

**EXPENSES AND PROFITS OF
LIMITED PRICE VARIETY STORES
IN 1944**

CHAINS AND INDEPENDENTS

**BY
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DIGEST

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This report, by giving 1944 data for limited price variety chain stores, brings up to date a series of figures which has been prepared for 14 consecutive years. In addition to data for chains, for the second time figures for independent variety stores are also provided.

As in the past the study includes many tabulations of sales, margins, expenses, earnings, and supplementary data. While these detailed data are of special interest to retail executives who wish to compare the experience of their company with the average performance in the trade, the study also includes many generally interesting and useful facts about limited price variety stores.

Some of the highlights of the report, which was written by Elizabeth A. Burnham, Assistant Professor of Business Administration, are summarized below.

Chain Stores

In the face of increasing scarcities of many types of merchandise, the 37 reporting variety chains expanded their sales in 1944 by approximately 6% over 1943. The total volume realized in 1944 by those firms in their 5,279 stores was \$1.4 billion, or more than 85% of the estimated total variety chain sales in the United States.

The 6% sales growth compares with a 7.4% rise in total consumer expenditures and a 10% to 12% increase in department store sales. The evidence suggests that the somewhat more moderate sales growth in the variety field resulted partly from a "trading up" among the customers and partly from scarcities of low-end merchandise. For instance, sales of apparel, in relation to total sales, were less important than in 1943, while substantially better volume was attained in such lines as ready-to-wear accessories, stationery, games, books, and toys.

The change in sales emphasis to merchandise characteristically carrying high markons, and lowered shortages and markdowns, produced higher gross margin percentages in 1944 than in prior years. At the same time total dollar expense did not increase to the same degree as volume rose, and hence percentage costs declined. As a consequence total expense including interest averaged somewhat less than 28% of sales, and

net earnings after sundry income and deductions amounted to approximately 11.5% of sales.

A large share, roughly two-thirds, of these earnings was paid out in state and federal taxes on income and excess profits, leaving 3.8% of sales as net earnings to cover dividend and surplus requirements. The comparable figure in 1943 was 3.92%. The earnings after taxes amounted to 9.83% of net worth, a figure practically identical with the 9.8% reported by the National City Bank of New York for 1,327 leading manufacturing corporations in 1944.

Average dollar inventories per store were about 15% lower at the end of 1944 than at the end of 1943. Declining stocks were a characteristic of the late summer and autumn months in 1944, and, in general, chains faced the heavy seasonal demands of December with inventories sufficient for about 45 days. The annual reports of several leading chains disclosed that the companies as a matter of policy were purchasing with caution substitute merchandise which might fail to sell as better civilian merchandise became available.

There was little net change in the number of stores operated between 1943 and 1944, and for the most part the operations were carried out in the same locations as in the earlier year. New information assembled on tenancy arrangements indicates that for 25 reporting chains, operating 4,897 stores, 10.0% of the store property was entirely owned by the chains while in more than 88% of the cases the stores were leased, usually from outside landlords. More than half the leases involved flat rental payments or flat rentals plus taxes or plus taxes and insurance. Many chains, however, particularly the large organizations, had percentage leases or modified percentage leases in some of their stores. Tenancy cost payments which always constitute an important part of the total operating costs of variety chains, in 1944 averaged for all reporting chains 6.73% of sales or almost one-fourth of the total operating expense including interest. It was exceeded only by payroll which amounted to 14.89% of net sales and by taxes on income and excess profits (not included in operating expense) which amounted to 7.65% of sales.

The medium-size chains tended to obtain greater sales increases from 1943 to 1944 than did the large chains. This situation quite possibly reflected differences in demand in various regions. The results of the national chains may have been influenced, for instance, by the relatively less favorable markets in the New England and Middle Atlantic areas where many of their stores are located.

The study reveals some interesting contrasts between large and small chains. New data available for the first time in this report disclose that payments to executives in dollars averaged \$35,000 per executive in chains

with sales of more than \$25,000,000, while in firms with sales of \$2,000,000 to \$25,000,000 the corresponding figure was \$15,000. The large chains, however, by virtue of their substantially greater sales, incurred lower percentage expenditure for administrative and general accounts than did the medium-size chains in 1944. The advantage of large volume appeared chiefly in the payroll item. Despite the fact that executive payments in dollars averaged higher, the additional volume secured was sufficient to result in total percentage payments to executives of about one-third the size of the corresponding costs for moderate-size chains.

Independent Stores

The averages based on figures for 43 reporting independent variety stores shed light on the ability of independent management to capitalize on favorable business conditions. In these stores, primarily operated by partnerships or proprietorships, sales typically increased more than 18% from 1943 to 1944. The average sales per store in the latter year was \$56,495. About one-third of the sales was realized as gross margin, and final earnings before income taxes averaged more than 11.5% of net sales and between one-fourth and one-third of net worth.

