

Working Capital Management

Alan Litchman: My wife and I, in 1998, we bought Finagle-a-Bagel. So it was in October of 1998. The company was about four or five years old at the time, and it was about four stores, and me and my wife were working in corporate industry, in corporate America, and we decided we wanted to do something on our own. So we bought a little company here in Boston, and so far it's been great.

Litchman: Hi, I am Alan Litchman, and I am co-president and owner of Finagle-a-Bagel.

Laura Trust: Hi, my name is Laura Trust, and I am owner and co-president of Finagle-a-Bagel. Why did we think it was a sound investment? You never know if it's a sound investment. I mean we're going into a business we know basically nothing about. We had never been in the food business before. Entrepreneurship, to some degree, is a little bit of, you know, faith, and luck, and hope that it's going to turn into what we think it could be.

Litchman: You know if we want to revamp a store and we want to, you know, spend a hundred grand to bring some equipment that maybe will make different products, things of that nature, we try and look down and see how many people are going to buy the new stuff and then what type of profit would you make from it. And does it justify the cost? So what we try and tell our team members and our managers is that, if someone walks in from the street and buys something and gives you a dollar, you really got a dime. Okay? Because 90 cents, in essence, has gone to pay the lights, pay the employees, things of that nature, in terms that are really simple. So if you want to spend a thousand dollars on something, you need to get \$10,000 in to justify it.

Trust: You need to do pro-formas and things like that to understand where the opportunities lie, and what kind of capital you would be required to continue to grow it. So there's some financial aspects to mapping out the future, but at the end of the day you just have to have a sense that there's something there that's going to continue to grow for you.

Litchman: Well, um...cash flow questions are great. Cash flow is a very difficult thing in a small business. The first thing that, you know I'm 44, so I came of age with computers, and so it's wonderful that a color screen came into play a few years back, and you could see red and you could see black. And red is when you don't have cash flow and black is when you do have cash flow. So the first thing that you need to really understand are banking relationships. So you've got to start with a good bank, and then you can try and really understand how to model your business.

Trust: The reason why we were comfortable taking on debt versus going with a venture capital partner—I want to qualify that—we weren't comfortable taking on debt. It's a necessary evil when you're going into business. The reason we left corporate America is we didn't want to work for somebody else. So when you, in essence, take on a venture capital partner, you're putting yourself right back into a situation where you're working

for somebody else. And that wasn't our goal. So we understood we had to take on debt. We also understood that, if the company continued on the path that it was on, and we opened the right stores in the right locations, the cash flow would allow us to service any debt. And we understood what the time frame was for the amount of debt that we took on. We understood the payback schedule, and we had a plan.

Litchman: And so you have to try and decide, what's it going to cost you to borrow the money. What's the opportunity cost of using your own money that might be in the stock market or something of that nature, when you're putting it into a business. And you've just got to make those decisions all the time. Since we've been doing this, people value companies in multiples, and multiples on product have gone from 10 times earnings, to basically negative earnings, now they're probably about four or five times earnings. Okay? So that's a big change over 13 years.

In interest rates, we've seen borrowing rates go from almost in the double digits down to...now I think we pay .25 or .45 in our line of credit. I mean, those are big differences. And all that plays into when you're making decisions.

The...um, the question about buying things and owning things, or renting and leasing is a great question, and it's something that you really have to think hard about short-term and long-term. In a small business you never have any monies, but you know in the long term it's better to own things in this case.

And one of the things that we found is that we knew by owning real estate...and you see, we're in New England, and real estate in New England is scarce. And the things we were able to get our hands on are wonderful sites, and we've always felt that, if we ever had a problem, we have equity, and we'd figure out some other way to deal with these things. Not knowing what the problems would be, but 10 years later with the recession...the irony in the recession is a lot of our sites are great banking sites. And banks were, they were, they were ringing our bell left and right to try and get their hands on some of these properties, which they thought we leased. And it turns out we owned them, and it was great. We were able to reposition properties, get our cash flows better, and in some cases these banks were our lenders to our company and it gives us a little bit of leverage to renegotiate things.

On the retail side, it's the exact opposite of selling bagels to grocery stores. The retail side you're receiving your money immediately, but you don't have to pay your bills for 30 days. So, while 50% of our money is cash and 50% is credit cards, that...credit cards come within 24 hours, so, in essence, all of our revenues come in immediately, which is great, on the retail side. You know, you don't have to pay those bills for 30 days, so obviously you're cash flow positive, and you have a little bit extra, and you can earn a little interest and things of that nature.

The selling bagels to the grocery stores is the exact opposite. You have to pay for everything with your suppliers, probably within 21 days, or maybe 30 days because you're buying in larger quantities. And you don't get paid right away. And one thing

we've learned is you don't always get paid what you agreed that sale price was, because there's so many programs. Grocery stores, you agree with the price, and they'll say, "Well, we'd like to put your program on sale, can you give us a discount price? We'd like to advertise it." Lots of different things are helping your top line, but they hurt your bottom line, and they're unexpected.

We try and establish terms to get paid, and we try and have rules, and we try and have people sign off on things, which obviously include interest if you don't pay it, it covers some administration costs and things of that nature. It's actually quite the opposite. In very large companies, if they, let's say they owe you \$50,000, and they send you an e-mail and they say they were about to pay you the \$50,000, but you need to pay an administration fee of \$45 for something. You need to respond to this e-mail. And if you don't respond to it, they charge you \$300 for not responding to the e-mail. And one of our large customers charged us \$6,000 in 30 days on a \$20,000 bill because we didn't respond to e-mails. So it's quite the opposite.

So you definitely need a line of credit, and you definitely need some surplus, and you definitely need a good accounting department to go get the money.

Trust: There are various ways that the company uses credit in its ongoing operations. One of the ways is through trade credit, which is the amount of time you are given to pay back your vendors for the products that you buy. And the longer the terms are for your trade credit, the better off you are, because it allows you the time to get paid for the products that you used the ingredients or the paper or whatever it is to sell to your guests and have the money in your pocket. So we've been very fortunate to work with some very flexible vendors, who have allowed us decent terms to get them paid back for the product that we buy. And that trade credit's been very important to us over time.

Some vendors aren't as flexible with it as others, but many of the larger ones understand small businesses and the needs that they have. So that's been a great thing for us. The use of that, sort of, free money, if you will, is vital to businesses our size, particularly ones where the product doesn't necessarily get sold right away. So you bring in a truckload of flour, before that flour becomes a bagel and gets sold and you get the money in your pocket, it's a fair amount of time. So the longer you have to get that money back before you have to pay your vendors is...is good.