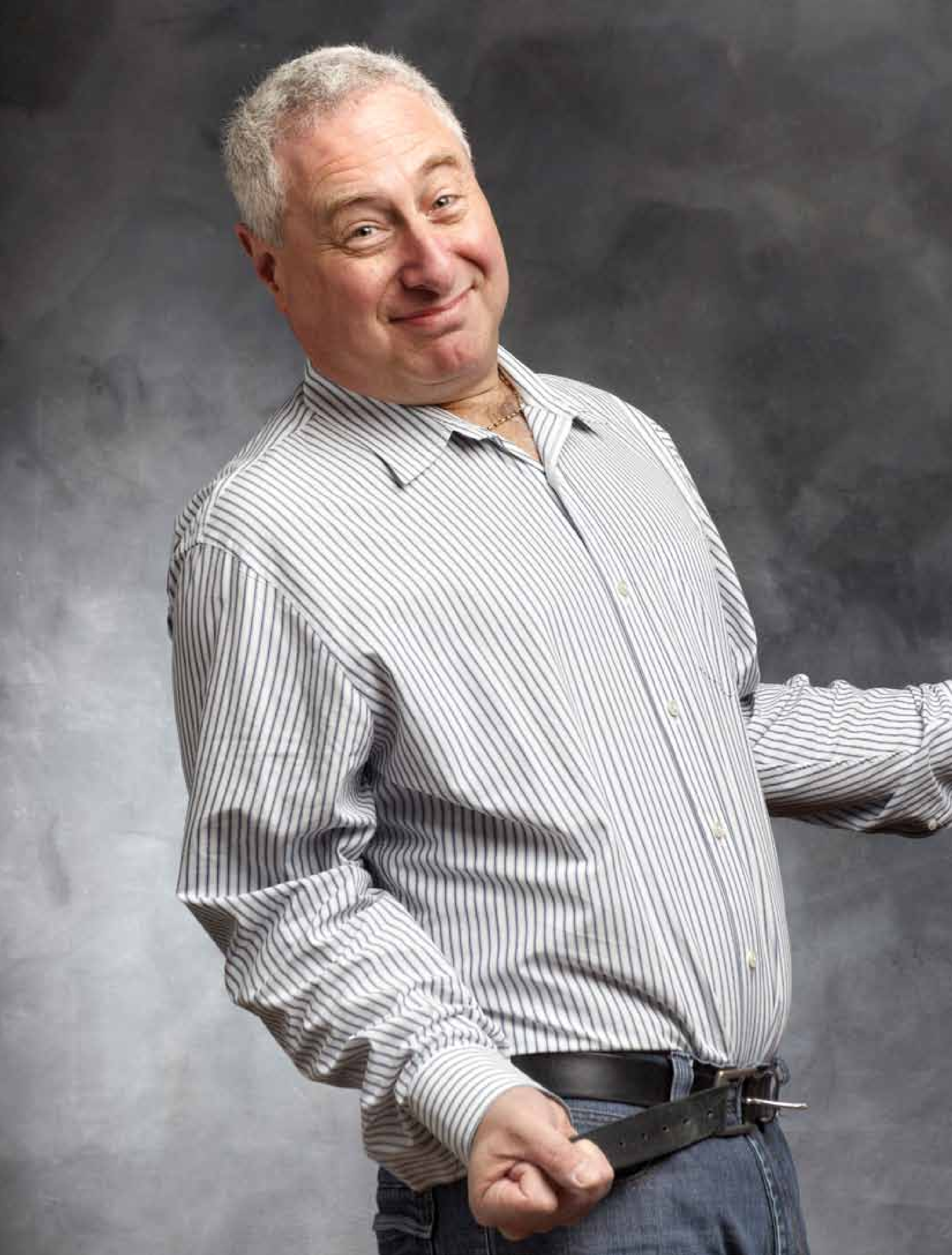
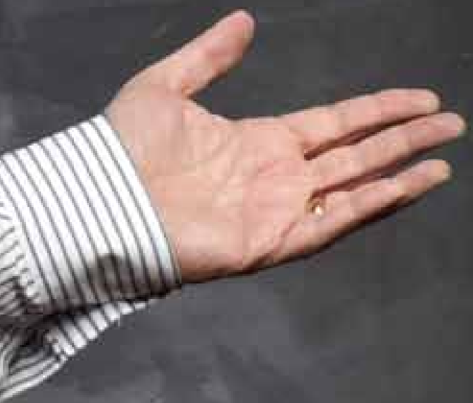