About three-fourths of the reporting independents were members of voluntary chains. Examination of the data for all the firms disclosed little significant variation between the results for members of voluntary chains, on the one hand, and the results for firms without such affiliations, on the other hand.

For 35 independent firms providing detailed balance sheets, net worth including real estate equity typically amounted, at the beginning of the year, to somewhat more than one-quarter of net sales for the year. Earnings during the year increased the proportion to more than one-third. Commonly a firm with annual sales of about \$35,000 began the year with an investment other than in real estate of about \$10,000, while a firm with sales of roughly \$85,000 began the year with an investment of \$25,000.

Reporting independent firms increased their inventory investment between the end of 1943 and the end of 1944, a situation contrary to that found for the variety chains.

Soldiers Field
Boston 63, Massachusetts
September, 1945

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GRADUATE SCHOOL OF BUSINESS ADMINISTRATION
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FOREWORD

In the years of postwar adjustment ahead, the retail industries have a very vital part to play. If a high rate of employment is to be maintained in this country, the retail industries must distribute far greater quantities of merchandise than they have ever sold before. Competition will be keen, and high standards of efficiency in operation will be required. Under these circumstances a knowledge of past trends of expenses and standards for current comparison should be especially helpful.

In this bulletin are reported analyses of sales, margins, expense, and earnings data for limited price variety chains and independent variety stores in North America. This is the fourteenth consecutive year in which our research organization has analyzed the chain store data and the second year in which data on independent variety stores have been included. Thus these studies provide not only a statement of current results for purposes of comparison, but the studies also are building up a record of operations during a period of drastic change.

It has been possible to carry on this research only because of the interest and cooperation of the members of the Limited Price Variety Stores Association. The association also has provided funds essential for defraying the cost of the research. For this interest, cooperation, and support we are sincerely grateful.

The author of this bulletin, Professor Elizabeth A. Burnham, who has long been in charge of the cost research program of the Bureau of Business Research, also supervised the accounting phases of the work. For any conclusions and opinions expressed herein she assumes complete responsibility.

MELVIN T. COPELAND
Director of Research

BOSTON, MASSACHUSETTS
September, 1945

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APPENDIX

Base of Percentages. All percentages in this bulletin, unless otherwise indicated, are based on net sales as 100%.

Gross Margin. Gross margin is the amount remaining after the deduction of net cost of goods sold from net sales. Net cost of goods sold is billed or invoice cost of goods sold, less discounts taken and allowances received, plus transportation charges, and plus proper charges for merchandise depreciation and stock shortages.

Transportation Charges. In this account are included all transportation charges on merchandise shipped either directly to individual stores or to chain warehouses. Any transportation cost incurred by the chains for transferring merchandise from warehouses to stores or between stores likewise is included in this item. The transportation charges are considered as a part of the cost of merchandise.

Salaries and Wages. The salary and wage classification embraces all items of payroll expense both in stores and in the case of chains in the central organizations, including the compensation of chief executives. For proprietorships or partnerships fair salaries have been included for executives. One change in the definition of the account made for the 1936 study and continued in following years should be noted: pensions, formerly included in salaries and wages, are now considered as miscellaneous expense.

Tenancy Costs. Tenancy costs comprise all expenses on property used in the business. They therefore cover, in the case of leased property, not only rentals paid but other payments made in lieu of rent, such as taxes, insurance, repairs, and amortization of leaseholds. Charges on owned real estate included in this account comprise taxes, insurance, repairs, and depreciation on owned real estate, plus a fair charge for interest on equity in land, buildings, and improvements, as well as interest actually paid on mortgages. The definition of the tenancy cost account for 1944 differs in two respects from that for 1929, 1931, and 1932, but is the same as that obtaining in the years 1933 through 1943. Charges for amortization of major improvements on leased property, formerly combined with charges for depreciation on fixtures and equipment, have been allocated to the tenancy cost item. Also, since many of the firms lease stores for which heat is provided by the landlords, the cost of heat has been included with other real estate charges in order to assure comparability.

Interest. In order to obtain comparability be-

tween businesses using different methods of financing, interest at the rate of 6% on the average net worth exclusive of real estate, leaseholds, and goodwill is considered as an expense, as well as interest actually paid other than mortgage interest. Interest computed on real estate equity and mortgage interest are considered as tenancy expense. From the sum of the actual interest payments and the interest on owned capital is deducted the amount of interest and dividends received.

Total Expense including Interest. Total expense including interest is the complete cost of doing business, comprising, in addition to the usual outlays, salaries of executives, proprietors, and partners; rental charges for owned real estate; and interest on owned capital.

