IDEAS

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ASK ALAN | BY ALAN FRIEDMAN

Radio Gaga About Buying

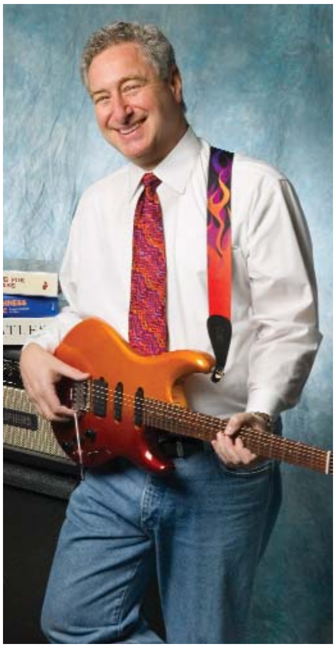
As promised in the February issue of *Music Inc.* ("Doing Inventory at 50"), this is the first installment of a year-long series on the ins and outs of music retail inventory management.

Over the coming months, we'll explore how to track and safeguard inventory accurately, how to value it for both financial and tax reporting purposes, how to determine if you're making enough money on your inventory investment, and what to do if you've made some inventory-buying mistakes.

Let's start at the beginning of the inventory life cycle, the moment you decide to buy product.

To keep the discussion lively, I thought I'd appease some of my *Music Inc.* fans by returning to one of my old tricks: inserting innuendos and off-handed references about a favorite band of mine.

Accordingly, I hereby honor the Brighton Rockers, the Seven Seas of Rhye (or is that "seven seeds of rye"?), the Rhapsody Bohemians: Freddie, Brian, Roger and John (and now Paul Rodgers of Bad Company, go figure) of Queen. Talk about an example of "re-merchandising" old inventory.



'What music retailers need to realize is they've only gotten a great deal on their inventory when they sell it, not when they've bought it.'

CRAZY LITTLE THING CALLED LOVE

Why is the very mention of inventory management enough to cause a sheer heart attack?

Why is inventory management — or mismanagement — usually the primary cause when another one bites the dust? Are suppliers at fault for the usual glut of retail inventory, or are music store owners stone cold crazy? And why do I suspect most of you are missing all of my killer Queen references?

Just spend a day at the races or a night at the opera, and you'll hear everyone, including the fat-bottomed girls, agree on the attributes of your typical music retailer. He or she is a current or former musician, entrepreneurially spirited, and a graduate in sales and marketing from the School of Hard Knocks.

Music retailers also have in-depth product knowledge. But more than just knowing their inventory, they love their inventory.

They love their Les Pauls, P basses and Marshall amps. They love their Yamaha pianos and Korg keyboards. They love their Gretsch drum kits, and they love anything with DigiDesign written on it. They love their Bach trumpets, they love their Gemeinhardt flutes and they totally adore all of their pretty, colorful, crisp, freshly printed, glossy covered sheet music.

Yes, they love it all, but they don't love paying for any of it.

They also love having inventory decorate their stores, as if it's their personal shrine to these inanimate objects

I suspect this odd behavior stems from a love deprived during their teenage years, when music store owners spent all their time practicing Lydian and Aeolian scales instead of going out on hot dates like normal people.

Whatever the psychological reason, most music retailers are often lured into unnecessary inventory buys by notions of what they want instead of what their customers want.

Yes, there are other enticements that cause an overstocking of music product inventory, such as interest-free flooring, blow-out deals by suppliers or a retailer's large buying commitment in exchange for the exclusivity of a coveted product line.

But what music retailers need to realize is they've only gotten a great deal on their inventory when they sell it, not when they've bought it.

TIE YOUR MOTHER DOWN

(As hard as I tried, I couldn't find a politically correct reference to that song — perhaps "Tie Your Supplier Down" could have worked. Frankly, I just like the song and wanted to use it for my subhead.)

So, can anything be done to stop this natural tendency to overbuy?

Yes, as long as retailers recognize the flaws in how they buy product, adopt a more pragmatic approach to purchasing and managing their inventory, and be strong-willed enough to say "no" to the ludicrous buying demands dictated by some of their suppliers, employees and customers.

You have now learned the first of three valuable lessons for buying music product inventory: Fall out of love with your inventory. It's not likely to love you back.

UNDER PRESSURE

As retailers decide on an appropriate selling price for each of their items, they tend to consider only one component of that item's cost: the purchase price they paid the supplier. This is yet another critical flaw in the retailer's thinking.

There are several inventory-related costs that proportionally increase as inventory levels grow.