# Tightening the Belt

BY ALAN FRIEDMAN

## WANT TO SURVIVE THE DOWNTURN? THEN IT'S TIME TO GET REAL ABOUT YOUR PERSONAL AND BUSINESS SPENDING



At last year's winter NAMM show, I had the good fortune to be part of a panel discussion on the fiscal state of the music products retailing industry. During the session, I was asked to predict when the recession would end. Frankly, I could have predicted next year's Super Bowl winner with more accuracy, and I know absolutely nothing about football. (I'm a guitar player, remember.) But I took a stab at it and said "the end of 2011," based on my recollection that most recessions seem to last about five years. I figured if our economic tumble started in early 2007, it theoretically should be over by the end of 2011 — a very scientific analysis even my dog could have done.

I was then asked to give one piece of advice from lessons learned by the recession. I politely answered, "Make sure you save some retained earnings in your business to get you through the next recession." What I really wanted to do was jump up and down like a crazed lunatic and yell, "Tighten your belt — both at the store and at home — and stop whining about it!" And while I would have felt justified making this point, I'm confident I would've blown any chances for a slot on future NAMM show panels.

Thank heavens I took my meds that day.

Now, with the benefit of a full year behind me, I still hold that same notion. I believe we'll start to see meaningful economic improvement after 2011. But in light of continued financial woes (see "How We Got Into This Mess," page 50), music store owners still need to make some tough, often unpopular decisions by tightening their spending belts. They need to get over themselves and heed the important lessons taught by every bad recession.

Some music retailers will suck it up. They'll learn from these invaluable lessons and survive and flourish in later months. Others will continue their bad spending habits, simply because they can't bring themselves to downgrade their personal lifestyles. Unfortunately, this narrow-minded stubbornness and lack of fiscal discipline will cause further financial deterioration until their businesses and personal lives implode.

With that said, let's look at what we can do to minimize the recession's effect and take advantage of opportunities it will undoubtedly create, so we never have to be a casualty of future downturns.

### IT'S JUST HUMAN NATURE

When business is booming, it's all we can do to keep up with our work each day. But when business slows, two unexpected benefits arise: time and opportunities. These benefits give you a meaningful chance to examine your revenue-generating activities, improve them and reduce wasteful costs along the way. But before we discuss what you can do to improve your bottom line during a recession, you need to be aware of a couple things to avoid.

When business slows, there's a tendency to start cleaning the store or spending a lot of time in "strategy" meetings with staff. In other words, you engage in housecleaning and esoteric conversation. There's nothing wrong with staying organized and brainstorming, but too much of it can be a form of reality avoidance. You're merely waiting for things to get better, rather than *making* things better.

But rest assured, things will improve. Unless your clairvoyant speculation of the world ending on Dec. 21, 2012, comes true (in which case, now would be a good time to sell your '59 cherry sunburst Les Paul, '72 Ludwig Vistalite four-piece Zep kit and Beanie Babies collection), things will get better. The key is to use this downtime to prepare yourself for the better times ahead and do what you can to accelerate that inevitable era. Think about it: When recessions hit and the media keeps pumping out bad news, your competition's probably going to hunker down with the same old business model and wait for the good times to return. Given that short-sighted, fear-driven behavior, now's a perfect time to make gains on them by trimming the fat and creating opportunities.

