Tightening The Belt

BY ALAN FRIEDMAN

At last year's 2010 Winter NAMM Music Trade Show, I took part in a panel discussion on the current fiscal state of the music products industry. Given the deep recession affecting both the U.S. and global economy, I was asked for my prediction of when it would end. Frankly, I could have predicted next year's Super Bowl winner with more accuracy—and I know absolutely nothing about football (of course, I'm a guitar player). 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 woes started in early 2007, theoretically, it should be over by the end of 2011–a very scientific analysis.

I was then asked to give one piece of advice from lessons learned by this recession. Politely I answered, *"Make sure you save some money both in your business and at home to get you through the next recession."* What I really wanted to do was jump up and down like a crazed lunatic and yell: "Cut flagrant spending and stop whining about it." While I would have felt justified in making this very important point, I'm quite confident my abrasive remark would have blown any chance for a slot on any future panel discussions. Thank heavens I took my meds that day.

Now, with the benefit of a full year behind me, I continue to believe the notion I held one year ago. I still believe we'll start to see some meaningful economic improvement after 2011 ends. But in light of the continued poor earnings for most musicians, the music industry and our economy, most people still need to make some tough, and often unpopular, decisions by tightening their spending belt. They need to get over themselves and heed the important lessons taught by every bad recession.

Some of us will suck it up, learn from and implement these invaluable lessons, and will survive and flourish in later months. Others will continue their poor spending habits, simply because they can't bring themselves to downgrade their personal lifestyles. Unfortunately, this narrow-mindedness and lack of fiscal discipline will cause further financial deterioration until businesses and personal lives literally implode. With that said, let's talk about the cause of our current recession, what we can do to minimize its affect and seize the opportunities it will undoubtedly create, and never again be a casualty of future recessions that will most assuredly occur.

RECESSIONS ARE DEPRESSING

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 as well as 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. Here's why: lending institutions have practically stopped lending. While I could write several pages explaining why banks have stopped lending money, I'll try to briefly explain in layman's terms what's led to this crisis.

WAS IT OUR FAULT?

While some of our economic woes weren't even our fault, much of it was. When we suffered an unprovoked attack on 9/11, our government (via Federal Reserve Chairman Alan Greenspan) immediately lowered interest rates in an effort to keep our stock markets and domestic economy from faltering. While this knee-jerk reaction did in fact work, we inadvertently created another problem that grew into a huge financial bubble that ultimately burst: low-interest rate mortgages. By the Feds lowering interest rates to unprecedented levels, many people were now able to afford and qualify for high-priced homes and low interest mortgages. Demand drove real estate values up, but when the low rates on variable mortgages started to rise again a few years later, these same people could no longer afford the increase in their mortgage payments. As they defaulted on their mortgages and abandoned their homes, home values plummeted often below the value of the mortgage.

Worse still, 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 investment 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 (like Lehman Brothers and Bear Stearns) began to fail and major banks and financial institutions started posting annual losses in the hundreds of billions of dollars. This constant flow of bad economic news fueled corporate layoffs and cutbacks, causing our economy to crumple. As unemployment rose, people became extremely cautious about their spending and began postponing major spending decisions. It's no wonder retail sales from big-ticket items (like pianos and high-end pro audio gear) have been hit the hardest by the decline in consumer spending. A depressed real estate market, high unemployment and lack of consumer confidence will most certainly stop most people from buying expensive discretionary items.

BUSINESS IS OFTEN PERSONAL

When consumer spending declines, so does business-to-business spending. After all, people who run businesses are consumers themselves, and become more cautious about both their personal and business spending. When employees see their employers pull back, they often get the message to adjust their spending at home. This classic recessionary mass psychology now affects everyone's pocketbook. But therein lies the irony of why recessions can sometimes be a good thing: they can provide unique opportunities for improvement and future growth for those that seize the opportunities that arise during recessions.

When business is booming, it's all we can do to keep up with our daily workload. But when business slows, two unexpected benefits arise—time and opportunities. These two 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 what to avoid.