Net Profit. The above procedure with respect to interest leads to a narrow definition of net profit as a theoretically residual sum over and above a customary interest return on invested capital.

Net Other Income. Net other income has three component parts: profit or loss from real estate operations; interest on net worth other than real estate; and other revenue, net. In the first of these are included net profit or loss on owned real estate not used in the business, interest previously charged as expense on the investment in owned real estate used in the business, profit or loss on real estate which has been sublet, and profit or loss of any subsidiary real estate holding companies. Under interest on net worth is credited back the interest at 6% on the average net worth, excluding real estate, previously included as an operating expense in arriving at the net profit on merchandising operations. Miscellaneous revenue, including such receipts as dividends from manufacturing and/or foreign subsidiaries and income from weighing machines and telephones, is considered as sundry revenue, net. Commissions or net profits from leased or concession departments were included here by several chains.

Net Gain before Income Taxes. To arrive at the final net gain or net business profit, net other income is added to the net profit. Therefore the net gain figure, while not affording, from a statistical standpoint, so valid an interchain comparison as the net profit figure, may be taken as roughly approximate to net business profit in the commonly understood sense. Net gain is expressed both as a percentage of net sales and as a percentage of the average net worth. The use of the average net worth as a base for this figure introduces the com-

plication of differing policies in regard to real estate. For a chain which, either directly or through a subsidiary real estate corporation, owns many of the stores operated, the total average net worth is large in proportion to the net sales volume; and as a result the rate of return on invested capital is low as compared with that for a chain owning little or no real estate.

Taxes on Income and Excess Profits. Taxes on income and excess profits have been considered as deductions from net gain. In this tax figure a deduction has been made for the 10% credit whether used currently for debt reduction or set up as a postwar rebate.

Taxes (except on real estate or income). This tax account includes all tax expense except real estate taxes, included under tenancy costs, and federal and state taxes on net income. Where state or municipal taxes on sales or gross income are not collected directly from customers but are absorbed by the firm as expense, such cost is included under sales taxes, a subdivision of the tax account. Other tax expense includes special chain taxes, licenses, taxes on equipment and merchandise inventory, corporate taxes, the federal capital stock tax, payments for unemployment and old age taxes made in compliance with the Social Security Act, and other taxes not specifically mentioned elsewhere.

Rate of Stock-turn. The rate of stock-turn, or rapidity of merchandise turnover, is calculated by dividing the cost of merchandise sold by the average inventory at cost. For chain enterprises the average inventory includes merchandise both in stores and in warehouses. Stock-turn figures of two types have been computed: the first rate, available for all firms, is based on the average of the beginning and ending inventories; and the second rate, available for part of the chains only, is based on the average of 12 monthly inventories.

Leased or Concession Departments. Twelve of the 37 chains indicated that leased departments or concessions were operated in some of their stores in 1944. Volume in such departments usually was small in relation to total sales, and the firms were requested to exclude the revenue from total sales and consider the commissions received under net other income.

For a few chains, however, leased department or concession sales amounted to 3.0% or more of the total volume. In such cases adjustments were made to insure comparability of the operating percentages. Two alternate methods were suggested

to the firms as acceptable bases for the adjustments. The first method was to exclude the leased department sales from total sales, estimate the indirect expenses incurred by the chain in behalf of the departments, and exclude these charges from expense; the difference between commissions and the estimated indirect expenses was to be considered under other revenue. The second method was to include the leased department sales in chain sales and add to chain operating expenses estimates of the expenses incurred directly by the leased or concession departments. An amount corresponding to these direct expenses was then added to the commissions and included in the gross margin with the difference between leased department sales and this figure charged to merchandise cost.

Methods. The statements used in the study were carefully examined for comparability and completeness of data. Whenever questions arose concerning the omission of or the interpretation of material, letters were written to the individual firms requesting additional information. Usually the necessary material was forthcoming. In other cases when it seemed probable that the omission of a figure by a firm was equivalent to a zero entry, zero figures were used in arriving at the averages presented. When it was evident that one reported expense figure covered two or more accounts, adjustments were made to allocate the amount to the proper accounts. In still other instances where material was not reported, the averages were based on a reduced sample; usually medians only are presented in this latter case, and asterisks in the tables indicate the lack of averages for such items.

Aggregates and Averages. Some of the figures included in this report are averages based on aggregate dollar figures. Such aggregate figures manifestly are weighted according to sales volume. These average figures based on dollar aggregates obviously do not afford a good year-to-year comparison unless only identical firms are used, since the averages are substantially affected by the omission or addition of one or two large firms.

Median Figures. Many of the other data presented in this report consist of median figures. These figures are based on percentages computed for each firm in the group individually. Such figures, therefore, give equal weight to each firm, irrespective of sales volume and number of stores. The median is the middle figure in an array of percentages listed in order from the smallest to the largest.

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