**'Even if you cut spending from every other overhead expense category, it may still be necessary to reduce your compensation.'**

### BUT IT HURTS

Here's another cliché: No pain, no gain. Some belt-tightening decisions don't feel good, so we avoid them. No one likes firing an employee, freezing or lowering compensation levels, cutting back on family vacations, or fixing the old clunker instead of buying a new car. But not making tough decisions puts you and everyone who relies on you in further financial jeopardy. Chances are you're going to have to make these decisions at some later point in crisis mode. Making them now, along with seizing some unexpected opportunities, will make everything better a lot sooner.

This is a good time to first answer one important question: Do you really want to be in this business? If the answer is, "I love what I do, even during challenging times," terrific. Become even more committed to achieving financial success, no matter what it takes to accomplish that goal. If, on the other hand, the answer is, "I'm not enjoying this anymore, and my heart's no longer in it," then it's time to make some big changes. It's important we assess the things we do routinely, so we don't get to the end of our careers with regrets that we didn't pursue our real dreams. Lastly, if your answer is, "I still love what I do, but I need to make more money," keep reading.

### ANOTHER NOTCH IN THE BELT

Let's take a closer look at the specific things we can do to put another notch in our spending belts and tighten them. Under the banner of "turning lemons into lemonade," implementing these recession-driven tactics may be the best lessons in self-control for future ups and downs in your business.

There are generally four things you can do to get your business through tough times: increase revenues, decrease expenses, invest in your business and borrow money. Frankly, items No. 3 and 4 are nothing more than cash-flow Band-Aids. They help, but they don't fix the real sources of poor cash flow — declining sales and/or rising costs. So let's look at ways to increase revenues and, more germane to our expertise, cut operating expenses.

### HOW TO GROW THE TOP LINE

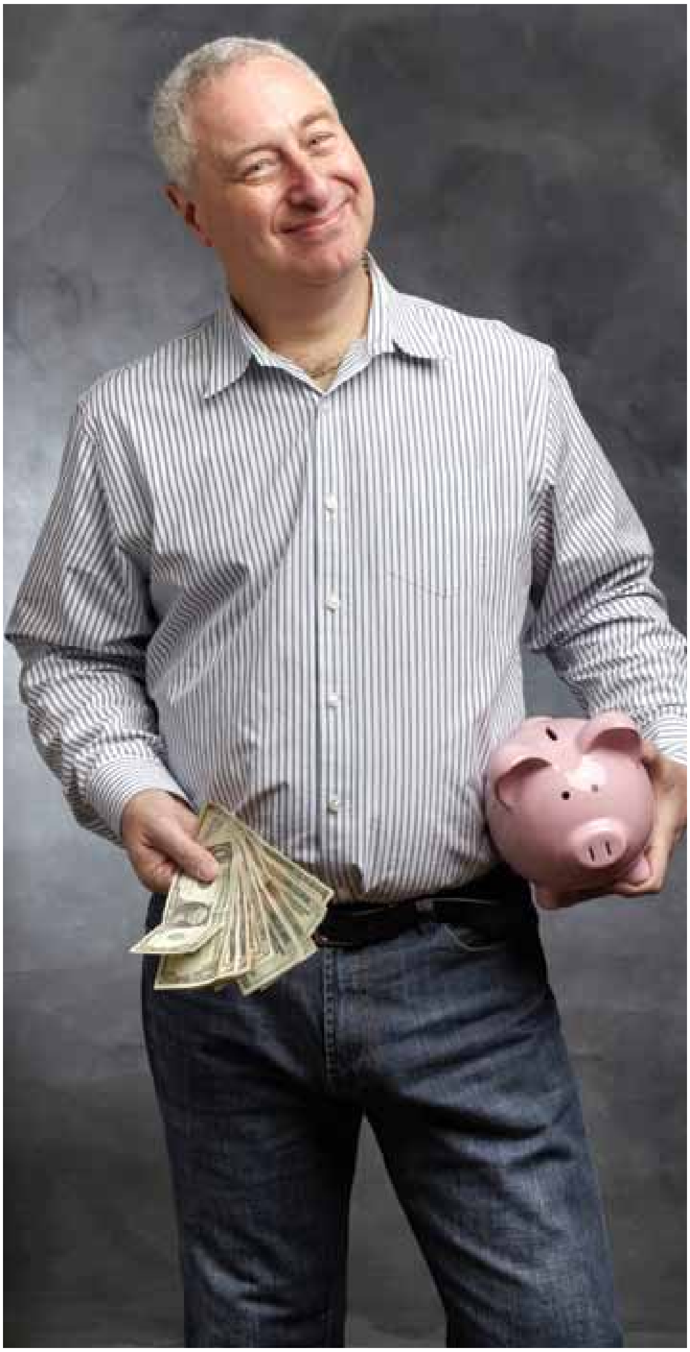
In order to increase revenue, you need to gain a deeper understanding of your customers' concerns when they're making spending decisions. Customers are more hesitant than ever to spend these days, but they're also more open to describing their spending concerns to you if you approach them the right way. During any conversation with customers, resist the initial temptation to sell to them — save that for later. Instead, get them to talk, so you can find out what they're looking for and at what cost.

