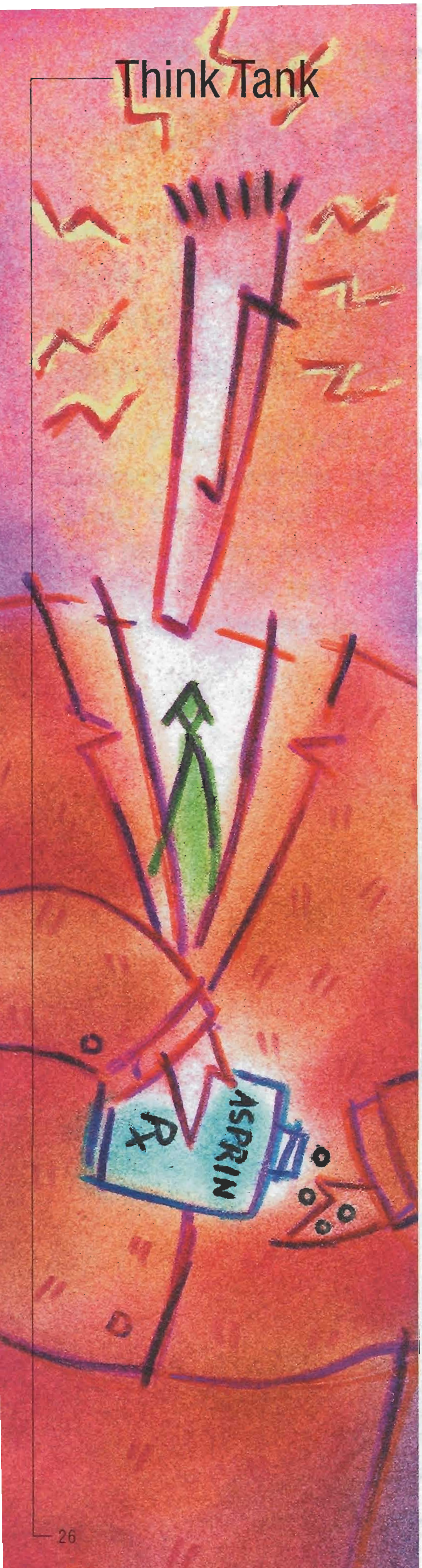


by Alan Friedman

The Dumbest Things Music Retailers Do

I once heard a motivational speaker make the following observations on human behavior:

"What we all ultimately want in life is to be happy. How do we obtain happiness? From exercising good judgment. How do we obtain good judgment? From experience. How do we obtain experience? From our mistakes. Therefore, happiness comes from our mistakes."

(Hmmm—this guy has obviously never invested in the stock market.) He also went on to say that we are more inclined to remember lessons learned from our errors than those we are taught or read about.

While I do believe and value these insights, I'd also like to believe that you don't have to burn your hand on the stove to learn that it's hot. So before you grab the Neosporin Ointment and bandages, let me provide you with some eye-opening, sure-fire, valuable pearls of wisdom (okay, how about just some common sense advice?) so you can feel the heat without the second-degree burns.

Living La Vida Bankruptcy

This may come as a shock, but there's many music retailers making critical financial mistakes in the way they run their business—oooh, so shocking! The irony is they're all making the same silly mistakes, and some of these mistakes are leading to business failures. Seriously, this is no laughing matter.

Recent statistics are—once again—showing a decline in the number of U.S. music product retail storefronts. When you eliminate the number of new storefronts from the continued expansion of Guitar Center, Sam Ash and MARS, the decline is even greater. Given the stiff competition from these big-box retailers, coupled with the growth in catalogue houses and e-commerce transactions, the independent music retailer can't afford to keep making costly mistakes to gain the practical experience necessary to live the good life. Today's music retailer needs to gain experience from the mistakes they and other retailers have already made.

Identity of the Mistaken

Over the past several years, our accounting firm keeps seeing the same financial mistakes made by music product retailers, large and small. And don't think bigger means smarter—just look at the recent demise of some well-known, high-volume dealers. Bigger retailers simply make bigger dumb mistakes. These mistakes are made due to a variety of reasons: (1) out-of-control growth and spending; (2) financially inexperienced owners and management; (3) lack of timely and/or accurate financial data; (4) weaknesses in accounting systems and internal controls; (5) internal fraud and theft; (6) poor or no advice from their key advisors (CPAs, bankers, lawyers); and (7) good, old-fashioned stupidity.