IT'S JUST HUMAN NATURE

When business gets slow, there's a tendency to start cleaning your office (or teaching studio, music store, recording studio, etc.), or spend a fair amount of time in "strategy" meetings with your co-workers. In other words, you engage in some housecleaning and esoteric conversation. While there's nothing wrong with being organized and brainstorming, doing too much of it is often just a form of reality avoidance. You're now merely waiting for things to get better, rather than making things get better.

But rest assured, things will improve. Unless your clairvoyant speculation that the world will end on 12/21/2012 comes true (in which case now would be a good time to eBay your '59 cherry sunburst Les Paul, '72 Ludwig Vistalite 4-piece Zep kit and Beanie Babies collection), things will get better as they always have. The key is to use this downtime to prepare yourself for better times ahead and do what you can to accelerate that. As the saying goes, "The cans can, and the cant's can't." Acting like (or not acting like) things are getting better will become a self-fulfilling prophecy. Think about it, when recessions hit and the media keeps pumping out the bad news, your competition is probably going to follow the laws of human nature by hunkering down with the same old business model waiting for the good times to return. Given that short-sighted, fear-driven behavior, now is a perfect time for you to make gains on them by trimming the fat and creating opportunities.

BUT IT HURTS

Here's another cliché, "no pain, no gain." Some of these belt-tightening decisions don't feel good. And because they don't feel good, most of us will avoid doing them. Whether it's firing an employee, freezing or lowering compensation levels, reducing business travel and entertainment expenditures, or fixing the old clunker instead of buying a new car, no one likes making those kinds of decisions and delivering the bad news. But putting off these tough decisions now is worse. All you're doing is placing you and everyone who relies on you in further financial jeopardy. More likely than not, those same decisions will have to be made at some later point during a crisis. So, making these tough but necessary decisions now, coupled with seizing some unexpected opportunities, makes everything better a lot sooner.

Now is a good time to ask one important question: do you really want to be in the business you're in? When things get tough, this is always a good question to ask. If the answer is, "I love what I do, even during these challenging times." Terrific. Become even more committed to achieving financial success—no matter what form or shape 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 to routinely assess the things you're doing. You don't ever want to get to the end of your career with regrets that you didn't pursue your dreams. Lastly, if your answer is, "I still love what I do, but I need to make more money," then keep reading.