As an accountant, I lay no claim to wisdom in sales and marketing. But I am a consumer, and like all consumers, I want

to feel connected to people I do business with, especially when I have a multitude of choices. The last thing most of us want is to be sold on some product we have no interest in or at a price we can't afford, so don't do that. Instead, connect by finding out who customers are, what they want, what dollar value they've attached to the product or service they're considering, and what value they'll receive for the price they're being asked to pay. In simple terms, be sweet, be engaging, educate customers and ask them to pay a fair price. If you accomplish that, customers will happily fork over their hard-earned cash over and over again. Or instead, be cranky, be disinterested, ignore customers and take unfair advantage of them, and they'll tell 100 of their closest friends why they should never shop at your store.

Seize the opportunity during slower times to look at the processes you're using to find new business, close each sale and generate associated paperwork. Examine the sales process from start to finish. Where do customers and leads come from? What happens to them when they come in? Are they assigned to a salesperson? How quickly do salespeople follow up? What questions do the customer and salesperson typically ask during the sales process? What clinches the sale? Is the customer thanked for his or her business? Is the customer asked for a testimonial or to refer others? No matter what's happening with the economy, knowing the answers to these questions — and making appropriate changes to get things running more smoothly — will boost revenue.

Lastly on the revenue side, take a look at what your competitors are doing, and implement some of the things they're doing better than you. We can all learn from the competition. And what better place to find out what other retailing leaders are doing than the educational programs presented at the NAMM Idea Center and NAMM U Online? Much of this info is readily available 24/7 at NAMM's website, namm.org — and it's free to members.



## TRIMMING THE FAT

Just like the 20 (okay, 30) extra pounds I'm carrying, overhead expenses can creep onto the income statement in the same way weight does — a day at a time. And just like fat and cholesterol, if you let expenses and operating losses go uncontrolled, they'll kill you.

Some expenses vary with revenue, such as sales commissions, merchant credit card fees and store supplies. These expenses probably won't kill you because of their variable nature. But other expenses — rent, utilities, lease payments and administrative salaries — are fixed and occur every month whether you sell anything or not. These fixed expenses will quickly create losses and put you right out of business if not managed, especially during tougher economic times.

Business owners need to pay extra attention to operating expenses, as overhead grows one decision at a time. When you make the decision to hire extra office staff, add another cell phone or move your store to a higher-rent building, it all increases your monthly overhead. And with each dollar increase in overhead, you need to generate three to four times more revenue just to stay even. This recession should be your wake-up call to cut overhead or run the risk of damaging your business beyond repair.

There was a wonderful article by Greg Billings in the February 2009 issue of *Music Inc.,* titled "29 Ways to Cut Costs." Everyone should read and reread that article. It provided dozens of time-tested pearls of wisdom on where and how to cut overhead expenses and needless spending. The only spending topic Greg's article didn't address is the one that needs to be dealt with head-on during tough economic times: the need for owners to scale back their personal lifestyle spending and related compensation. Let's talk about why this cutback is so important yet is inherently avoided and often causes heated discussions at the store and at home.