Fortunately, the common causes of financial distress can be prevented with a little education.

and proactive management. Accordingly, I've compiled my list of "The 25 Dumbest Things Music Retailers Do." I guess it might be funny to simply list these dumb things, stop there, and let you have a good chuckle at your own expense. But because these problems truly threaten the financial health of your business, I've highlighted some time-tested corrective measures to help you from becoming another music industry casualty.

By the way, as we go through the list of music retailing mistakes, you'll notice the absence of "Poor Cash Flow" as a retailing problem. That's because poor cash flow is NOT a problem—it's a symptom. The following problems cause poor cash flow. Also, I want you keep track of how many of these mistakes you and your store are currently making. At the end of this article, you'll be able to rate your management ability, as pitiful as it may be. OK kids, here we go:

#1. Too much inventory. This is clearly the number one problem plaguing music product retailers. Enticing buys, too many product choices and an insatiable lust for cool product are causing music retailers to buy too much inventory. This causes a slow down in overall inventory movement and cash flow, missed vendor discounts and blown buying opportunities. So, forget about holding out for a 40-percent gross profit margin because "turns" are the name of the game. Blowout the dogs, start moving goods and you'll quickly realize it's gross profit dollars that matter, not gross profit percent.

#2. Wrong accounting method for rent-to-own contracts. A student walks in and rents a saxophone for $50/mo. for 36 months, and you book an $1,800 sale, right? WRONG! Under proper rent-to-own accounting (and tax) methodologies, you merely record the $50 of rental income, show your continued ownership of the sax on your books as a fixed asset and start depreciating. Otherwise, you're erroneously overstating profits and paying taxes prematurely.

#3. Internal Fraud. Statistically, 30 percent of a retailer's theft comes from customers, 70 percent from your long-time, most-trusted employees. Get involved. Separate bookkeeping functions, take physical inventories in teams of two and fire the first employee who offers to take out the garbage without being asked.

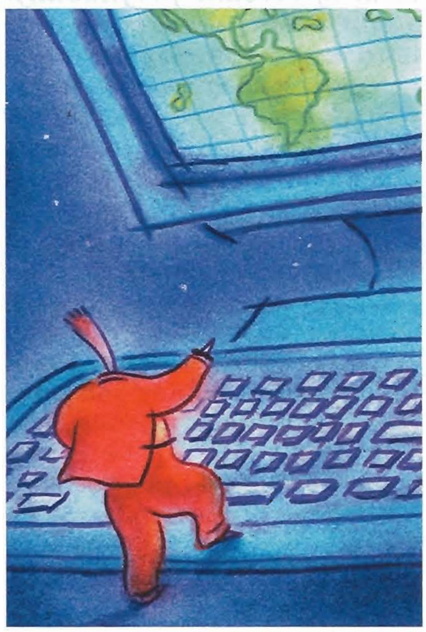
#4. Mismatched Financing. To finance the $100,000 of rental instruments you just bought, you go to your local bank and get a line of credit—moron. And your banker's a moron too! Long-term assets (that, by definition, convert to cash in a year or longer) should be financed with long-term amortizing notes (over three to five years), not with short-term lines of credit that have to be paid off within the next 12 months.

#5. Poor Compensation Plan. All of your employees are salaried. Where's the incentive to produce? All of your sales staff are paid commissions based on their gross sales. Where's the incentive to be profitable? Sales staff should be paid based on the gross profit dollars they produce. And don't be a Scrooge. Take care of your No. 1 asset—your employees—and they'll take care of you.

#6. Aging Accounts Receivable. You're extending credit to poor musicians, mismanaged bands, fly-by-night clubs and the new "School for the Study of Music and Chia Pet Sculpting." Are you nuts? Do an extensive credit check before you let anyone walk out of your store with unpaid product.

#7. No clue who your customer is. You may love carrying Fender, Gibson, Peavey, Ernie Ball, Ibanez, Paul Reed Smith, Jackson, Tom Anderson, Brian Moore, Hamer, Gretsch, Squire, Epiphone, Yamaha, Dean, B.C. Rich, Danelectro, Schecter, ESP, Fernandes, DeArmond and Aria Pro electric guitars, but do I really have to finish this sentence? Determine who your customer is, and pick a few lines that fit. You'll go out of business trying to be all things to all customers, so don't.