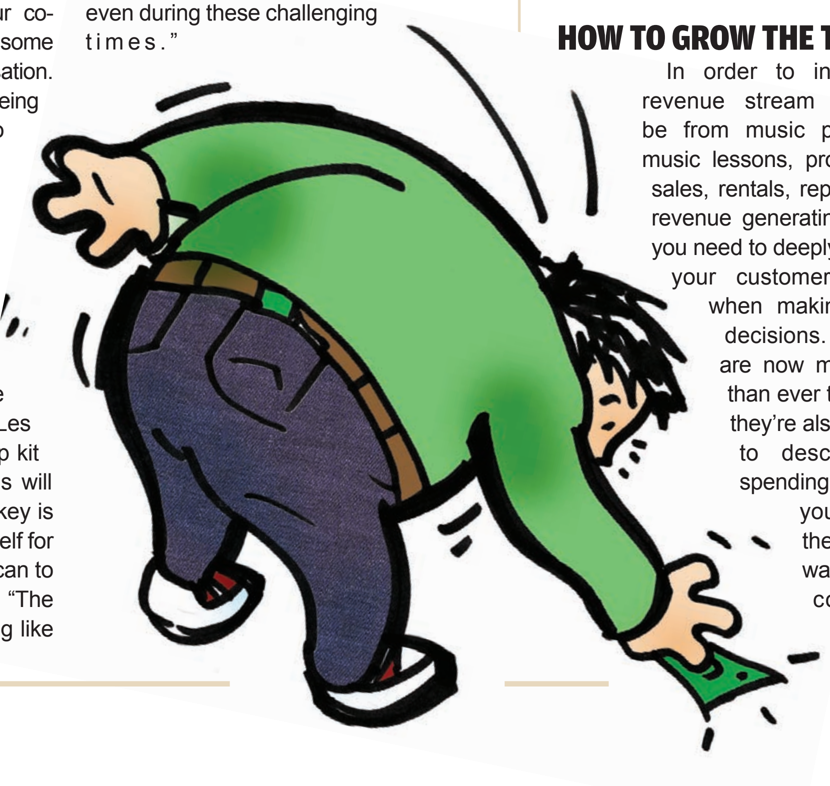
ANOTHER NOTCH IN THE BELT

Let's take a closer look at some of the specific things we can do, both in the store and at home, to tighten our spending belt. While perhaps this isn't the notch in the belt some of you were hoping for, tightening the belt may prove to be far more meaningful. Under the banner of "turning lemons into lemonade," implementing these recession-driven tactics may prove to be the best lessons in self-control for the inevitable future ups and downs in our economy.

When things get tough, there are generally four things you can do to get you and/or your business through rough times. They are: (1) increase revenues, (2) decrease expenses, (3) invest more money in your business, and (4) borrow money. Frankly, items three and four 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 increasing costs. So let's look at ways to increase revenues and, more relevant to our expertise and this article, cut expenses.

HOW TO GROW THE TOP LINE

In order to increase any revenue stream (whether it be from music performance, music lessons, product or CD sales, rentals, repairs or other revenue generating activities), you need to deeply understand your customers concerns when making spending decisions. Customers are now more hesitant than ever to spend, but they're also more open to describing their spending concerns if you approach them the right way. During any conversation with a



customer, 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 any deep wisdom in sales marketing, promotion and advertising. But I too am a consumer, and, like all consumers, I want to feel connected to the people I do business with—especially when I have a multitude of choices. The last thing I want is the hard sell of some product or service I have no interest in or that is at a price I can't afford. So, don't do that. Instead, connect with me by finding out who I am, what I want, what dollar value I've attached to the product or service I'm considering, and educate me on what value I'll receive for the price I'm being asked to pay. In simple terms, be sweet, be engaging, educate me and ask me to pay a fair price. If you accomplish that, I'll happily fork over my hard-earned cash to you over and over again. Or instead, be cranky, be disinterested, ignore me or take advantage and I'll be sure to Twitter 1000 of my closest friends why they should never do business with you.

Seize the opportunity during slower times to look at the revenue generating processes you're using. 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? If so, how quickly do salespeople follow up? What questions are typically asked by both the customer and salesperson during the sales process? What clinches the sale? Is the customer thanked for his/her business? Is the customer asked for a testimonial? Do you ask for the customer to refer others? No matter the economy, knowing the answers to these questions and adjusting the sales process accordingly, will result in higher revenue.

Lastly on the revenue side, take a look at what your competition is doing and implement the things they're doing better. We can all learn from our competition, and what better place to find out what other music industry leaders are doing than the educational content found on the Internet and in educational magazines like Drumhead?

TRIMMING THE FAT

Just like the 20 (okay 30) extra pounds I'm carrying, business expenses can creep into your life the same way weight does: a day at a time. And just like fat and cholesterol, if you let these expenses go uncontrolled, they'll kill you. Some business expenses vary with revenue, like sales commissions, merchant credit card fees and supplies. These expenses probably won't kill you because of their variable nature. But other types of overhead expenses–rent, utilities, lease payments and administrative salaries–are fixed in nature and occur every month whether you produce a dollar of revenue or not. These kinds of fixed expenses will quickly create bottom-line losses and will put you right out of business if not managed during tougher economic times.

Business owners need to pay extra attention to operating overhead, as overhead grows one decision at a time. When you make the decision to hire an extra person, add another cell phone, or move your business to a higher rent building, it increases your monthly overhead. And with each dollar increase in overhead, you need to generate the same (or 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.

By now we all should understand the importance of cutting overhead expenses and needless spending. But there's one cost cutting topic that often needs to be dealt with head-on during troubled economic times—the need for business owners to scale back their personal lifestyle spending and related compensation. So let's talk about why this cutback is so important, yet is inherently avoided and often causes heated discussions both at work and at home.