## BUT I CAN'T (= WON'T) DO IT

When examining overhead, don't forget that owner's compensation is an integral part

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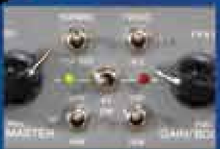


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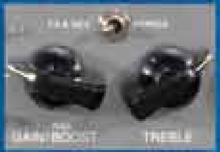
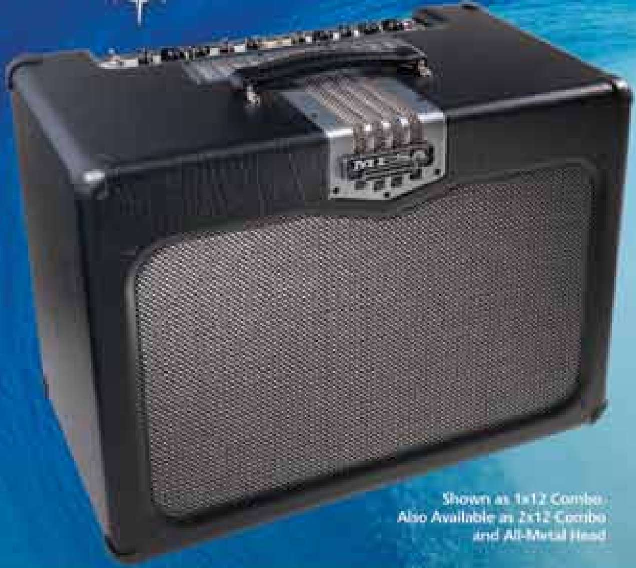



New lush, tube Reverb and transparent Series Effects Loop can be switched-in for full-featured performance or, Hard Bypassed for true-to-vintage purity.




Shown as 1x12 Combo
Also Available as 2x12 Combo
and All-Metal Head

Hot on the victory of worldwide accolades for the TA-15™ from players, critics and artists alike, the TransAtlantic wave comes ashore again. This time it's a rogue, two-pronged assault on the senses – delivering both Brit-inspired and classic American Tone in two incredible new and different amplifiers.

## The New TransAtlantic™ TA-30™

The TRANSATLANTIC TA-30 picks up where the TA-15 tops out and offers the next level of our patented Multi-Watt™ Channel Assignable Power. These soulful choices range from 15 or 30 watts Class A – to 40 watts of our patented Class AB Dyna-Watt™ Power for Heavyweight headroom and bass-control in a Bantamweight package. The new TA-30 also ups the ante with luscious all-tube Reverb and a Hard-Bypassable Effects Loop.

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# The Invasion Continues!

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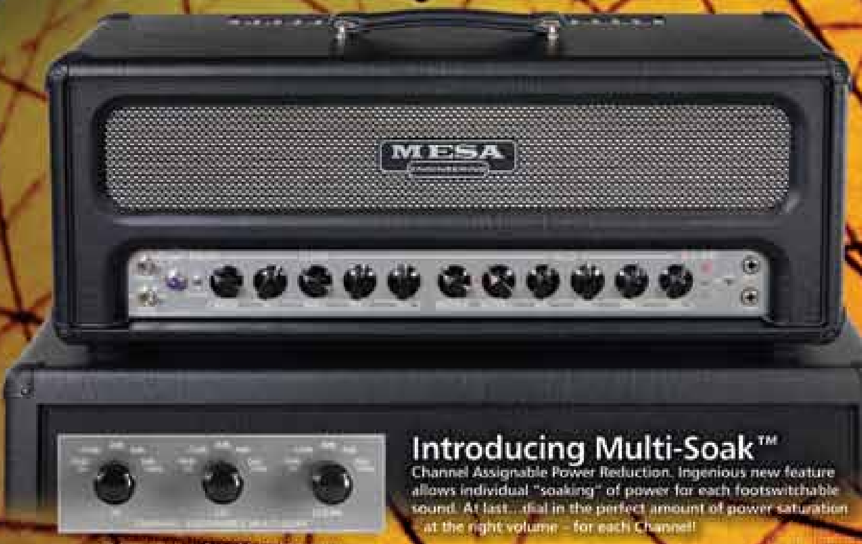


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# HOW WE GOT INTO THIS MESS

A depression is one of the worst things that can happen to our economy. It affects just about everyone in every industry in our country and other countries, given our globally interconnected economies. Recessions, on the other hand, tend to hit particular industry groups the hardest, with lesser ripple effects felt by others. But the worse the recession, the more people it will affect, and this one has been pretty bad. And the reason why this recession has felt like a depression is because lending institutions have practically stopped lending.