Among them are storage and warehousing costs; shipping and inter-store transfer costs; insurance costs; set-up costs to make inventoried items retail-ready; data-entry costs to account for, track and report inventory; financing and flooring costs; property taxes on year-end inventories; physical inventory costs; security costs; repair costs for goods damaged while sitting in inventory; theft and shrinkage costs; and the personnel costs to perform all these functions.

Let's face it. The more inventory you buy over and above your current needs, the greater detrimental effect these costs will have on your store's cash flow and profitability. But you need an adequate amount of inventory to service your customers, create customer loyalty and generate sufficient gross-profit dollars to cover your store's operating expenses. It's a juggling act.

Hence Lesson No 2: Always bear in mind all inventory costs when ordering and pricing goods.

KEEP YOURSELF ALIVE

I truly believe the following four questions are the key to buying music product inventory. But to embrace this ideology you must first discard any thoughts, notions or concerns about quantity price breaks, early payment discounts, reorder opportunities, leverage with certain suppliers, product sold by your competition and other distractions from the buying considerations that are, in my opinion, most important; these ancillary factors merely cloud the basic issue of "what" and "how many" to buy.

By asking yourself the following four questions each and every time you buy, you'll begin to more accurately hone in on "what" and "how many" to buy.

1. Can I sell this product?

In its simplest terms, is this product marketable, useable or in demand by your customers? Or are you buying it because you like the product without regard to whether your customers will like it? If you realistically can sell it, move on to question No. 2. If you can't, find something else to buy.

2. Will I make a profit?

For purposes of this discussion, the terms "profit" and "gross profit" mean the same thing. If you sell an item for \$100, and it cost you \$60, you made a \$40 gross profit (and at a 40-percent gross profit percent). I generally don't care if you're making a 50-percent margin or a 15-percent margin — it's the gross profit *dollars* you generate that matter most. So, if you can sell it and make a profit, move on to question No. 3.

3. How quickly can I sell it?

Here's a general guideline. If you can sell a product within 30 days, buy tons of it; 60 days, buy many; 90 days, buy some; 120 days, buy few; and

THE 'HOW TO BUY' GOLDEN RULE OF THUMB

STEP 1: CALCULATE THE GROSS-PROFIT PERCENT

EXPECTED SALES PRICE	\$1,000	100%
COST	\$750	75%
GROSS PROFIT	**\$250**	**25%**

STEP 2: MULTIPLY THE GROSS-PROFIT PERCENT TIMES 360 DAYS

25% X 360 DAYS = 90 DAYS

STEP 3: ASK YOURSELF: CAN I ABSOLUTELY SELL THIS PRODUCT IN 90 DAYS?

IF YES, BUY IT
IF NO, DON'T BUY IT.

if it's going to take you more than four months to sell, don't buy any.

4. How soon do I have to pay for it?

The trick is to sell most, if not all, of the product before your vendor's payment due date. If you don't, you'll have cash-flow shortages, requiring you to either borrow money, invest money, string your vendors out on payment, or close your doors and say "good-bye."

Notice the order of these four questions. As long as you get a "yes," "yes" and "30 to 120 days" answer to questions 1, 2 and 3, respectively, go ahead and buy the product. The answer to question No. 4 will impact cash flow. If cash is tight and terms are c.o.d., you may have to decline purchasing the product.

NEWS OF THE WORLD

Now I'm sure everyone can think of some exception to each of these rules. So here's Lesson No. 3, my all-encompassing, easy-to-remember, easy-to-apply, unbreakable "How to Buy" Golden Rule of Thumb." (see chart)

Simply multiply the product's gross profit by the number of days in the year (use 360; it's a nice round number, and you can do the calculation in your head), and ask yourself this simple question: "Can I sell all of this product in 'x' days or less?" If "yes," buy it. If "no," reduce the order quantity until the answer is "yes." If the answer is never a "yes," don't buy it at all!

'The trick is to sell most, if not all, of the product before your vendor's payment due date. If you don't, you'll have cash-flow shortages.'

WE ARE THE CHAMPIONS

Since high-profit-margin products are generally a thing of the past, the key to making money in this industry is all about inventory turns. The faster you turn inventory, at any gross profit percent, the faster you'll have cash to buy more highly profitable, fast-moving goods, which in turn creates more profit.

In upcoming articles, we'll talk about selling slow-moving or obsolete items at a loss and other quirky but important inventory management concepts that will maximize cash flow and minimize buying mistakes. Embrace it all — you are the champions (I mean we are the champions…or we will rock you…or, whatever…I just want to ride my bicycle). MI