IDEAS

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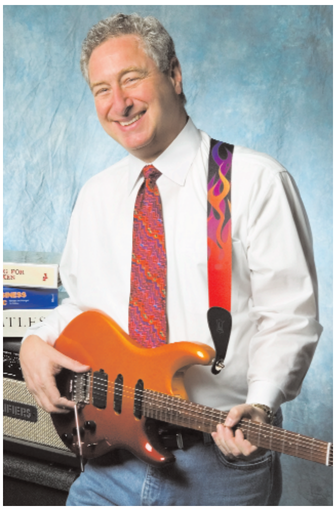
ASK ALAN | BY ALAN FRIEDMAN

CREDIT WHERE IT'S DUE

It's now fall 2007, and we're almost a full year beyond arguably one of the worst years in the history of the music products industry. Along with a dismal financial performance, last year also produced the demise of several longstanding dealers, most notably Brook Mays and Woodwind & Brasswind.

Yet despite a rough 2006, I know a bunch of music store owners who found the perseverance and dedication to fix what went wrong and make 2007 a better year through innovative sales promotions, smarter business practices and improved fiscal management. And the last thing they need is what's starting to happen as a byproduct of last year: a pull-back, or tightening, of vendor credit.

This will be the first in a series of articles I am writing on the topic of supplier credit in hopes that suppliers and retailers will stop and consider the potential impact each other has on a supplier's willingness to extend credit and a retailer's willingness to buy that supplier's products. It's often a mutually dependent relationship that requires both parties to honor their obligations to one another and, more importantly, to keep the lines of communication open, especially when trouble is brewing.



Tightened credit is a symptom of a changing retail environment, a lack of timely financial info and, ultimately, a perceived change in risk

RISKY BUSINESS

Businesses will always take on a certain amount of risk to buy goods, make sales, get paid, cover costs and make a profit. But like a good banker, a supplier's credit manager is charged with the responsibility of managing the risk associated with selling products to music retailers. In simple terms, the credit manager needs to make sure his or her company will be paid for any goods shipped to music retailing customers in a timely manner.

It's not unusual for a supplier's credit manager to find themselves in the unenviable position of having to tell a sales rep that a customer's order can't be filled unless "less risky" payment arrangements are made. While these decisions have an impact on a sales rep's commission and a music store's ability to make sales, there was a time when they were later modified or overturned once a retailer provided supporting financial documentation or paid off old vendor invoices. Those days now seem to be gone.

What has changed is the supplier's definition of what constitutes an "acceptable risk." Over the past few years, several prominent suppliers have had to write off tens of millions of dollars in bad debts by having granted credit to companies like Mars, Manny's, Brook Mays and Woodwind & Brasswind, to name a few on a long list of failed retailers.

Given the hundreds of millions in sales dollars that need to be generated to make up these losses, suppliers seem no longer willing to take the same level of risk they've taken in the past. This is evidenced by the recent demands of many notable suppliers for personal guarantees, higher levels of CPA assurance on a music store's interim and year-end financial statements, and an overall tightening of vendor credit through reduced customer credit limits.

WHO'S REALLY AT FAULT?

The one common notion many retailers have about tightened vendor credit is they're being punished for the vendor's mistakes. They're not wrong, in my opinion, but they also need to consider the following.

First, it doesn't take long for finances to get out of hand at a music store. Many music stores had a record year in 2005, which was reflected on the 2005 financial statements they furnished their vendors in the spring of 2006. Then came the gas crisis, higher interest rates, sales slumps, increased Internet sales, big chain expansion and a host of other troublesome factors, all culminating in a horrible 2006.

And when are these financial results published for a vendor to manage that credit? A whole year later in the spring of 2007 (at best) for most calendar-year retailers. Like I said, a lot can happen in a year without the vendor's knowledge.

'Why doesn't a vendor have the right to ask for the same assurances given to a bank?'

Second, why doesn't a vendor have the right to ask for the same assurances given to a bank? Vendors shipping product without any customer prepayment or personal guarantee have lost the upper hand and are at risk of not getting paid. If music store owners want to continue enjoying the receipt of product without prepayment or personal guarantee, they've got to be willing to give their suppliers something in return … like timely payment of invoices and timely financial statements. I think that's fair.

But before you retailers start writing letters to the editors of *Music Inc.*, I've saved my last comment for the suppliers. It strikes me as grossly unfair to punish a retailer with new necessities, like personal guarantees and other onerous requirements, when that retailer has made timely payments (or has communicated if a payment was going to be late) and has provided accurate financial information upon request. That kind of credit policy reminds me of the definition of an auditor — someone who shows up at the scene of the battle and shoots the wounded.

A SERIES OF INSIGHTS

Many of the aforementioned comments are merely my thoughts, notions and assumptions on the current state of vendor credit. Luckily, we won't have to rely on my guesswork as to what's going on in the minds of our most beloved vendors. Over the next few months, I'll have the opportunity to pose a few related questions on the topic of vendor credit to senior credit managers of a prominent music products supplier, distributor, floor planning company and rental instrument financier. Then we'll really be able to give credit where credit is due. Stay tuned. **MI**

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