While some of our economic woes weren't our fault, many of them were. When we suffered an unprovoked attack on 9/11, our government immediately lowered interest rates to keep our stock markets and domestic economy from faltering. While this knee-jerk reaction worked, we inadvertently created another problem that grew into a huge financial bubble that ultimately burst: low interest rate mortgages. Many people were now able to afford high-priced homes, which drove real estate values up. But when the low rates on variable mortgages started rising again a few years later, these same people couldn't afford the increases in their mortgage payments. As they defaulted and abandoned their homes, values plummeted, often below the mortgage debts.

Worse, banks had sold off these mortgage assets to mortgage investment pools created by Wall Street. When homeowners couldn't pay their mortgages, investors in these pools found themselves with non-performing assets that ultimately imploded and failed — the media called this debacle the subprime lending crisis. As the real estate market went into the proverbial toilet, Wall Street firms, such as Lehman Brothers and Bear Stearns, began to fail, and major banks and financial institutions started posting annual losses in the hundreds of billions. This constant flow of bad economic news fueled corporate layoffs and cutbacks, causing our economy to crumble. As unemployment rose, people became extremely cautious about their spending and began postponing major spending decisions. It's no wonder the piano business has been hit the hardest by the decline in consumer spending. A depressed real estate market, high unemployment and a lack of consumer confidence will stop most people from buying an expensive discretionary item.

And when consumer spending declines, so does business-to-business spending. People who run businesses are consumers themselves and become more cautious about their personal and business spending. And when employees see their employers pull back, they often get the message to adjust their spending at home. This classic recessionary mass psychology affects everyone's pocketbook. *—A.F.*

of your operating expenses. Even if you cut spending from every other overhead expense category, it may still be necessary to reduce your compensation. Yes, cutting your compensation can be a traumatic decision that affects your psyche, motivation and commitment to the store, not to mention the negative affect it has on your family's mood and lifestyle. It hurts, but it usually only hurts once — on the day you decide to do it. Like a spoonful of nasty-tasting medicine, after you swallow hard and get used to the horrible taste, you're generally on the road to recovery.

Accordingly, here are the tough, distasteful but often necessary personal expense cuts you need to consider making in the store and at home:

**1. Travel, meals and entertainment.** Business meals and entertainment should be the first items on the chopping block. Let's get real: While some meals and entertainment have a business-generating purpose, most are just excuses to get out of the store, have a good time, enjoy an expensive meal or rock concert, and get a tax deduction. I love it when people say, "Oh, it's no big deal for you to pick up the tab for this meal because you can get a tax deduction." What a load of crap. If you're in the 25-percent tax bracket, the $100 meal (which is only 50-percent deductible) will save you a whopping $12.50. It still costs you $87.50 after-tax! So say goodbye to needless meals and entertainment.

And with regard to travel, a $75 webcam and free Skype account can often deliver the same benefits as airline tickets, hotels and rental cars. Think how little it costs to attend or host an online meeting or webinar. However, if you're going to spend money on travel, make sure you spend it attending NAMM or some other industry event that has a meaningful and educational purpose. That newfound education can deliver financial rewards far greater than its travel costs. Just be smart. You know the difference between a worthwhile business trip and an escape from reality.