#8. Poor accounting software. You're using Tri-Tech for point-of-sale and rentals, QuickBooks for G/L and payroll, Microsoft Access for inventory and A/R as well as A/P are handled manually. None of these packages talk to one another and, accordingly, you're doing double work. I know it sucks, but it's time to invest the time and money in a single "integrated" accounting software solution that can produce timely and accurate financial statements and management reports. Stop complaining and just do it!



#9. Outdated computer hardware. I frankly just don't get it. Even if you're a small retailer, you still have hundreds of thousands of dollars flowing in and out of your transaction-laden, data-intensive business. Yet you still won't spend a measly $2,000 on a fast, capable computer. It's time to junk the IBM PC-XT, wake up and smell the megahertz!

#10. No bar coding. Simply put, bar coding saves time (at product tracking, point-of-sale processing and physical counting of inventory), saves money

(through reduced labor) and provides greater accuracy in capturing data (through no keystrokes). Contact NAMM at 800-767-6266 to get your free guide for implementing bar code in your store.

#11. No succession plan (exit strategy). Two facts still remain true: (1) we're all going to die at some unknown point in time, and (2) our surviving families will face estate (death) taxes unless you plan now. Through the use of wills, trusts, insurance and other estate planning tools, you can minimize (or eliminate) estate taxes, chose a smart path for the profitable disposition of your business and ultimately leave more money to your family.

#12. No separate measurement of revenue profitability. You're selling product, renting instruments, delivering and tuning pianos, installing sound systems, giving music lessons and providing repair services. Yet your financial statements lump all revenues together, and fail to separately report the corresponding costs to these revenue sources. How do you even know if these departments are profitable? Answer: you don't. Follow the NAMM Cost of Doing Business Guide and separately report these activities from one another.

#13. Excessive debt. You keep running out of cash, and what do you do? Borrow more from your bank, get more floor planning credit, string out your vendors and take cash advances from your personal credit cards. No, No, No! Instead, blowout slow moving product, buy less (or a smarter mix of) inventory, get on the phone and collect old receivables, and start communicating with the suppliers that you've been avoiding.

#14. No budgeting. How can you achieve profitability if you don't plan for it? The time to learn about a lack in sales—or react to an overspending in key expenses—is NOT 12 months after it happens. Put together a budget of revenues, cost of goods sold and detailed operating expenses (using a Microsoft Excel spreadsheet, for example), monitor and update it monthly, and stick to it.

#15. No employment benefits. It's tough enough finding an employee with the talent and skill set to practice your commitment to excellence. A steady paycheck isn't enough in today's employment marketplace. You need to offer company-paid health insurance, vacation and sick time. Pension (401k) plans and other pre-tax benefits are becoming standard fare. And let's not forget career guidance and advancement. If your employees think you don't care about their continued contribution to your store's success, they'll leave and find someone who does.

#16. Poor vendor relations. When cash gets tight (and it always does in music retailing), store owners let human nature override good business judgment. They start avoiding contact with suppliers whom they owe money. Stop doing this—you need these vendors. Simply pick up the phone, explain your predicament, what you're doing to correct it and when they can reasonably expect payment. Open and honest communication (even of bad news) can go a long way to keeping and preserving these vital relationships.

#17. No tax planning. The time to do tax planning in order to minimize income taxes is not after your fiscal year has ended. A few weeks before the end of your tax year, get together with your accountant and develop a strategy to minimize taxes by paying year-end bonuses, accelerating depreciation and other expenses, and deferring income into the next year.

#18. Everyone purchases. I can't get over how many stores suffer from too much inventory, but they'll let any employee call a supplier and order stuff. Gee, why not give them direct access to the cash in your wallet, because that's essentially what you're allowing them to do. All employees (including department managers) should submit inventory requests to one person (preferably the store owner) to authorize purchases. How many times has someone ordered product that was already in stock or out of demand?

#19. Inadequate insurance. Unfortunately, we've been involved in the often frustrating and emotional struggle to get an insurance company to pay a large claim after a catastrophic event (fire, flood, earthquake, theft). They're your best friends when writing a policy, and your worst nightmare when it's time to collect on a claim. Make sure you have adequate insurance coverage and understand all the provisions and limitations of your policy.

