

IDEAS

>>> Inside IDEAS

> The Lesson Room Page 40

> Trends Page 42

ASK ALAN | BY ALAN FRIEDMAN

THE RISKY BUSINESS OF CREDIT MANAGEMENT

Obtaining the necessary financing credit and borrowings to run a music store has been on everyone's minds, retailers and suppliers alike, lately. So much so that I've devoted this third installment of my series on retail credit to the topic.

We'll continue our discussion with the esteemed panel of credit professionals who spoke during my educational session at the 2007 winter NAMM show. To recap, the panel, also known as "The Loan Rangers of Music Retailing," consisted of Larry Dunn, CFO of Kaman Music; Karren Salter, general manager of customer financial services for Yamaha Corp. of America; Jim Satterberg, vice president of GE Capital; and Greg Grieme, president of BGE Financial. Together, they represent the financial voices of a major supplier, distributor, inventory flooring financier and rental instrument lender.

The following is an edited transcript of our NAMM discussion on how vendors go about minimizing risk.



Friedman asks credit managers how they minimize risk

Me: Business financial statements can be internal, compiled, reviewed or audited. In layman's terms, **internal financial statements** are created by store management and have no assurance from a CPA firm. **Compiled financial state-**

ments are produced by store management whereupon a CPA firm makes sure the statements are presented in an acceptable format. The information, however, carries no verification or assurance by the CPA firm.

Reviewed financial statements are created by store management whereupon a CPA firm performs analytical tests and inquiries to provide some assurance of the business' financial condition. **Audited financial statements** are created by store management whereupon a CPA firm performs the highest standards of financial examination to render whether the statements represent the true financial condition of that business.

By their very nature and related cost, audited financial statements are designed to provide the highest level of accuracy for the comfort of bankers, suppliers and other readers. Think of Enron's audited financial statements, and you'll begin to understand why Arthur Andersen is gone.

So, I ask our panel, knowing that the expense for professional accounting services often

increases with higher levels of financial statement assurance, what level of assurance do you require? Or, are you happy just to get financial statements when you request them?

Grieme: We're a secured lender. We go out 24 to 36 months on instrument rental pool financing, and we do require financial statements. As far as the level of assurance we require, we try to get comfortable with the relationship between the dealer and its CPA.

Alan, as you pointed out earlier, some CPA firms, even large ones, don't really have the [necessary] understanding of music retailing to produce meaningful financial statements, especially in the accounting of rental pools. So, we will often have a one-on-one conversation with a store's CPA to get comfortable with [his or her] knowledge of the music retailing industry and to determine if the financial statements are accurate.

Salter: Our company likes to monitor profitability and liquidity trends in music store clients. So, we routinely ask for financial statements for not only the

current year but the two prior years, as well. We know some of you have bank loans, and your bank loans require a higher level of financial statement assurance, especially when those loans and lines of credit are for large amounts. So, we will always look for current financial statements. If there are items on the statements we don't understand or find unusual, we will also call for an explanation of those items if they aren't discussed in financial statement footnotes.

Satterberg: GE requires financial statements and, the larger the floor planning credit lines, the higher the likelihood we'll require audited financial statements. Although audited financial statements are rare, hard to get and costly, some of our credit lines are \$5 million

to \$7 million.

Similar to what Karren said, there are changing trends we see on financial statements. Some of our music store customers are highly leveraged, and the credit line requests are really a stretch for us to meet. We'll work hard to try to meet that credit request, and in doing so, we'll sometimes ask for both comparative and interim financial statements. If a store has set high profitability goals to repay our loans, we'll ask for quarterly financial statements. Your ability to produce those interim financial statements is not only beneficial to you, it also endears you to us because it shows us you're paying attention to your financial performance, as well.

Me: Jim, I'm glad you mentioned quarterly financial state-

'Sometimes, these credit professionals are truly your friends and doing you a favor by saying "no" to a loan or credit request.'

ments. A lot can happen in one year. You all take a lot of risk by relying solely on annual financial statements and not knowing what has financially taken place over the past year until you get that year's financial statements.

I think it's important for our music retailing audience to understand that risk.

And here's an important message I want to send: Sometimes, these credit professionals are truly your friends and doing you a favor by saying "no" to a loan or credit request. They don't want you to become over-extended with debt and unable to pay it off. We all know how easy it is to buy too much merchandise, especially if you have an unlimited pocketbook in the form of vendor credit. Their denial of credit will force you to take a closer look at your aging inventory and start to move it quicker to generate cash, pay-down debt and reduce the various carrying costs of too much inventory — all good things, forced upon you by these profes-

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sionals knowing when it's time to say no.

Grieme: All of us have a vested interest in this industry, and a lot of our questions may seem intrusive and only about protecting ourselves. On the contrary, we are truly interested in making sure your businesses are successful, and we all financially flourish together. You should always take our questions as us trying to help.

Satterberg: We've talked about how important it is to have financial statements each year and how things can happen in any given year. But it's equally as important to have those financial statements provided to us in a timely manner. It's January right now. Many of you have just ended your fiscal year, and it's common for you to take 90 days to get us your year-end financial statements. But you need to be aware that as the months drag beyond March or April, your credit needs are still ongoing, and you may find your credit will shrink back a bit as those months drag without your financial statements in hand.

Dunn: We have some customers who give us a blank stare when we ask for their financial statements. They don't have them or didn't know they needed them because they just opened their music store. But that doesn't mean we can't have them start with us on a c.o.d. basis while they learn how to generate financial statements and develop a payment history with us. That allows us to extend credit to a brand-new customer over time in a responsible manner.

Me: We just took a poll of our audience, and by a show of hands, about half of our audience has annual financial statements prepared by a CPA firm. I can tell you from first-hand experience: There are a lot of music retailers who get nothing more from their accountants than the preparation of their annual tax returns. Furthermore, that tax return comes with neither an explanation of what's reported in the return nor anything explaining what's going on with the business.

That's why timely and accurate financial statements are so important. They not only convey credit information to your bank and suppliers, they also can be used as a management tool to understand what's fiscally happening with your business.

How do you know if you're making

money on rentals or repairs, if you have sufficient liquidity to run the business or if some of your operating expenses are too high? A financial statement will tell you all that.

The next question for the Loan Rangers: "If a retailer shows a loss on a financial statement or tax return in a particular year,

does that send up flags or put the dealer on a "bad boy" list? Will you still sell to that retailer? If so, do the dealer's payment terms change?" Stay tuned. **MI**

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