**2. Personal auto expenses.** When it comes down to it, the primary purpose of a personal vehicle is to provide a means of getting from point A to point B. Let's not lose sight of that when deciding whether it's worth the extra $15,000 or more for an exclusive name-brand auto, heated seats, premium stereo and upgraded wheel trim. If you desperately need a new vehicle and cash flow is at a premium, consider leasing instead of buying. That said, I like buying (and financing) my cars because it forces me to buy something reasonably priced (as financing payments are usually higher than lease payments), and I avoid punitive charges on high-mileage leased vehicles. Irrespective of whether you buy or lease, the more reasonable the purchase price, the more affordable the monthly payment. Forget the heated seats. Your butt has enough padding to keep itself warm.

**3. Employment perks.** Some employee perks are critical, such as health and disability insurance. Some are valuable when times are good (i.e. pension plan contributions) but become burdensome when times are tough. Some are unnecessary and utterly ridiculous (i.e. airline and health club memberships) when cash flow is tight. Ask yourself, "Am I really going to be hurt by eliminating this perk?" If the answer is "no," get rid of it. And don't forget: Some valuable perks, such as pension contributions, can be reduced and/or halted for periods

of time and resumed when times get better.

**4. Funding outside investments.** Over the years, I've seen store owners kill the proverbial golden goose of a financially healthy music store by stripping out vital operating cash to fund outside investments. And when these investments are made into business models outside of the owner's core expertise, they often end in total financial disaster. Not only do the investments fail but they put a world of hurt on the music store that's looked upon to fund a cash bail-out. When you consider the economic return a music retailer can earn from investing in a rental pool or a well-run music education program (in light of a lack of expertise to run other kinds of businesses), a music store owner should look no further than the four walls of the store for investment opportunities. The only exception I can think of is a bargain deal on a valuable piece of commercial real estate that can house the business. But beware: Unless you can forecast your space needs for the next decade, you're often better off renting to avoid becoming an empty building's landlord.

**5. The bullsh*t expenses at home.** My mom told me to never swear. It didn't work. And I'm hoping she'll forgive me if my flagrant potty-mouth startles at least one reader into "getting over it" on some of these nonsensical expenditures at home. Season tickets to the ball game? Get over it. Watch the game on TV from the comfort of your home with far more friends than you could ever bring to the stadium. Country club dues? Get over it. Go play miniature golf with the entire family, and enjoy a fun dinner at Denny's. Cell phones for every kid? Make them earn it by mowing the lawn, washing the car and doing meaningful, but safe, chores at home. That's how I bought my first guitar and amp, and I learned invaluable lessons in work ethic, independence and perseverance. And what better way to teach kids a sense of accomplishment than to lead by example? Leave the roofing and plumbing to the professionals. Have your kids clean and paint the garage.