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

When examining business expenses, don't forget that the amount of compensation you pay yourself is an integral part of your business's operating expenses. Even if you cut spending from every other overhead expense category, it may still be necessary to reduce your compensation. Yes, a cut in owner compensation can be a traumatic decision that affects your psyche, motivation and commitment to the store: not to mention the negative affects it can have on your family's mood and lifestyle at home. Yes, it hurts, but it usually only hurts once (on the day you actually decide to do it). Like nasty tasting medicine, after you swallow, you're on the road to recovery. Accordingly, here are the tough, distasteful, but often-necessary personal expense cuts you need to consider making both at work and at home:

1. Travel, meals and entertainment. Business meals and entertainment should be the first items on your expense-cutting list. Let's get real, while some meals and entertainment do have some 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 while you're at it. 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% tax bracket, then the $100 meal (which is only 50% deductible) will save you a whopping $12.50 ($100 x 50% x 25%). After tax, it still cost $87.50! So say goodbye to needless meals and entertainment. And with regard to travel, $75 spent on a webcam and a free Skype account can often deliver the same benefits as thousands of dollars on airline tickets, hotels and rental cars. Think of 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 some industry event that has a meaningful and educational purpose. That newfound education can deliver financial rewards far greater than the travel costs incurred. 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 any personal vehicle is to provide a means of getting from point A to point B. Let's not lose sight of that fact 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. But with 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 Perquisites ("perks"). Some employment perks are undeniably important, like health and disability insurance. Some perks are valuable when times are good (like pension plan contributions), but become burdensome when times are tough. Some perks are unnecessary and utterly ridiculous (like 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. Don't forget, some valuable perks, like pension contributions, can be reduced and/or halted for periods of time and then resumed when times get better.

4. Funding Outside Investments. Over the years, I've seen business owners kill the proverbial "golden goose" of a financially healthy business by stripping out vital operating cash to fund other outside investments. I've seen a variety of investments made (ranging from ice cream stores to a used car lots) by successful people in the music industry. But when these investments are made outside the owner/investor's core expertise, they often end in total financial disaster. Not only do the investments fail, they put a world of hurt on the owner and his/her primary business, which now has to bailout these failed investments. When you consider the economic return most of us can earn from an investment within our own business, business owners should look no further than their own four walls for investment opportunities. The only exception I can think of is when you can make the bargain purchase of a valuable piece of commercial real estate that can house your business. But beware: unless you can forecast your space needs for the next 10 years, you're often better off renting to avoid becoming an empty building's landlord.

5. The Bullshit Expenses at Home. My Mom told me to never swear; it didn't work. But I'm hoping she (and Drumhead Magazine) will forgive me if my flagrant potty mouth startles one reader into "getting over it" on some of these nonsensical home expenditures. Season tickets to the ball game? Get over it…watch the game on TV in the comfort of your home with far more friends than you could ever bring to the stadium–all for the cost of soda, chips and pizza. Country club dues? Get over it…go play miniature golf with the entire family and enjoy a fun dinner at Denny's. Each kid needs a cell phone? 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. I also gained invaluable lessons in work ethic, independence and perseverance. And what better way to teach kids the joy from a sense of accomplishment than to lead by example? Leave the roofing and plumbing to the professionals, but 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. Right now you're probably asking "How far do I have to go with these personal expense reductions and eliminations?" The answer is quite simple: Enough to get your monthly cash inflows to exceed your cash outflows both at work and at home. 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.

GOODBYE/HELLO

There is 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, electricity, home heating, medicine, health insurance and co-payments, car and property insurance, and postage, to name a few. Since it's hard to live without these essentials, something else has got to give. The only meaningful thing you can do during these tough times is to "tighten the belt." So, goodbye premium cable channels, goodbye weekly lawn service, goodbye expensive restaurants. Hello packed lunches, hello gardening, hello Saturday night family Scrabble®. Embrace the new frugal you—trim the fat, breathe easier, get lean and mean. Eventually you'll be able to loosen the belt without your pants (or your financial life) falling down.