#20. No physical inventories. In short, there's no way you can know the profitability (or lack thereof) of your business unless you're routinely taking periodic counts of your inventory (more commonly referred to as taking a "physical inventory"). You want to make this burdensome task easier? Divide your store into several departments (if it's not already) and take an inventory count of at least two departments each month, allowing you to effectively take inventory counts throughout the year. This way, you probably can hit each department at least twice a year, instead of just once at year-end.

#21. Untimely financial data. Running a business without timely financial data is like trying to fly an airplane without a map—you may get somewhere, but it's probably not where you want to be. And waiting until your accountant shows up at year-end to produce the store's only financial statements is practically useless and a waste of time and money because most of the information is a year old! You need to be reviewing key financial reports at least every month—cash requirement reports, A/R and A/P agings, sales analysis by department and salesperson, inventory turns and margin reports, the balance sheet and comparative income statements by period and year-to-date.

#22. No new technologies. Come on, get with the program. The internet has proven it's here to stay. E-mail can instantaneously communicate vital information; old or used goods can quickly be sold on a well organized website; complete accounting records can be attached to an e-mail and sent to a financial advisor more than 2,000 miles away; order stock status can be checked on a vendor's website; and other state-of-the-art programs (i.e. Alfred Publishing's new EDI plan) can be had by simply embracing new technologies.

#23. Poor professional advice. Your banker won't take the time to understand your business and financial statements. Your lawyer bills you $500 an hour to review your instrument rental agreement (which is still out of compliance with state laws). Your accountant specializes in dairy farming and thinks an aural exciter is some kind of kinky sex toy. Get rid of 'em all. Your professional team should be made up of people who understand retail (maybe even rental accounting) as well as care about you and your business.

#24. Penny wise and dollar foolish. Even if you happen to have the right professionals on your team, you won't spend the money to buy their services. Although most retailers wear many hats (i.e. sales and marketing), most lack the expertise to wear all of them (accounting, finance and management). Don't be afraid to buy the right financial services if you don't possess the necessary skills and expertise. And stop complaining that you can't afford them; sometimes you can't afford not to have them.

#25. Poor quality of life. You get no time off because no one can run the store. You have no time for your family because you can't manage your time. You have no retirement savings because there's never any extra cash around. You have no sex life—well, that's a whole different story. If your business is running you instead of you running running your business, it's time to take a step back and assess. Focus on the big picture. Reaffirm your short and long-range goals, get help if you're having trouble, or get out of the music retailing business. Life is way too short for you not to enjoy it.

My New Book: Dummies in Retailing

Now go back over the list and give yourself one point for each financial blunder that you're currently making. Grade yourself accordingly:

0 points = You're either lying or you're not a music retailer.

1 to 5 points = With a little fine tuning, you'll continue to run a successful business, retire with lots of money and join a rock 'n' roll band.

6 to 10 points = You need to start paying a little more attention to matters at hand so that you can make it to retirement; forget about the band, you're too old anyways.

11 to 15 points = You've got some serious financial issues. Take the bull by the horns, get together with your staff and start putting in a concerted effort to correct the problems at hands before they get

any more serious. Start attending some NAMM University courses at the next trade show.

16 to 20 points = There's little time left. Both you and your staff should start attending every regional NAMM University course and professional development seminar at the NAMM Trade Shows (and pick up a few dozen books at the NAMM Bookstore). Go back through your old Music Inc. magazines and read the last three years worth of Think Tank articles at least five times, then go back and read them again. Contact your professional advisors and get them in your store immediately. Things are almost beyond your control so you need all the help you can get. But try to look like you're having a good time.

21 to 25 points = Guess what? You're not a music retailer either! Why? Because you're technically out of business. You're just waiting for the last of your inventory to be sold so that you can hand out pink slips to your employees, default on your bank notes, stiff your vendors who were kind enough to stand by you, file bankruptcy, stick it to your in-laws who gave you the last of their retirement money and lose your house, your wife, your car and your '57 Strat. Hey, look at the bright side—the rest of us will learn from your mistakes. You're one of the ones that should have touched the hot stove, you big dope.

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