## NO LIMITS

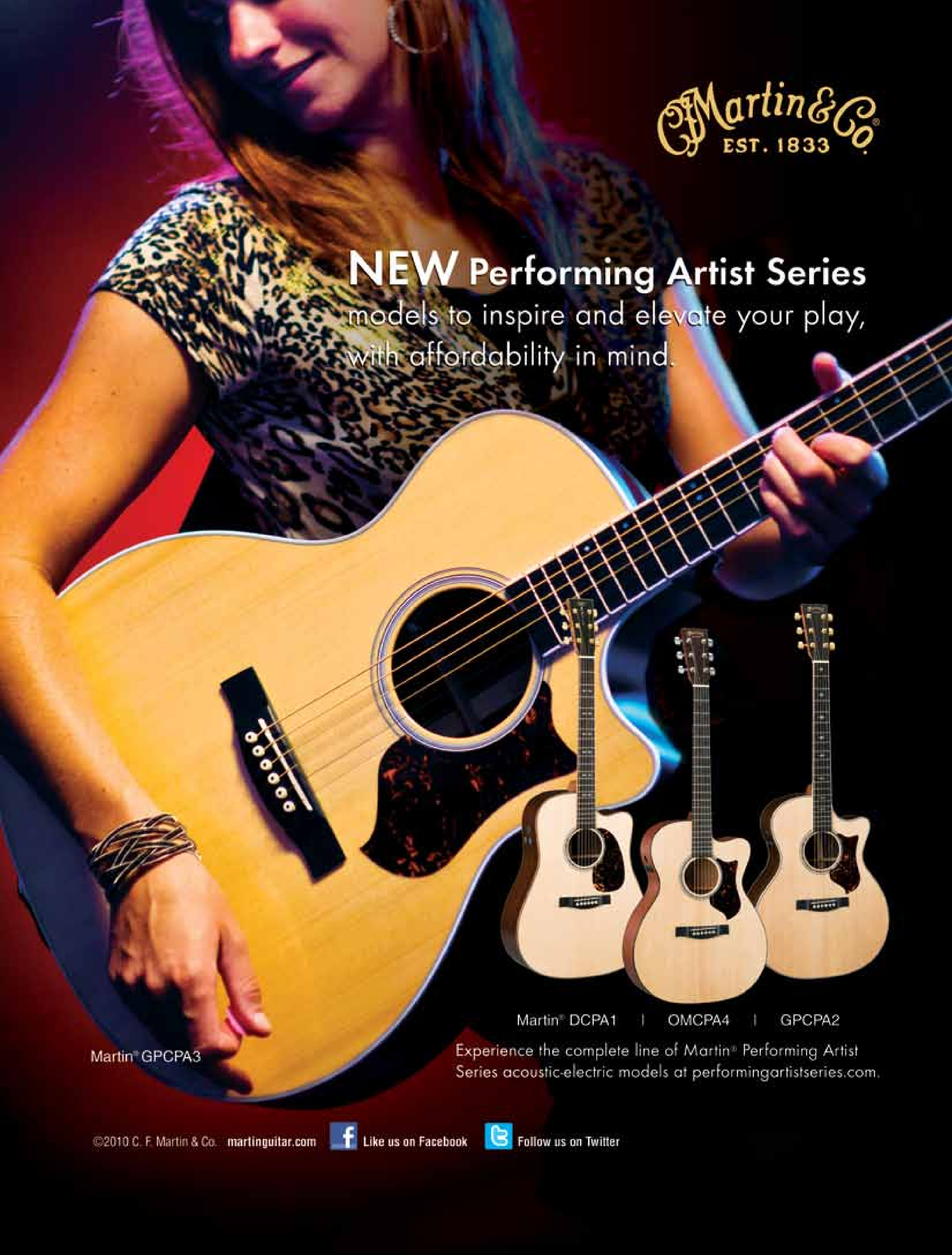
People, if you're looking for a single huge, dollar-saving cut, you probably won't find it. Instead, view every dollar in expense reduction as a new dollar in profit and cash flow for your store. Remember, at a 30-percent gross profit margin, you need $1 less revenue for every 30 cents of expense you save, or $100,000 less revenue for every $30,000 you save. Actually, when you consider the variable nature of some overhead expenses, the amount of revenue relief is even greater. That's why expense cutting is so vital during revenue downturns.

**'Music store owners should look no further than the four walls of the store for investment opportunities.'**

Right now, you're asking, "How far do I have to go with these personal expense reductions and eliminations?" The answer is simple: Enough to get rid of the losses on your bottom line. Basically, don't spend a dollar more than you have to. Don't let your personal lifestyle dictate the amount of compensation you need to draw, whether you're earning it or not. And don't use the lame excuse that it's just a few dollars and it really won't matter if you spend it. When you add it all up, it does matter — a lot.

There's no easy fix to this economic crunch, and everyone's situation is different. The bottom line is to watch your spending and live within your means. Unfortunately, most vital expenditures have increased — groceries, utilities, medicine, health insurance and copayments, auto and property insurance, and postage. Since it's hard to live without these essentials, something else has to give. The only meaningful thing you can do during these tough times is tighten the belt. So goodbye premium cable channels, weekly lawn service, expensive restaurants. Hello packed lunches, gardening, Saturday-night family Scrabble. Embrace the new, frugal you. Trim the fat, breathe easier, get lean and mean, and eventually, you'll be able to loosen the belt without your pants — or your business — falling down. **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 860-677-9191 or alan@fkco.com. Visit his Web site, fkco.com.



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